

REPORT OF
 SPECIAL STUDY OF SECURITIES MARKETS
 OF THE
 SECURITIES AND EXCHANGE COMMISSION
 PART 1

CONSISTING OF

LETTERS OF TRANSMITTAL OF APRIL 3, 1963, FROM THE CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION AND FROM THE SPECIAL STUDY OF SECURITIES MARKETS, AND THE FOLLOWING CHAPTERS:

CHAPTER I.—INTRODUCTION

CHAPTER II.—QUALIFICATIONS OF PERSONS IN THE SECURITIES INDUSTRY

CHAPTER III.—BROKER-DEALERS, INVESTMENT ADVISERS AND THEIR CUSTOMERS—ACTIVITIES AND RESPONSIBILITIES

CHAPTER IV.—PRIMARY AND SECONDARY DISTRIBUTIONS TO THE PUBLIC

OF THE REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS, RELATING TO THE ADEQUACY OF INVESTOR PROTECTION IN THE SECURITIES MARKETS, PURSUANT TO SECTION 19(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (PUBLIC LAW 87-196)



APRIL 3, 1963.—Referred to the Committee on Interstate and Foreign Commerce and ordered to be printed with illustrations

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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., April 3, 1963.

The PRESIDENT OF THE SENATE.
The SPEAKER OF THE HOUSE OF REPRESENTATIVES.

SIR: I have the honor to transmit the first segment of the Report of the Special Study of Securities Markets. The report is submitted pursuant to section 19(d) of the Securities Exchange Act of 1934 (Public Law 87-196), which directs the Commission to make a broad study of the adequacy of investor protection in the securities markets.

I

At the outset we emphasize that, although many specific recommendations for improvements in rules and practices are made in the Report of the Special Study, the report demonstrates that neither the fundamental structure of the securities markets nor of the regulatory pattern of the securities acts requires dramatic reconstruction. The report should not impair public confidence in the securities markets, but should strengthen it as suggestions for raising standards are put into practice. Serious shortcomings are apparent and the report, of course, has concentrated on their examination and analysis. Yet it is not a picture of pervasive fraudulent activity and in this respect contrasts markedly with the hearings and findings of the early thirties preceding the enactment of the Federal securities laws. The study confirms the strength of those laws and the heightened sense of obligation of the financial community.

At the same time the report makes very clear that important problems do exist, grave abuses do occur, and additional controls and improvements are much needed. The tremendous growth in the securities markets over the past 25 years, and most particularly the increased public participation, imposed strains on the regulatory system and revealed structural weaknesses. Neither the securities acts, the Commission, nor the industry itself fully anticipated the problems arising from the entry of unqualified persons, the spectacular development of the over-the-counter market, the vast number of companies going public for the first time, or a variety of other striking changes. Some of these problems resulted from inadequacies in established enforcement machinery, both Government and industry. Others reflect patterns of conduct now tolerated, but which, upon exposure and analysis, appear incompatible with the public interest. Testimony to this effect has been given by many responsible members of the financial community in their comments and most vividly in their adoption of higher standards of conduct without compulsion of law. It is these

voluntary standards which regulation should reflect and make generally applicable.

The functions of this report and of any changes proposed are to strengthen the mechanisms facilitating the free flow of capital into the markets and to raise the standards of investor protection, thus preserving and enhancing the level of investor confidence. Raising capital from the general public is a marked feature of the American economic system. In this country there are now approximately 17 million shareholders. As the study attests, this phenomenon has been advanced and protected by the securities acts, a proven legislative achievement. Yet no regulation can be static in a dynamic society; unanticipated changes in the markets and the broader public participation should be accompanied by corresponding investor protection. The importance of the capital markets to our national economic progress does not permit anything less than the most fair and efficient operations. Government and industry regulation and the efforts of the financial community must continue to be directed against practices which undermine the integrity of the securities markets and which can only be harmful to the economic growth of this country and to the investors who furnish the funds for that growth.

While the report focuses upon shortcomings in the industry and in the self-regulatory authorities, in certain respects it is an express or implied criticism of the Commission as an institution. The Commission has not fully exercised its powers, nor coped effectively with all of the problems confronting it. There are undoubtedly several reasons for this. Important among these is the expansion of the securities markets, which renders exceedingly difficult the task of identifying and responding to a myriad of new problems while preoccupied with a heavy flow of administrative tasks. Furthermore, at times the Commission has been hampered by a lack of personnel or has concentrated its efforts on particular areas. Finally, in certain instances, statutory power has been lacking. But our job, like industry's, is not to rationalize inactivity but to initiate improvements. The Report of the Special Study will be a catalyst in this process.

As a final prefatory comment, we should like to emphasize that this report is not a commentary on the level of securities prices, nor upon the investment merits of any particular company mentioned. These types of economic analyses have traditionally been outside the scope of the Commission's responsibilities.

II

The complete Report of the Special Study of Securities Markets will be the most comprehensive of its kind in over 25 years. The examination of the securities markets and the writing of the report have been done by a separate group established in the Commission and designated the Special Study of Securities Markets, under the supervision of Milton H. Cohen, Director. The Special Study was given freedom to analyze and point out problems as they appeared to it; in this respect, the judgments, analyses, and recommendations in the report are those of the Special Study and not the Commission. However, the Commission has worked very closely with the study throughout and has gone over every section of the report. We be-

lieve that the report is a thoroughly responsible document. We do not embrace every recommendation as our own, but we do accept them as a sound point of departure for proposals to the Congress, for rulemaking by the Commission and by the self-regulatory agencies, and for discussions with the industry. Like the study, we at the same time recognize the complexities and subtleties of the problems presented.

III

Transmitted here are chapters I through IV and chapter IX. The remainder of the report, while nearing completion, is not available at this time essentially because of the scope of the undertaking. The Congress repeatedly made clear that the report should be broad and thorough. The study, with the support of the Commission and its operating divisions, has made every effort to carry out this mandate. However, the breadth of the obligation was not evident at the outset and a proper fulfillment necessitates some delay.

The chapters submitted deal with important and basic areas and practices in the securities markets. In many respects they disclose problems calling for vigorous and prompt responses by the Commission and the industry. The Commission will very shortly recommend to the Congress certain legislative proposals (to be discussed below) where the present statutory scheme appears inadequate. An important part of these reflects our continuing belief in self-regulation as an ingredient in protection of the investor. Certain deficiencies can be treated through rulemaking by either the Commission or the self-regulatory agencies. Still others can be resolved only by a more uniform and voluntary adoption of improved procedures by the members of the industry.

A

The report begins where regulations must begin—the point of entry into the business. It is self-evident that the standards of conduct of the securities industry are vitally dependent on the integrity and competency of its personnel. Obviously, no system can be devised which eliminates all potential wrongdoers. But the Report of the Special Study concludes that the minimal controls furnished by existing regulation are inadequate. Notable ease of entry is apparent under both Federal law and the rules of the National Association of Securities Dealers, Inc., the self-regulatory agency for the over-the-counter market. With the exception of the major exchanges, significant standards of character, competence, and minimum capital have not been generally imposed. Nor has attention been sufficiently directed to the unique problems of supervisors, such as branch managers, and research analysts. Furthermore, certain sectors of the industry, including most importantly certain distributors of mutual fund and real estate securities and also investment advisers, are not subject to the discipline of self-regulation. In addition, the present legislative scheme, in revolving around the firm as the regulated unit, provides an artificial and unsatisfactory means of focusing on the individual in the many instances where he is the appropriate object of disciplinary action. Finally, useful and needed intermediate sanctions, short of revoking the registration of a broker-dealer, are not available to the Commission.

We shall, therefore, recommend to the Congress legislative proposals in the following direction :

1. Authorizing standards of character, competence, and financial responsibility as conditions for entry into the business, to be established and administered by the national securities associations, notably the NASD, which will complement similar regulation by the exchanges of their members;
2. Requiring all firms and individuals to be subject to the authority of one of the self-regulatory agencies;
3. Granting the Commission direct disciplinary controls over individuals and perfecting NASD controls in this area; and
4. Providing the Commission with intermediate sanctions over firms and individuals.

B

A basic factor underlying the enactment of the Federal securities acts was recognition of the intricate nature and high liquidity of securities and of the corresponding duties necessarily assumed by those who deal in them. The heightened public participation in the securities markets severely tested the adequacy of controls, external and self-imposed, particularly in the area of selling practices and investment advice. The examples of sales techniques cited by the study show a striking spectrum: from the illegal operations of boiler rooms to the disciplined patterns of the responsible, reflecting elaborate supervisory procedures and voluntary codes of conduct. Even in the latter, which represent high standards of achievement, serious lapses have occurred. Yet it is their best formulae which, if universally followed, would result in increased investor protection. Certain excesses also appear to have developed in the investment advisory materials of both broker-dealers and investment advisers, as evidenced by fanciful recommendations based on little more than mere rumor. Here again uniform application of the best industry practices would seem to be in order. In this area, legislation is not presently recommended. Powers exist in the self-regulatory institutions and the Commission to advance selling and investment advisory practices.

C

The mechanism, practices and rules for distributions in the securities markets are examined in the report with particular emphasis on the so-called "hot issue" phenomenon that accompanied the active and rising markets of the late 1950's and the early 1960's and involved primarily companies going to the public for the first time. A record flow of these new issues was another critical trial for both the regulatory pattern and industry practices; the findings of the report do not invalidate the general thrust of this pattern or those practices. At the same time particular weaknesses have developed; their elimination should strengthen the distribution mechanism without impairing access to the capital markets. Most of these can be remedied by rules of the Commission and the NASD, with one important exception.

At present a prospectus containing business and financial information about a company must be delivered to the purchasers of the company's stock during a period of 40 days after a registered public offering of that stock. The findings of the Report of the Special Study demonstrate that, particularly in the case of new issues, dramatic price

movements may result from uninformed investor action and that maximum exposures of financial and public information is crucial to securing knowledgeable evaluation of these securities. The Commission will, therefore, recommend to the Congress that, in the case of new issues, the 40-day period be extended to 90 days or such shorter period as the Commission may prescribe by rule or order.

D

Much of the material submitted evidences the fundamental importance of adequate disclosure by issuers as a most vital means of investor protection. The report points out the broad range of problems and abuses in the securities markets, including improper selling practices, misleading public relations, irresponsible investment advice, and erratic "after markets" for new issues, which can be greatly mitigated by the more complete availability and dissemination of financial information. The report further demonstrates, as have prior studies, that the longstanding contrast in the disclosure-oriented protections afforded investors owning securities listed on national exchanges and investors owning securities traded in the over-the-counter market is not warranted. Issuers of over-the-counter securities, unlike their listed counterparts, are under no obligation to comply with the Commission's proxy rules or, except in certain cases, to furnish annual and periodic financial reports. Another void in investor protection in the over-the-counter market relates to insider trading. An insider of a listed company must report his transactions in the company's stock; his short-swing trading profits in the stock are recoverable by the company; and he is prohibited from selling the stock short. The policies expressed in these sections should also be applicable in the over-the-counter market. The so-called sponsorship problem, where an underwriter makes an after-market in a stock he has underwritten and at the same time is represented on the board of directors of the issuing company, has been carefully analyzed by the study. Its findings indicate that the application of the insider trading provisions will not disrupt trading markets in over-the-counter securities, except perhaps in very limited instances which could be handled through exemptions on a case-by-case basis.

Accordingly, the Commission will recommend extension of those sections of the Securities Exchange Act of 1934 which provide for the filing of annual and periodic reports, compliance with the proxy rules, and protections against insider trading to certain companies whose securities are traded in the over-the-counter market. A phased program of coverage would gradually include all those companies with 300 or more stockholders. In the case of bank stocks, which appear to account for about 20 percent of the issues of the over-the-counter market, if Congress so desires, disclosure requirements could be administered by the appropriate Federal bank regulatory authorities in order to integrate these controls with the existing patterns of bank regulation.

E

An analysis of the over-the-counter market will be submitted in our complete report. At this time, however, we wish to inform the Congress that we shall propose a legislative recommendation essentially directed to the wholesale quotations systems of that market.

At present the National Quotation Bureau dominates the business of over-the-counter wholesale quotations. The Bureau, a private corporation, is not regulated by any agency, Federal, State, or self-regulatory. Despite the efforts of the Bureau, which has operated with a conscientious regard for the responsibility which its function and dominant position entail, this crucial segment of the over-the-counter market has had inadequate controls; numerous abuses involving quotations have been perpetrated by broker-dealers. Moreover, developments in electronic data processing have foreshadowed the emergence of new and perhaps revolutionary quotation systems. In view of the vital significance which these systems can have to the functioning of the over-the-counter market, they should not be allowed to emerge without due regard to the welfare of the market and to the public interest.

Accordingly, the Commission will recommend to the Congress that operators of quotations systems, like the National Quotation Bureau, be required to register with the Commission and adopt and enforce rules of fair practice in the use of their systems, just as is presently the case with the self-regulatory agencies.

F

We have described a substantial part of the legislative measures which we shall recommend to the Congress this year. A few others will subsequently be proposed; a very important one of these might concern certain aspects of security credit regulation—which would be submitted only after full coordination with the Federal Reserve Board. Not all of the study's legislative recommendations in the chapters transmitted have been adopted by the Commission; these are the subject of our continuing study and may be proposed to the Congress at a subsequent date.

To secure the benefit of industry views on our legislative proposals, we shall immediately request leaders of the financial community to form liaison committees.

IV

The Report of the Special Study is a major contribution to the understanding of the operations and problems of the securities markets. In its collection and analyses of data, it provides a thorough and responsible foundation for action. Furthermore, the enactment of Public Law 87-196 and the very existence of a Special Study have assisted in the creation of a more salutary environment and have resulted in numerous important developments. The American Stock Exchange has undergone an intensive reorganization. The New York Stock Exchange has commenced a program for improved controls over selling practices and initiated new qualification standards. The NASD has undertaken a comprehensive revision of its bylaws and rules of fair practice. Broker-dealers have reviewed and altered their systems of supervision. It would go too far to assert that all of these, and other numerous changes, are the direct products of the Special Study and of the initiating legislation. Yet it would be difficult to deny that their existence has at least produced a reevaluation of existing practices and procedures by the industry, as well as the Commission, which can only be beneficial. In other words, the financial

community has taken the opportunity to make its own special study, with valuable consequences.

As has been pointed out throughout this letter, the Report of the Special Study is only a prelude; it discloses many problems whose resolution will require the efforts of the Commission, the exchanges, the NASD and the industry itself. To these we will now turn our attention. Our legislative recommendations to the Congress will be an important first element, indeed a prerequisite for needed improvements. However, much of the action may be taken through the self-regulatory agencies, through exercise by the Commission of existing powers and through the influence of leaders in the securities industry to raise standards.

In concluding, the Commission wishes to express its appreciation to the members of the financial community, the self-regulatory institutions, and the numerous companies that fully cooperated with the Special Study. Many gave generously of their time and manpower in assisting the study to gather information and viewpoints.

The superlative efforts of the staff of the Special Study and its supervisors must be especially singled out. All worked tirelessly and with a fine understanding of the heavy responsibility they were obligated to discharge. The Commission was uniquely and most strongly served in having Milton H. Cohen as Director, Ralph S. Saul as Associate Director, Richard H. Paul as Chief Counsel, Sidney M. Robbins as Chief Economist, and Herbert C. Schick as Assistant Director. Not to be overlooked are the contributions to the study in counsel and data collection of many persons in the operating divisions and offices of the Commission.

By direction of the Commission:

WILLIAM L. CARY, *Chairman.*

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., April 3, 1963.

*To the Chairman and Members of the
Securities and Exchange Commission:*

We have the honor to transmit herewith chapters I, II, III, IV, and IX of a report of the staff of the Special Study of Securities Markets. These are 5 of what is expected to be a total of 14 chapters in the complete report. The vast scope and size of the report and the complex nature of the problems with which it deals have unfortunately made it impossible to deliver the entire report to the Commission as a single unit at this time. The remaining chapters are all well advanced, with some segments entirely completed and others substantially so, and it is anticipated that they will all be delivered to the Commission by the end of May. The contents of the present chapters and those still to come are briefly identified below.

The total report will constitute the findings, conclusions and recommendations of the staff of the Special Study as a result of its study and investigation, made pursuant to section 19(d) of the Securities Exchange Act, "of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations."

The study and investigation reported herewith have been carried on for the Commission by the staff of the Special Study under the direction of the undersigned. The report by its size reflects the intent of the Congress, as evidenced both by the language of the statute and its legislative history, that the Commission conduct a broad study of the rules, practices and problems in the securities industry and markets. The House committee report which preceded the enactment of section 19(d) pointed out that while the language of the section was specific, its scope was "very broad." A brief review of the content of the report indicates the breadth of the subject matter which it fell to the Special Study to review.

Chapter I of the report, after describing briefly the purposes and methods of study and the general nature of recommendations arrived at, sets forth general data highlighting the growth of the securities industry in the postwar period, which was an important reason for the study and provides the background for many of the subjects explored. Chapters II and III are concerned with the broad range of persons and business entities engaged in the securities business—broker-dealers, salesmen, salesmen's supervisors, and persons engaged in giving investment advice. The first of this pair of chapters examines the standards and controls relating to their entry into and removal from the business; and the second, their activities and responsibilities in the course of that business and the related controls. Chap-

ter IV deals with primary and secondary distributions of securities to the public, with particular emphasis on new issues and briefer review of other specific areas such as registration of seasoned issues, unregistered distributions, intrastate offerings, and real estate securities.

Chapters V, VI, VII, and VIII extensively explore the functions, structures, and problems of markets in which securities are traded after their distribution. Chapter V is a general introduction to this group of chapters. Chapter VI covers the exchange markets, with special attention to the most important of these, the New York Stock Exchange. The chapter reviews the functions and activities of various specialized categories of members, particularly specialists, odd-lot brokers and dealers, and floor traders, and also deals with the subjects of short selling and commission rate structures. Chapter VII discusses the over-the-counter markets, their vast and heterogeneous character, their wholesale and retail components, the quotations systems, and present controls over all of them. Chapter VIII then examines various interrelationships among trading markets, including patterns of distribution of securities among exchange and over-the-counter markets, institutional participation in various markets, over-the-counter trading in listed securities, and the regional exchanges as "dual" and primary markets.

Chapter IX reviews the legal requirements and standards in respect of reporting, proxy solicitation and "insider" trading which are applicable to issuers of securities in public hands, contrasting those relating to securities listed on exchanges with those relating to over-the-counter securities and emphasizing the need for legislation in the latter area. It also considers problems in the dissemination of corporate publicity by issuers of both kinds of securities. Chapter X deals with the purposes, effects, and enforcement of securities credit and margin regulations and some inconsistencies and anomalies of the present regulatory pattern. Chapter XI is concerned with certain aspects of open-end investment companies ("mutual funds") which are covered neither by the recent industry study conducted by the Wharton School of Finance and Commerce nor by continuing inquiries of the Commission's Division of Corporate Regulation. It contains the results of an investor survey and also specifically treats with selling practices, contractual plans, and certain problems in connection with fund portfolio transactions. Chapter XII deals with the self-regulatory pattern which is largely unique to the securities industry. It evaluates the regulatory functioning of the New York Stock Exchange, the American Stock Exchange, the principal regional exchanges, the National Association of Securities Dealers, Inc., and certain quasi-regulatory agencies, notes the absence of self-regulatory organizations in certain areas, and assesses the role of the Commission in relation to all of them.

The market break of May 1962 was thought to merit separate examination as a major market phenomenon, and also afforded an opportunity to study certain aspects of the securities markets, already studied under more normal conditions, in the circumstances of a precipitous decline. The results of this study are set forth in chapter XIII, although other chapters dealing with particular topics also reflect the findings of this special inquiry. Chapter XIV, still tentative in nature, is reserved for a few general topics that may fit neither

within the scope of any of the previous chapters nor within the limits of a further transmittal letter.

In general, each of these chapters provides an intensive evaluation of the subjects indicated, based upon detailed questionnaires, public and private hearings, interviews with members of the industry, and review of existing data of many kinds. In addition to the basic analyses of this material, specific conclusions and recommendations are set forth in each chapter except I and V. When all chapters are completed, it is also planned to prepare a summary volume bringing together all of these conclusions and recommendations.

Ambitious though the scope of the investigation undertaken by the Special Study may have been, it still could not embrace the full potential of the enabling statute and its legislative history. In selecting those areas which it was felt could be thoroughly and responsibly studied within the limits of available time and manpower, it was necessary to exclude others of unquestionable importance. Among the subjects omitted from the study and report there are undoubtedly some that merit separate study by the Commission in the future.

* * *

In presenting a report of the size and scope of the present one, it is perhaps appropriate to add some general comments which reflect impressions resulting from the entire work of the Special Study but which may not find a place in the report itself. Other general comments may be added in transmitting the balance of the report.

The enormous growth of the securities markets experienced since the original enactment of the Federal securities laws, reflecting both the vigor of the industry's own activities and the general expansion of the country's economy and population in the intervening years, has been accompanied by many qualitative changes in methods, practices, controls, and standards. A basic objective of the Special Study was an evaluation, in the light of both quantitative and qualitative changes, of the theories and mechanics of direct governmental regulation and industry self-regulation originally envisaged by those laws. The study and report indicate that under the stresses of its expanded role the framework of regulation needs considerable adjusting and strengthening, but its basic design appears to have stood the test of time and to have worked effectively in most areas.

Since the Federal securities laws have been in force for a full generation, it is hardly surprising that the Special Study has not disclosed the prevalence of gross abuses such as were characteristic of the era which preceded their enactment. Nevertheless, as will be evident from the entire report, many serious problems do exist and important improvements are needed. It is inevitable that in reflecting the results of any investigation, a final report will give greatest attention to the problems uncovered and the areas in which the need for improvement is most pressing. Nevertheless, the emphasis in this report on present shortcomings should neither obscure nor detract from the many aspects of the securities business and its regulation and self-regulation which afford reason for pride and satisfaction. The strength of the American economy and its free-enterprise system both reflect and are dependent upon an investment banking system and market institutions that are basically strong and sound, but this makes it all the more,

rather than less, necessary to expose and correct the weaknesses and abuses that still exist. Many of the substantive recommendations in the report can, indeed, be regarded as attempts to raise the entire securities industry to the best standards which the industry itself proclaims and to the highest levels of attainment which some of its participants have in some sectors achieved.

Because of the number and variety of subjects covered it was, of course, necessary to devise sampling procedures of different kinds for different subjects. In each case the attempt was made to use as broad and representative a sample as possible while still holding down the total burden on members of the industry and distributing the burden among them as equitably as was practical. Nevertheless, it has undoubtedly happened that the names of some firms appear in the report, in connection with particular practices, incidents or viewpoints, more frequently than those of comparable firms. It should be recognized that the naming of any particular firm in this way, whether favorably or unfavorably, often means, not that the matter under discussion is unique to it, but that the processes of study and investigation happened to bring that firm's name to the fore, rather than another's, in the particular context.

Given the scope and complexity of the studies undertaken and the limited resources of time and manpower available, it would be presumptuous to suggest that the Special Study could propose complete or "final" answers to all the questions that call for answers. No such effort is made in the report. For some of the problems considered, fairly immediate and specific measures are recommended; for others, broader long-range programs are outlined; and for some of the most knotty there is merely an indication of possible approaches—sometimes alternative or multiple ones—that may point the way to future solutions.

Prompt adoption of the specific measures and rapid implementation of the longer range programs hopefully will be the earliest fruits of the study, but perhaps an equal contribution will have been made in the areas where solutions are least clear, for surely one goal of any study of this kind is to create a ferment of thought and discussion. Where the report has not itself produced answers, it may at least have posed the important issues for which the securities industry and regulatory authorities must seek solutions.

A corollary of prime importance is that broad-gaged studies of the kind undertaken by the Special Study cannot be once-in-a-generation affairs but should be a major part of the Commission's regular and continuous activities. To be able to see the forest instead of just the trees, to be able to evaluate current trends and future potentials as well as past results, the Commission should have a permanent staff group, small but expertly manned, that is free from routine administration and assigned the responsibility of observing and measuring important trends, identifying and evaluating new developments, and from time to time making special studies of particular subjects. By and large the functions of continuous study, long-range planning, and broad policymaking have been too much subordinated to day-to-day administration, except for the very earliest years of the Commission's existence.

If the experience of the Special Study is any guide, not the least benefit of more continuous activities of this kind would be their invigorating effect on the self-regulatory institutions and their admonitory effect on members of the industry generally. The period since the study began has witnessed a quite remarkable display of fence mending, roof patching, and even foundation strengthening. Some of the specific items may have been merely coincidental, some may merely have represented acceleration of developments that would otherwise have occurred, but unquestionably many of them were in some degree a valuable byproduct of the study itself.

The original Federal securities laws of 1933 and 1934 were a remarkable legislative achievement, and have well served the needs for which they were designed for over a quarter century. Nevertheless the review of past experience and current conditions which has been completed by the Special Study makes evident the urgent need for some amendments which can make them as effective now and in the foreseeable future as they have been in the past. The tremendous growth of the financial community and of public involvement in the securities markets, the increased importance of the over-the-counter markets, and the immense improvements in means of communication and data processing account for the major legislative recommendations of the report. In the chapters presently transmitted, the principal such recommendations are for stronger controls over entry into the securities business and better disclosure protections for investors in over-the-counter securities.

Another category of desirable amendments would be those designed, not to provide new protections, but to make existing ones more flexible and adaptable. The problems of today are more complex and subtle than the gross abuses disclosed in the hearings that followed the traumatic experience of the 1929 market crash, and more flexible instruments are needed to deal with them. In many areas the Commission today must either take drastic action or take none at all. It may revoke a broker-dealer's registration for a violation of law, but it may not proceed administratively against an individual perpetrator of the violation. It may impose no sanction to enforce the obligations of an exchange other than suspension or withdrawal of its registration. It may, with the approval of the President, suspend trading on an exchange for up to 90 days but it has no lesser powers to deal with periods of general market crisis. Various intermediate powers are needed to enable the Commission to avoid the hard choice between no action and excessive action.

An impression repeatedly and forcefully brought home in the course of the study is that aggregated or averaged data, although of unquestionable importance and usefulness for many purposes, may be useless or misleading in arriving at conclusions on some types of questions. To give a few of many possible examples: the average percentage of institutional transactions for all securities may obscure the fact or miss the point that institutional transactions in particular securities can be many times the average for all securities; the total quantity of short selling or floor trading over a period of time in all securities may mask the significance of crucial transactions at particular times in particular securities; averaged or aggregated figures for specialists as a class may conceal great disparities in the performance of individual specialists.

It is quite clear from the study that the data now compiled and used routinely for many purposes of regulatory surveillance and public information are inadequate or misleading in showing only totals or averages where particulars or ranges are needed. The aim of many separate studies in the course of the Special Study was precisely to go behind available aggregated data and provide crucial "disaggregated" data. It may be open to dispute whether the Special Study has always succeeded in carrying out this aim, but the lesson for the future seems clear: Both the self-regulatory agencies and the Commission need to give consideration to the many places where presently provided data, in aggregated or averaged form, appear inadequate for regulatory needs or public information.

One final general comment is in order at this time. If the securities industry is to operate on the level of ethical standards at which its regulatory and self-regulatory organizations aim, it is important that the public's understanding of the securities markets and the securities business not be clouded by many illusions and misconceptions which now surround them. It is an excellent thing to aspire toward high standards of professionalism, undivided loyalty to customers, expert and unbiased investment advice, more responsibility of specialists, greater diligence and responsibility of underwriters, more liquidity and stability of markets, stronger regulatory and self-regulatory protections, and so forth—the list is legion—but it is an entirely different thing to encourage the investing public to believe that the aspiration is now the fact. Mere lipservice or exaggeration in these matters may do more harm than good, because the investing public may be led to expect too much in the way of certainty and protection, may fail to appreciate the risks inherent in investment, and may not exercise the vigilance and care required of the investor even under a statutory philosophy that emphasizes caveat vendor instead of caveat emptor. Perhaps the most pressing need of all, without any diminution of efforts to improve the securities markets in the respects mentioned and in other respects, is to foster accurate and realistic public understanding. This has been a major function, and hopefully will be a major result, of the Special Study and its report.

* * *

The report is the product of the staff of the Special Study of Securities Markets, which has varied in number from time to time but has averaged approximately 65 persons, of whom about half were attorneys, economists, analysts, and investigators, and the balance were clerks, secretaries, and stenographers. It is impossible adequately to express appreciation for the diligent efforts and sacrifices on the part of everyone who participated in the enormous task with which the Special Study was faced.

The study operated with a flexible organization under which all personnel were available for whatever duties needed to be performed, and no person has been exclusively responsible for any part or parts of the report. The work of the study was divided into more than 30 separate projects, each of which had a project head and one or more contributors. Some persons headed one or more projects and contributed to

others, while other persons made substantial contributions to a number of projects. It would be invidious to single out individuals for special mention, except for a few who, if there had been a more formal organizational structure, would undoubtedly have had supervisory titles reflecting their actual roles: Robert L. Knauss, Robert N. Leavell, Martin Moskowitz, Frederick Moss, Norman S. Poser, Eugene H. Rotberg, Arthur J. Rothkopf, and David Silver.

Other members of the professional staff, each of whom contributed importantly to the study and report were: Special editorial assistant: Roy A. Schotland; attorneys: James E. Bacon, Robert J. Birnbaum, James Hallisey, William C. Mammarella, Richard M. Meyer, Allan S. Mostoff, Lawrence W. Newman, Stephen J. Paradise, Ira H. Pearce, Sheldon Rappaport, Stanley Sporkin, Gary J. Strum, and C. Howard Thomas, Jr.; economists and statisticians: Leslie P. Anderson, Rolf Kaltenborn, Jonathan V. Levin, Helen K. Steiner, and Robert Tucker; financial analysts: Harry Krueger, Bruce J. Simpson, Stuart R. Allen, Fred Siesel, Charles C. Sharpe, and Lois E. Zazove; investigators: Carmine Asselta, John E. Connor, Frederick Richard, Daniel Schatz, and Harry Zimmerman.

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prove beneficial to the industry itself, to the investing public, and to the country as a whole.

Respectfully submitted.

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Special Study of Securities Markets.

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CHAPTER I

INTRODUCTION

A. THE SPECIAL STUDY OF SECURITIES MARKETS

1. AUTHORITY FOR THE SPECIAL STUDY

On September 5, 1961, section 19(d) of the Securities Exchange Act was enacted, authorizing and directing the Securities and Exchange Commission "to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including rules for the expulsion, suspension, or disciplining of a member for conduct inconsistent with just and equitable principles of trade." The Commission was called upon to report to Congress "the results of its study and investigation, together with its recommendations, including such recommendations for legislation as it deems advisable."¹

The wording of the law and its legislative history made clear that it contemplated a very broad study of the rules, practices, and problems in the securities business and the securities markets. The existing rules of the exchanges and of the National Association of Securities Dealers, the only existing national securities association, are themselves broad in scope and varied in content. But quite apart from the existing rules, it was made clear that the study was to be concerned with any inadequacy or lack of rules relating to any aspect of the securities business and securities markets, and also with problems that might require legislation or changes in the rules promulgated by the Commission. This was expressed in the report by the House of Representatives Committee on Interstate and Foreign Commerce² that preceded enactment of the law:

During recent months the president of the New York Stock Exchange has issued two very firm warnings against speculation in the stock market. The country's largest brokerage firm has run a dozen newspaper ads urging investor caution, and many other brokerage houses have alerted employees to the danger of uninformed public speculation. The National Association of Securities Dealers has written to all members expressing concern over the very large total of outstanding undelivered transactions. The Chairman of the Securities and Exchange Commission has stated that there have been evidences of a substantial amount of manipulation and that they have more manipulation cases in various stages of proceedings than ever before. The Commission has initiated an investigation of the American Stock Exchange to determine whether additional rules or laws are required to insure proper operation of the exchange * * *.

Since the market collapse which led to the enactment of the Federal securities laws, there has been a rebuilding of public confidence in the securities markets as a result of both efforts at self-regulation by the industry and the enactment

¹ H.J. Res. 438, 87th Cong., 1st sess. (known as the Mack resolution, after its author, Congressman Peter F. Mack, Jr., then chairman of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce) became law as Public Law 87-196. The resolution provided for a reporting date of Jan. 3, 1963, and provided \$750,000 to carry out the study and investigation. On July 27, 1962, H.R. 11670 became effective as Public Law 87-561, extending the reporting date to Apr. 3, 1963, and increasing the authorized appropriation by \$200,000.

² H. Rept. 882, 87th Cong., 1st sess., pp. 2, 4 (1961).

of the statutes and their administration by the Securities and Exchange Commission. The maintenance of this confidence is most essential. There has been a great growth and increased activity in the securities markets. It is important to be informed as to whether at this time in the light of changed market conditions the investing public is afforded the protection which was envisaged in the passage of the original legislation. What new statutes or rules are needed? What now unregulated areas of the securities markets need regulations? What rules need change?

* * * * *

In view of the comments which recently have been made as to today's market conditions and the testimony before the committee relating to market practices and to violations of statutes and rules, and in view of the nearly 25 years which have elapsed since the last overall study of the operations of securities markets, it seems to this committee that it is now highly appropriate again to review the rules governing the activities of the various securities markets to see whether they are adequate to protect investors, to determine just how they are being administered by the exchanges and the over-the-counter associations, and whether changes, modifications, or expansions of the rules or statutes are desirable now in the public interest.

Awareness of the general nature and scope of these changed conditions coincided with an absence of precise information and data about them. Although the Commission had from time to time conducted specific studies of certain aspects of securities markets, some of the very developments that had given rise to new questions and problems had so overburdened the Commission and its staff with routine administrative and enforcement work as to preclude adequate study of these changes and of the adequacy of existing regulatory institutions and procedures to deal with them. The creation of what came to be known as the "Special Study of Securities Markets" (Special Study) was thus regarded by the Congress and the Commission itself as a necessary measure to provide comprehensive and current data on both old and new phenomena in the market.

To appreciate the full scope of the new section 19(d) and the significance of its focus on the rules of national securities exchanges and national securities associations, it is necessary to bear in mind the existing pattern of regulatory controls and the expressed purposes of Congress in directing the investigation and report.

2. RULES OF THE EXCHANGES AND SECURITIES ASSOCIATIONS IN THE REGULATORY PATTERN

The body of Federal securities law is comprised of six separate statutes,³ the first two of which, the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act),

³ In chronological order and stated briefly, the statutes are: (1) The Securities Act of 1933, 15 U.S.C., sec. 77a, et seq. (2) The Securities Exchange Act of 1934, 15 U.S.C., sec. 78. (3) The Public Utility Holding Company Act of 1935, 15 U.S.C., sec. 79. This was enacted to meet the special problems of those companies holding as subsidiaries gas and electric utilities; it requires the holding companies' registration, regulates their finances and operations, and provides for simplification and integration of the holding company structure. (4) The Trust Indenture Act of 1939, 15 U.S.C., sec. 77aaa, et seq., integrated with the Securities Act, provides that bonds and similar evidences of indebtedness shall be issued under an indenture meeting specified requirements, including an independent and financially responsible trustee, and that the indenture be duly qualified with the Commission. (5) The Investment Company Act of 1940, 15 U.S.C., sec. 80a, concerns entities whose primary business is investing in other companies; such entities must register, and provision is made for regulation of their management, voting and capital structure, their financial reporting, and the offering of their securities. (6) The Investment Advisers Act of 1940, 15 U.S.C., sec. 80b, requires the registration of persons whose business is advising or informing others about securities, and regulates their contracts and transactions.

The Commission is also responsible, under the Bankruptcy Act, ch. X, 11 U.S.C., sec. 608, for advising courts sitting on corporate reorganizations under that statute.

are basic to the regulatory scheme and most relevant to this study. These and the other four statutes are administered by the Commission, an independent administrative agency of the Federal Government.

The Securities Act, often referred to as the "truth in securities" law, requires full disclosure in the flotation of securities (by any means of transportation or communication in interstate commerce or by the mails), and prohibits fraud in their sale. In brief, it requires issuers of securities to register them with the Commission before they are distributed and to disclose in a prospectus, of prescribed content, information important to a prospective investor's assessment of the security offered and the investment risks involved. It also prohibits fraud and misrepresentation in the sale of securities on initial distribution or thereafter. It does not, however, authorize the Commission to pass on the merits of securities or to determine which securities may be offered to the public.

The Exchange Act regulates securities markets and the business of securities brokers and dealers. It adopts two regulatory techniques. One is to impose direct requirements and prohibitions, either as statutory provisions or as rules and regulations promulgated by the Commission pursuant to the statute. The act requires, for instance, that securities exchanges register or obtain exemption from registration as a prerequisite of lawfully doing business. Similarly, it requires registration of securities, with limited exceptions, before they may be lawfully traded on an exchange. Other direct prescriptions restrict borrowing by brokers and dealers; prohibit the manipulation of prices of securities traded on exchanges and the use of manipulative or deceptive devices, as defined by the Commission, in the sale or purchase of securities; require issuers of securities listed on an exchange to file annual and other periodic reports; direct the furnishing of specified information in connection with proxy solicitations; and provide for the recapture by issuers of "short swing" profits derived from purchases and sales of securities by corporate "insiders."

The second regulatory technique of the Exchange Act is reliance on supervised self-regulation. This involves control of exchange markets by requiring or permitting national securities exchanges to adopt rules governing their practices and procedures and the business conduct of their members, and in each case imposes the responsibility for enforcement of these rules on the exchanges themselves. It requires exchanges, for instance, to adopt rules providing for the expulsion, suspension, or disciplining of a member for conduct inconsistent with just and equitable principles of trade; it expressly permits them to adopt rules on other specified subjects; and it generally authorizes them to adopt any rules not inconsistent with the act. Pursuant to these provisions, each of the major exchanges has a substantial body of rules covering operations and activities of members both inside and outside the actual marketplace. The constitution and rules of the New York Stock Exchange (NYSE), for example, filling almost 350 pages, deal extensively with such subjects as membership; commissions and service charges; dealings and settlements between members; activities of such members as specialists and floor traders; operation of member organizations, including capital requirements, the conduct of customers' accounts, financial statements, advertising, and market letters and sales literature; private wire and other connections; and the listing and delisting of securities.

The Exchange Act entrusts supervision of exchange rules to the Commission, requiring it to pass on their fairness and adequacy as a condition of exchange registration, requiring exchanges to file rule amendments with the Commission promptly upon their adoption, and empowering the Commission to request changes in rules relating to specified topics and, in the absence of compliance, itself to promulgate alterations or additions. The range of those specified subjects is quite broad; safeguards relating to the financial responsibility of members; registration of or trading in a security within a specified period after its issuance or primary distribution; listing or delisting of any security; hours of trading; the manner, method, and place of making settlements, payment and deliveries, and of closing accounts; the reporting of transactions, both on the exchange floor and on tickers; the fixing of reasonable rates of commission, interest, listing, and other charges; minimum units of trading and odd-lot purchases and sales; minimum deposits on margin accounts; and similar matters.

The Exchange Act relies heavily on supervised self-regulation to control over-the-counter markets also. It includes some direct prescriptions, either set forth explicitly in the statute itself or stated generally for more precise definition by the Commission, e.g., provisions requiring registration of broker-dealers and directing the Commission to deny registration to and revoke that of persons who have been guilty of offenses against securities laws, and provisions prohibiting fraud, misrepresentation, and manipulation in the purchase and sale of securities traded over the counter. But in addition to these provisions for direct governmental regulation, a section of prime importance in the total regulatory scheme was added by amendment in 1938, authorizing the registration of associations of brokers or dealers as national securities associations and entrusting the regulation of the business of their members to such associations, subject to the supervision and ultimate responsibility of the Commission.

The act provides that association rules must make any over-the-counter broker or dealer eligible for membership unless he has been guilty of specified violations of securities laws or exchange or association rules; but membership may be restricted geographically, or by type of business, "or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors * * * ." ⁴ The rules must also assure fair representation of members in the conduct of association affairs; provide for equitable allocation of dues; and be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; * * * ." ⁵ The existing rules and interpretations of the National Association of Securities Dealers (NASD), although not so extensive or detailed as those of some of the exchanges, implement the quoted statutory language by incorporating provisions relating to such subjects as fraudulent and manipulative transactions; advertising: "free riding and withholding

⁴ Exchange Act, sec. 15A(b)(3).

⁵ Exchange Act, sec. 15A(b)(7).

(i.e., improper handling of allotments in connection with a public offering); suitability of recommended investments; charges, prices (including "markups," i.e., the spread between a dealer's selling price and his cost or the prevailing market price) and commissions; certain types of disclosure; transactions in mutual fund shares; and record-keeping. When the resolution authorizing the study was being considered by Congress, W. H. Claffin III, then chairman of the board of governors of the NASD testified:

As we find problems that are new or coming up that we have not met before, we try to either build a rule or interpretation that will give us the authority or the ability to solve that problem, or we rewrite an existing interpretation or rule to try to fill in the niche. Obviously new problems and new ways of getting around existing regulations are being thought up all the time and we have to keep on our feet to meet the changing times.⁶

The generality of the statutory language delineating the scope of association rules obviously calls for such an effort, and the resulting body of existing rules covers a considerable number of subjects.

The rules of national securities associations are subjected to Commission authority in a manner comparable but not identical to those of exchanges: the Commission is empowered to disapprove rule changes before they become effective, to abrogate existing rules, and to request or itself formulate certain rule changes.

3. GENERAL SCOPE AND LIMITS OF SPECIAL STUDY

It will be apparent from even this brief description of the rules of the exchanges and of the NASD that a study of those rules' adequacy for the protection of investors, as contemplated by Congress, would potentially include virtually every aspect of the securities business and the securities markets. The committee report⁷ preceding enactment of section 19(d) makes clear, moreover, that Congress intended its actual coverage to be "very broad." At page 5 of that report, the intended scope of the study was set forth as follows:

The resolution directs the Commission to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations. It should be noted that while the language of the resolution is specific, the scope of the resolution which is telescoped in this succinct language is very broad inasmuch as the subject matter encompassed or not encompassed by the rules of the securities exchanges and securities associations is extremely wide in breadth. The rules not only cover such items as are appropriate to the mechanism of a free and open market, the prevention of fraudulent and manipulative acts and practices, the promotion of just and equitable principles of trade, safeguards against unreasonable profits or unreasonable rates or commissions or charges, the financial responsibility of members and the financing of transactions, and the protection of investors in the public interest, but also certain types of disclosure of information by the issuers of the securities which are being traded. In addition, the rules (including those relating to expulsion, suspension, or disciplining of a member) of the exchanges and of the national securities association cover the ethical conduct of its members in all of their activities.

In view of the wide scope of existing rules of the exchanges and the NASD, and the clear indication by Congress that the inadequacy or absence of rules should also be examined, the study was led in-

⁶ Hearings on H.J. Res. 438, "Securities Markets Investigation," before the Subcommittee on Commerce and Finance of the House Interstate and Foreign Commerce Committee, 87th Cong., 1st sess., pp. 61, 68 (1961).

⁷ See note 6, above.

evitably to survey almost all aspects of the securities business and the securities markets. Included were such subjects as the caliber and qualifications of persons active in the business, including broker-dealers and investment advisers, and the standards of conduct and responsibility to which they adhered or should be expected to adhere; distribution practices, procedures, and problems; operations of the various exchange markets and over-the-counter markets, their mechanisms, components and structures, and their interrelationships; certain activities and obligations of issuers that affect the markets, including financial reporting, proxy solicitation, controls over "insider" profits and corporate publicity; securities credit and margin requirements; certain aspects of mutual funds related to the foregoing; existing and emerging uses of electronic equipment and their bearing on both business and regulatory methods; and the theory and practice of self-regulation, which underlies and pervades the entire regulatory structure.

Most of these subjects were first studied in the context of conditions prevailing in 1961 or early 1962 and many of them were, so to speak, restudied in the circumstances prevailing immediately before, during, and after the severe market "break" of May 28-29, 1962. That occurrence presented to the study both an added burden and an opportunity. As a separate market phenomenon it could not, of course, have been ignored; the study was clearly called upon to ascertain as accurately as possible what occurred during the actual "break" and, to the extent feasible, its causes and effects. At the same time an effort was made to supplement and further illuminate data that the study had already assembled on certain subjects, by obtaining comparable data as of a quite different set of conditions.

It will be evident that the actual scope of the study was extremely broad, and yet not so broad as the potential scope suggested by the enabling statute and its legislative history. It was apparent almost from the outset that the potential scope was too great to be covered completely, in a thorough and responsible manner, within the limits of time and budget provided in the authorizing legislation. In order to give maximum assurance that whatever data were presented and whatever conclusions were expressed would be reliable and meaningful ones, it was necessary to be selective and to exclude many subjects that might well have been considered under the potential scope.

4. METHODS OF INVESTIGATION AND STUDY

The tools and techniques of the study have been many and varied, depending on the nature of each subject matter. Among the principal means of study have been formal and informal questionnaires,⁸ interviews with individuals and groups, private and public hearings, examination of records and files of firms and organizations, analyses of data accumulated in the Commission's administration of the various securities laws, and review of prior studies by the Commission itself and by other persons and organizations. In the body of the report the methods of study are set forth in detail in connection with each

⁸ The titles and designations of the questionnaires submitted to different groups and used in the study are set forth in an appendix to this chapter. Copies of the questionnaires are presented in appendixes to the appropriate chapters.

topic discussed. Statistical tables and charts presenting data obtained from the questionnaires and other sources are generally presented at the end of each chapter; the bulk of them are discussed and referred to in the text.

The work of the study was performed by a special staff, recruited in part from regular Commission personnel, and formed into a temporary division of the Commission; it varied slightly in number from time to time, but was maintained at a general level of 65 persons. Management and direction of the study were the responsibility of the Director, assisted and advised by an Associate Director, a Chief Counsel, a Chief Economist, and an Assistant Director. Under their general supervision worked a staff of attorneys, economists and statisticians, analysts, investigators, clerks, and stenographers. Personnel from regular divisions of the Commission were called upon for assistance in limited areas and, on some aspects of the subject of securities credit, collaborative studies with the Board of Governors of the Federal Reserve System were made. Other studies were made with the assistance of outside groups or consultants. In order to permit the evaluation within the time available of the vast body of data collected, various Government agencies cooperated by providing data-processing equipment and attendant personnel.

5. NATURE OF CONCLUSIONS AND RECOMMENDATIONS

Because of the range and variety of subject matters, it was necessary to determine separately, for each individual topic and subtopic that was to be studied at all, what technique or combination of techniques and what breadth and depth of inquiry were called for in order to obtain significant data and responsible conclusions. It obviously was not practical to obtain a universal or 100 percent compilation of data relevant to every subject, and accordingly it was the constant concern of the study to determine what would be an adequate sample to provide representative and reliable data for each subject. In the course of the study a very great volume of material was amassed, but it can by no means be claimed that every possible permutation and combination has been examined.

In this report generalizations are expressed on particular subjects where the available data are believed to justify them; in other instances the report is confined to summarization of available data or presentation of a spectrum of representative examples. Similarly, the report contains specific or detailed recommendations with respect to only certain areas of the total study. In others, recommendations are necessarily made in broad terms, with no attempt to draw precise lines; or, they take the form of mere indications of approaches—sometimes alternative approaches—that merit further discussion and debate; or regarding certain subjects about which available data are clearly incomplete, they merely suggest further or continuing study by the Commission or the industry or by both in collaboration.

No part of the present report has been submitted in draft form, for comment or correction or any other purpose, to any of the private persons or groups referred to or potentially affected by the contents. Assuming that this would otherwise have been an appropriate course, it was an impossible one within the time limit of this study. Thus,

such persons and groups have not had the opportunity to respond directly to any of the factual material, analyses, or proposals contained in the report, as they undoubtedly would have been entitled to if the report amounted to a final disposition of any of the questions discussed. Since the report does not "decide" any question, but only expresses conclusions and recommendations of the Special Study, adequate opportunity for pointing out errors of fact or analysis or for disputing conclusions and recommendations will be afforded in the legislative hearings or administrative proceedings that necessarily will precede adoption of any recommendations to which there might be opposition.

Many recommendations are expressed in terms of substantive goals rather than referring specifically to the means of achieving the goals—whether legislation or rulemaking, and if the latter, whether by the Commission or by the self-regulatory agencies. This reflects in part the study's inability to devote the time that would have been necessary to explore all pertinent legal questions as to adequacy of existing powers. It goes without saying that finding administrative solutions under existing powers is to be preferred to seeking new powers, and it is believed that legislative changes can be kept to a minimum. Similarly, under the theory of self-regulation, appropriate action by self-regulatory agencies would generally have preference over direct action by the Commission.

Even if available time and manpower of the study had not been as limited as they were, it would have been foolhardy to suppose that simple and obvious solutions of a welter of complex questions were an attainable goal: It is relevant here to quote from a prefatory letter dated October 8, 1946, attached to a brief report submitted to the board of governors of the Midwest (then, Chicago) Stock Exchange by James E. Day, then and now its president: "After 2 years, we have found that the more we study markets, the more humble we become when expressing an opinion."

At the same time, though the resources of the study have been finite, they have been considerable and they have been diligently used. If at some points the study was able only to take soundings, at many points the probing was deep and broad. Further, an uncommon opportunity for seeing each subject in wider perspective was afforded by the very scope of the total effort. Thus, all conclusions in the report, expressed in each case with only such definiteness as seemed warranted by the data described, are submitted with confidence and conviction.

The work of the Special Study of Securities Markets ends with the completion of this report. But the conclusions and recommendations, whether proposing specific changes in legislation or rules, or indicating approaches to problems, or merely calling for further study, will involve new responsibilities and burden for the Commission and the self-regulatory agencies. Undoubtedly those burdens will be substantial, and additional resources of budget and personnel may well be required. It will not be surprising if every single conclusion and recommendation does not find favor in all quarters, but it is essential that the issues posed in the report be met and resolved by those with regulatory and self-regulatory responsibilities.

B. THE STRUCTURE AND GROWTH OF THE SECURITIES INDUSTRY

The securities industry in the United States is a complex structure of many disparate elements. Some of its separate aspects are described and analyzed in detail in the succeeding chapters of this report. The present part, briefly sketching a picture of the industry and its recent growth, is intended as a framework to facilitate an understanding of the particular aspects that are considered subsequently.

1. THE SECURITIES MARKETS

The broad term "securities markets" encompasses both the markets for distribution of securities into public hands and the markets for continuous trading in outstanding securities. Both kinds of markets are elaborate structures geared to bringing buyers and sellers together. Trading markets consist of both a limited number of organized stock exchanges and a greater, fluctuating number of far less organized over-the-counter markets. Distribution markets are essentially over the counter. Since shares of corporate stock once distributed may subsequently change hands many times, the volume of trading is substantially larger than the volume of distributions. For example, the Special Study estimates that in 1961 the dollar volume of stocks traded in exchange and over-the-counter markets was almost 30 times as great as the cash proceeds received by corporations from the sale of stocks. Speaking broadly, distributions are the main concern of the Securities Act and trading markets are the main concern of the Exchange Act.

a. The public interest in the securities markets

Securities markets in the United States are, in contemplation of law and in fact, *public* markets. They are public both in the sense that large numbers of people are directly or indirectly involved in owning and trading securities, and in the broader sense that the performance of securities markets affects the general economy and well-being in important ways. The former sense was recently expressed, for example, by the president of the New York Stock Exchange as follows:

The sole purpose of a modern marketplace is to provide the public with an efficient and dependable mechanism through which securities can be bought and sold.⁹

The latter sense is expressed by section 2 of the Exchange Act, which succinctly states various reasons why securities markets are "affected with a national public interest." In the following paragraphs some of the more important impacts of securities markets on investors and the general public are very briefly noted.

First, in a capitalistic society in which the corporate form of enterprise prevails, securities are an important form of private property, constituting an integral element of the resources, and materially influencing the long-term financial security, of a large segment of the population. Thus, on December 31, 1961, individuals had accumulated net financial savings of approximately \$900 billion, of which direct holdings of corporate securities represented more than one-

⁹ Funston, letter of comment on James, "Disputed Role of the Stock Exchange Specialist," 40 Harv. Bus. Rev. 7, 8 (September-October 1962).

half, almost all of which was common and preferred stock; these holdings were more than twice as large as the deposits and currency of individuals.¹⁰ Another indication of the widespread importance of securities is the New York Stock Exchange estimate that in early 1962, over 17 million individuals held shares in publicly held corporations.¹¹

Potentially affecting an even larger segment of the population, private retirement and insurance programs for individuals depend considerably on investments in corporate securities. This has been historically true as to corporate bonds and in recent years has become increasingly true as to corporate stocks. As of December 31, 1961, holdings of corporate securities by life insurance companies and private pension funds were estimated at \$93 billion, of which corporate stocks represented about 30 percent.¹² Personal trust funds held \$57 billion in corporate securities, mostly common and preferred stocks.

Turning briefly to the general public interest in securities markets, as distinguished from the direct and indirect interests of public investors, it may first be noted that the state of the trading markets unquestionably has an important bearing on the flow of new capital into private enterprise, and thus on the country's rate of economic growth. During the 5-year period 1957-61, as an illustration, corporations in the United States made expenditures for plant and equipment of \$148 billion plus \$38 billion for other investments and increased net working capital.¹³ Of this total expansion, \$39 billion came from the issuance of stocks and bonds representing the additional funds needed beyond reinvested earnings and depreciation.

Without doubt, original distributions of securities are facilitated by the confidence of investors that they can later dispose of their purchases in a trading market. Conversely, companies' plans to sell securities may be significantly affected by current market behavior. Indicative of this relationship, during the 4 months following the market break of May 1962, new effective registrations for the issuance of common stocks (excluding investment company shares) decreased over 60 percent in dollar amount and 40 percent in number from the corresponding months of 1961, a period of substantially higher prices. The securities markets' vast resources for marshaling the capital of individual and institutional investors all over the world give corporate enterprise access to large sources of funds that would not otherwise be available. At the same time, by providing liquidity to investments, the markets make possible the accumulation of aggregates of capital with the assurance that they can be converted to cash or readily valued when they may be needed for planned uses or to meet maturing liabilities.

Apart from their direct bearing on the flow of savings into private enterprise through distributions of securities, the actual state of the markets and the public's attitudes toward the markets are widely believed to have important bearing on the state of the economy. Thus, the potential impact on individual and corporate spending was

¹⁰ SEC, Statistical Bulletin 11 (April 1962).

¹¹ New York Stock Exchange, "1962 Census of Shareowners in America," 4 (June 1962).

¹² SEC, report to staff of the President's Committee on Pension Plans, tables 9 and 11 (1962).

¹³ SEC, "Source and Uses of Corporate Funds" based on SEC and Department of Commerce data.

a matter of concern and comment in the wake of the sharp market break in mid-1962.¹⁴

Finally, surely not the least important way in which the securities markets may affect the general economy and well-being is that described in clause (4) of section 2 of the Exchange Act:

National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets * * *.

It is to be remembered that the Congress that made this recital had fresh in its memory the market debacle of 1929 which preceded the great depression of the 1930's.

The emphasis on the public interest in this and other clauses of section 2 is echoed repeatedly in the substantive provisions of the statute. Over and over again Congress proclaimed that the regulatory authority conferred on the Commission was to be exercised "in the public interest" and "for the protection of investors." Thus, while the private ownership of exchanges was not disturbed, the Exchange Act, in the words of the House of Representatives committee report preceding its enactment, proceeded on the theory that "the exchanges are public institutions which the public is invited to use for the purchase and sale of securities listed thereon, and are not private clubs to be conducted only in accordance with the interests of their members. The great exchanges of this country upon which millions of dollars of securities are sold are affected with a public interest in the same degree as any other great utility."¹⁵ Similarly, "the public interest" and "protection of investors" were established as the dominant considerations in the operation and regulation of over-the-counter markets.

b. The stock exchanges

In reviewing the trading markets, consideration initially is given to the stock exchanges, of which there are at present 14 registered exchanges and 4 exempt exchanges.¹⁶ Of dominant importance among the exchanges is the NYSE, which in 1962 had \$47.4 billion of transactions in stocks, rights, and warrants, representing 86 percent of the total dollar volume on registered exchanges. Ranking far below, but nevertheless well above the others, is the American Stock Exchange (Amex), which in 1962 reported \$3.7 billion of transactions or 7 percent of the total. The rest, the "regional" exchanges, account for only a small share of total exchange trading; three of them, the Midwest, Pacific coast, and Philadelphia-Baltimore-Washington, produced 6 percent of the dollar volume of all exchange trading in 1962, while the remaining registered exchanges accounted for only 1 percent.

The leading role of the NYSE is also shown in its percentage of the aggregate market value of shares available for trading on all ex-

¹⁴ See, e.g., First National City Bank of New York, Monthly Economic Letter, July 1962; on the 1937 decline, see Roose, "The Economics of Recession and Revival," at pp. 219-222 (1954); and on the 1920's and early 1930's, see testimony of Federal Reserve Board official E. A. Goldenweiser, hearings on H.R. 7852 and H.R. 8720, on "Stock Exchange Regulation," 73d Cong., 2d sess., at p. 65 et seq. (1934).

¹⁵ H. Rept. 1383, 73d Cong., 2d sess., p. 15 (1934).

¹⁶ Included in the registered exchanges are the National Stock Exchange and the Chicago Board of Trade, the former having 10 listings at the end of 1962, and the latter having no securities transactions. The exempt exchanges are of minor significance and omitted from this report, except as specifically noted.

changes, which rose from 83 percent in 1940 to 93 percent in 1962 (table I-1). The aggregate market value on all exchanges increased over seven times during this period, with over 90 percent of that increase occurring in NYSE stocks and practically all the rest in Amex stocks. The preeminence of the NYSE is much less striking, but nevertheless clear, when gaged by the number of stocks listed on exchanges. Its share of one-third of the listings on all exchanges in 1940 has increased to one-half (table I-2). The number of listings on the Amex declined from 1940 to 1950, but then the trend reversed itself and in 1962 there were almost as many listings as there were in 1940. During this period a sharp decline occurred in the stocks exclusively traded on the other exchanges.

While each exchange has its own operating characteristics, the pattern of the NYSE sets the pace for the rest of the industry. Only individuals can hold seats or be "members" of the NYSE. However, the exchange sets up categories of "member firms" and "member corporations" for partnerships or corporations in which a member is a general partner or a director holding voting stock. Other general partners or holders of voting stock of these member firms,¹⁷ who are not actual members of the exchange, are denominated "allied members."

At the close of 1962 the NYSE's membership was 1,366, which included 1,101 individuals affiliated with 672 firms. The remainder were not affiliated with any firm or were inactive (table I-3). In general, there has been a tendency for the number of nonaffiliated and inactive members to decline. The most striking change in the membership of the exchange, however, has been the rapid expansion in the number of allied members. This group has doubled over the past decade to reach a peak of 6,238 in 1962.

The members of the NYSE perform various functions in connection with the market and may be classified on the basis of their principal activity (table I-4). As of December 31, 1962, there were 350 specialists, who play a focal role in the market's operations; in the securities in which a specialist is registered, he executes public orders generally forwarded to him by other members and also deals as principal, thus "making" markets in those issues. There were 666 members, affiliated with member firms, who were either "office partners" or were on the floor of the exchange handling orders transmitted to them by their firms. Another 150 members are floor brokers, commonly known as "\$2 brokers," who were unaffiliated with member firms dealing with the public but executed orders for them. There were 119 members involved in handling odd-lot orders, most of them brokers working on the floor exclusively for the odd-lot dealer firms, executing odd-lot orders and buying and selling round lots to meet the demands of odd-lot customers. There were approximately 28 individual members primarily engaged in floor trading; that is, buying and selling for their own accounts. Finally, there were 53 inactive members. Compared with 1950, the number of floor brokers and inactive members have declined while the other categories have grown modestly.

¹⁷ The NYSE uses the phrase "member organization" to cover both partnerships and corporations. In this report, unless specific qualification appears, "member firms" and "member organizations" are used interchangeably.

c. The over-the-counter markets for outstanding securities

Transactions in securities outside the organized securities exchanges are described as taking place in the over-the-counter market. The over-the-counter market is actually a group of markets, in which broker-dealers transact business with the public as principals or agents, dealing for the most part in securities not listed on any exchanges. Some dealers may maintain inventories in one or more over-the-counter securities and be willing to both buy and sell them to other broker-dealers, in which case they are known as "market makers" in those securities.

The bulk of the over-the-counter broker-dealers are members of the NASD. In trading with nonmember broker-dealers, NASD members must charge the same price as they charge the general public, whereas member broker-dealers may be given a "wholesale" price. Thus, there is an important economic pressure on all broker-dealers doing business in the over-the-counter markets, including member firms of the exchanges, to join the NASD.

Because of the differences in the mechanics of executing a transaction over the counter and on an exchange, it is difficult to compare activity in the two markets. Normally in the over-the-counter markets, two or three sales of a security may take place between broker-dealers before a security sold by one public customer is bought by another. Even if all of these dealer sales are included in over-the-counter volume, however, activity in the over-the-counter markets, in terms of value of shares traded, is not as large as on the Nation's securities exchanges. For example, based on the Special Study's OTC-3 questionnaire, it is estimated that in 1961 the dollar volume of trading in stocks over the counter was equal to about 60 percent of that on exchanges.¹⁸ If over-the-counter activity is measured in terms of share volume, the picture is quite different. Reflecting the low prices of a large number of over-the-counter stocks, share volume in the over-the-counter markets tends to be higher than that on exchanges. In 1961, it was probably 25 percent greater than the volume of trading on all exchanges.¹⁹

In the ordinary course of events, corporations issue new securities through underwriters in the over-the-counter market or through private placements. Unless or until an issue may become listed on an exchange, the trading in the security takes place in the over-the-counter market. If the issuer grows sufficiently, it may decide to list its securities on an exchange, in which case further trading in that issue will ordinarily be handled on that exchange.

2. THE SECURITIES TRADED

Securities traded in exchange and over-the-counter markets represent many different transferable evidences of debt or equity interests, and broker-dealers may handle a number of different types or specialize in one or a few. The securities range from those issued by the Government, including Federal, State, local, and agency bonds, to

¹⁸ For a further description of this survey and a detailed description of its results, see ch. VII.

¹⁹ Syndicated distributions and sales of open-end investment company shares have been excluded from over-the-counter volume.

issues of corporations, including bonds, debentures, convertible issues, and common and preferred stock; in addition there are such other securities as limited partnership interests in real estate syndications and trust participation certificates. Another important category, with unique characteristics, consists of investment company shares or, in the case of contractual plans, certificates evidencing an undivided interest in such shares.

Each of these different kinds of securities is usually employed by an issuer to satisfy a particular kind of financing need. Once an issue is distributed, it may follow a pattern characteristic for its type, veering to the over-the-counter markets or to the exchanges. For example, U.S. Treasury, State, and municipal bonds are typically traded over the counter, as are the issues of banks and insurance companies. The shares of open-end investment companies, or mutual funds, are sold only outside the exchanges; these shares are generally redeemable at or near their net asset value and usually are offered continuously by the fund. Much of the trading in corporate bonds is over the counter. Stocks that cannot meet the listing requirements of the exchanges are traded over the counter, and in a number of instances issuers elect not to list their stocks even though they meet listing standards. Moreover, a relatively small but increasing percentage of trading in listed stocks is over the counter.

It is extremely difficult to gage the number of stocks that are traded over a period of time in the over-the-counter markets. One problem is that the absence of a centralized reporting mechanism makes an accurate count difficult. Furthermore, the number of stocks traded is constantly changing as broker-dealers develop and lose interest in different securities. As a result, depending upon the definition used, different estimates have been made of the number of securities traded. Using as a criterion the existence of some indication of interest by broker-dealers to purchase or sell the security, the Special Study examined a 10-month period in 1961-62 and estimates that there were some 14,000 such domestic over-the-counter stocks during the period.²⁰ For comparison, on June 30, 1962, there were approximately 3,100 stocks available for trading on all stock exchanges in the United States, of which 1,565 were listed on the NYSE and 1,033 were listed or had unlisted trading privileges on the Amex.

The number of issues available for trading makes the over-the-counter market appears quite large. On the other hand, when one considers that the average number of shares of such issues outstanding is considerably below the average for listed issues and that over-the-counter stocks generally sell at a lower price than exchange stocks, the over-the-counter market appears smaller. Altogether, the study estimates that the value of the outstanding shares for the 14,000 unlisted issues was less than one-third of the value of outstanding shares of listed companies, which were valued at \$426 billion at the end of 1961.²¹

²⁰ This figure is based on an estimate (discussed in detail in ch. IX) of somewhat over 11,000 issuers of stock. About 22 percent of the companies surveyed in arriving at the estimate had multiple issues.

²¹ This discussion of the over-the-counter market excludes mutual funds shares, which had a value of approximately \$24 billion on Dec. 31, 1961.

3. THE BROKER-DEALER COMMUNITY

The definitions of the terms "broker" and "dealer" contained in the Exchange Act are broad enough to embrace most of the individual proprietorships, partnerships, and corporations engaged in the business of effecting securities transactions with or for the investing public, whether they act as agents for others or buy and sell for their own accounts, and whether they style themselves "brokerage firms," "investment bankers," "securities dealers," or just plain "brokers." The Nation's earliest securities firms were almost exclusively brokers operating out of a single office and dealing in the limited list of bonds and shares then available to the public, but today's firms vary greatly in size and character. They range in size from the giant organization with an elaborate worldwide network of branch offices to the one-man, neighborhood office, and in type of operation from the investment banking function of bringing new issues to the public market to that of executing orders for the purchase of open-end mutual shares. In the course of trading in securities, the broker-dealer firms may perform a number of supporting services. For example, many of them arrange clearing of certificates, afford custodial facilities, grant loans and furnish investment information and advice. The following overall description of these firms is bound to gloss over their individual differences, but at the same time it provides an insight into their characteristics.

a. Location

During the infancy of this country, Philadelphia, the seat of the Continental Congress, became the economic and banking center. It was also the home of the principal American holders of continental bonds, which formed the early basis for securities trading. As might be expected, therefore, the country's first stock exchange was founded at Philadelphia in 1791 and the city became the center for securities trading. New York, however, was not far behind Philadelphia, and in 1792 a group of 24 merchants and auctioneers founded the predecessor of the New York Stock Exchange. The transformation in 1817 of the relatively informal New York exchange into a more formal organization patterned after the Philadelphia institution marked the former's ascending importance.

Thereafter, the NYSE and its members continued to extend their activities and to establish and strengthen New York's position as the Nation's leading financial city. This position has been maintained, but in recent years the continuing shift of the population westward and the greatly enlarged number of individuals interested in securities have combined to bring about geographic changes in the industry. To serve the growing market of individual securities purchasers, many new firms have been organized and broker-dealers generally have considerably augmented their retail outlets, increasing their sales forces and opening new branch offices. Whereas in 1950 there were more than twice as many main offices as branches, by 1962 the numbers were almost equal (table I-5). Much of this expansion came in parts of the country where only a few offices had previously been located. Thus, the total number of broker-dealer offices in the Mountain States

grew from less than 100 in 1950 to 366 in 1962, and those in the South Central States increased from 334 in 1950 to 880 in 1962.

Despite this proliferation, New York City remains the Nation's securities trading center. It houses not only the major stock exchanges but also, at the end of 1962, 1,496 main offices of NASD members (table I-6). The 1,863 NASD member main offices in all of New York State were five times the number in California, the next ranking State, and almost 40 percent of the total for all NASD members. The branch office picture, however, is strikingly different. Here, New York State at the close of 1962 had 599 branch offices, less than the 682 in California and a bare 13 percent of the branch offices maintained by all members.

b. Size and turnover

It appears that there are over 6,000 broker-dealer firms in the United States engaged in some aspect of the securities business. Under the Exchange Act, all broker-dealers conducting an interstate over-the-counter business must register with the Commission. On February 28, 1962, there were 5,785 such firms registered. Through the OTC-3 questionnaire mentioned previously, the Special Study obtained from 4,964 of them data concerning their over-the-counter trading activities.

The bulk of these firms, of course, have no exchange affiliation and primarily confine their activities to various aspects of the over-the-counter market (table I-7). There were 677 members and member firms of the New York Stock Exchange registered with the Commission, despite the fact that the Exchange estimates that only some 500 of the firms do business with the public and the majority of the individual members not associated with any member corporation or partnership are engaged solely in activities on the floor of the exchange. Most of the registered broker-dealers—4,417 of the 4,964 covered in the study's survey—were members of the NASD. The total membership of the NASD at the time of the study's survey was about 4,750, but this included some inactive firms which did not reply to the study's questionnaire.

Broker-dealer firms can be divided into a relatively small number of large organizations employing a majority of all salesmen in the industry and a large number of small units employing few salesmen. The Special Study found that limiting the recipients of its "STS" questionnaires on firms' practices in screening, training, and supervising their sales employees²² to firms with three or more registered representatives (salesmen and active principals) reduced the number of NASD members to be analyzed from some 4,700 to about 2,100. The executive director of the NASD testified that 3,311 firms, or about 70 percent of the total NASD membership as of the fall of 1961, had less than 10 registered representatives.

Another indication of the number of small brokerage firms is the prevalence of single-office operations under the control of one man. Although some firms have more than 50 branch offices scattered throughout the country, the vast majority of registered broker-dealers have only one office. Sole proprietorships comprised about 30 percent of all broker-dealers registered with the Commission on June 30, 1962, and of the corporations registered—comprising 47 percent of the

²² This survey is discussed in detail in ch. II.

total—many are owned and operated by one person (see table I-19, referred to below).

At the top in size among broker-dealer firms are those affiliated with the NYSE, which combine both exchange and over-the-counter business in their nationwide branch operations. In general, NYSE member firms tend to do more business than member firms of other exchanges or than nonexchange firms. Thus, based upon a sample investigation made by the Special Study, it is estimated that 14 percent of NYSE member firms employing three or more registered representatives had annual gross incomes of \$300,000 or less, while 39 percent of such member firms of other exchanges, and almost 90 percent of such nonexchange firms had annual gross incomes of \$300,000 or less (table I-8). Even with regard to over-the-counter business, the NYSE firms are of major importance; for example, it was found that the NYSE firms accounted for more than half of the over-the-counter dollar volume in 1961.

Another characteristic of the broker-dealer population of the country is a high rate of turnover of firms, much of which occurs among the smaller ones. During the fiscal year ended June 30, 1962, 1,161 new broker-dealers were registered and 793 registrations were terminated, or 21 and 14 percent, respectively, of a registered broker-dealer population of 5,500 at the start of the year (table I-9). However, since Commission registration figures include changes in form of entity, as from partnership to corporation, a truer picture of the propositions of industry turnover may be suggested by the statistics of the NASD, which represent actual additions to or departures from its membership. During calendar year 1962, the NASD had 13 percent admissions and 12 percent terminations of membership.

c. Type of activity and amount of gross income

The varieties of the primary and secondary activities of the broker-dealer community were indicated in the study's survey of 4,964 broker-dealers registered with the Commission as of February 28, 1962. One-third of the firms surveyed were primarily engaged in the sale of mutual funds to the public, and about half of these did no other type of securities business (table I-10). About 27 percent were principally retail over-the-counter dealers, many of whom had as a major secondary activity either wholesaling in the over-the-counter market or selling mutual funds. Some 12 percent were primarily engaged in handling transactions on the exchanges, and their principal secondary activity was serving as retail over-the-counter dealers. About 9 percent were primarily underwriters, and most of these reported that wholesale or retail over-the-counter activities were their second most important source of income. Another 8 percent operated principally as over-the-counter wholesalers, and many of these acted secondarily as retailers in the over-the-counter market. The remaining 11 percent included those broker-dealers engaging in such various activities as specialists, floor brokers, commodity brokers, foreign exchange brokers, put-and-call broker-dealers, and investment advisers.

A relationship between the type of security business done and the amount of gross income from securities transactions is indicated by the Special Study's surveys which concentrated on NASD members

with three or more registered representatives (STS-1 and STS-2). As one means of classification, a distinction was drawn based upon whether or not the firms specialized in the sale of mutual fund shares. It is estimated that for the firms so specializing, the sale of these shares constituted 87 percent of their gross income, compared with only 10 percent in the case of the nonspecializing firms (table I-11). Reflecting the difference in their size and activity, about 90 percent of the mutual fund firms had gross incomes of \$300,000 or less, compared with about one-half of the nonspecializing firms (table I-13).²³ Similarly, the average annual gross income of the mutual fund firms was slightly over \$200,000 compared with an average annual gross income of about \$1,350,000 for firms handling other securities. Regardless of their size, the mutual fund firms as a class had no major source of income except for the sale of fund shares; the next most important source was over-the-counter business which constituted 8 percent of the income of these firms.

Over-the-counter activity was a particularly important source of income for the smaller broker-dealers not specializing in mutual funds. These firms (with gross incomes of less than \$250,000 a year) derived almost half of their gross income from dealings in over-the-counter stocks, as compared with about one-third for firms of a larger size (with incomes between \$250,000 and \$4 million a year), and about one-fourth for the biggest firms (with incomes of over \$4 million a year).

Firms earning the most from securities listed on exchanges were the large general securities organizations, most of which are exchange members. These firms derived an estimated 46 percent of their income from exchange business. Underwriting was a common factor in the earnings of firms not specializing in the sale of mutual funds, the average contribution running about 15 to 18 percent of total gross income.

d. Concentration of business

As the data above suggest, there is a concentration of business and income in the large securities firms. Even when the smaller firms are eliminated from the broker-dealer population, the bulk of the activity is concentrated among relatively few firms. It is estimated that about 60 percent of the gross income from securities transactions of broker-dealers with three or more registered representatives was earned by 5 percent of the total number of firms (table I-14). These were the large firms not specializing in mutual fund shares. Similarly, while those with NYSE affiliations numbered about 20 percent of the firms with three or more registered representatives, they earned some 75 percent of the total gross income.

When the two types of the country's trading markets are considered separately, no lessening in the extent of this concentration is apparent. With regard to over-the-counter business, despite its diverse character, approximately one-half of the total over-the-counter sales of stock in 1961 was effected by less than 2 percent of all registered broker-dealers. Similarly, half of all the commission business done

²³ As noted above, only 14 percent of the NYSE member firms employing three or more registered representatives had annual income of \$300,000 or less.

on the NYSE in 1961 was accomplished by not more than 5 percent of the firms.²⁴

Finally, the concentration is reflected in the sales force of the industry. The Special Study estimates that less than 1 percent of all broker-dealer firms employ approximately 30 percent of all salesmen.

e. The salesmen of the broker-dealer community

Broker-dealers employ a variety of personnel. These include salesmen; back-office people who perform the clerical and cashier duties in connection with the transfer of securities, handling of funds, keeping of accounts, etc.; traders who buy and sell for the firms' account; order clerks who receive the customers' orders from the salesmen; researchers and analysts; and supervisory personnel. Undoubtedly, those in the securities industry who have the broadest contact with investors are the salesmen, full and part time, who are about 60 percent of all persons connected with registered broker-dealers.

The ranks of securities salesmen have been swollen through the influx of considerable numbers of new recruits. As a result inexperienced salesmen form a larger part of the sales force than previously. Based on NASD figures on registered representative applications, it is estimated that in recent years between 15 and 30 percent of all NASD salesmen had less than a year's experience in the securities business.

The educational level of the securities industry generally is high. Ninety-nine percent of the incoming persons in 1961 had attended high school and almost 70 percent had spent time at college, according to a sample of NASD applications. Such statistics, however, tend to obscure the wide educational range in the industry, both among types of firms and within firms themselves.

Occupational backgrounds of salesmen show considerably more diversity than their educational backgrounds. Applicants had formerly been engaged in such varied occupations as business, teaching, sales of tangible goods, and accountancy, among many others.

4. THE INVESTMENT ADVISERS

Another distinct segment of the industry encompasses those who engage in research and analysis concerning securities and, in one form or another, furnish investment advice. Within this group are included persons whose entire business is furnishing investment advice for a fee, either by managing investors' portfolios or by publishing a subscription service, or both. As of June 30, 1962, there were 1,836 investment advisers registered with the Commission; some of this number are also registered as broker-dealers, and for them the primary function is usually that of broker-dealer. The total number of investment advisers registered with the Commission rose steadily from 1,043 in June 1950 to 1,867 in June 1960, and then dropped slightly to the 1962 figure (table 1-15).

Also included in the investment research and advice community are persons employed for those purposes by many broker-dealer firms to do the work underlying their salesmen's recommendations, and to pre-

²⁴The ratios indicate the high degree of concentration in both markets. It should be noted, however, that the ratio for the NYSE represents chiefly concentration of trading by the public through the facilities of relatively few firms, whereas the ratio for over-the-counter business reflects both the activity by a small number of large wholesale houses in dealing with other broker-dealers and the concentration of public business in large retail firms.

pare such printed advisory materials as the firms may distribute. There are no accurate figures on the number of such employees, nor on the number employed by investment advisory firms.

The volume of material circulated by the subscription advisers, although not as vast as that of the materials prepared by broker-dealers, is significant. Circulation figures of the subscription services are hard to determine since they vary in direct proportion to market fever and activity, but those with the highest circulations in 1961 had between 30,000 and 50,000 subscribers. It is estimated that of the investment advisers registered with the Commission in 1962, less than one-tenth published advisory materials at all, and even fewer published regularly.

As for the geographic distribution of investment adviser firms, the largest tend to be found in the major cities along with the broker-dealer community, but otherwise there is considerable dispersion throughout the country.

5. EMPLOYMENT AND EARNINGS IN THE INDUSTRY

The importance of the securities industry to the American economy may be gaged in various ways. As was pointed out earlier, the position of the securities markets in the operation of the economy is such that their vigor strongly influences other sectors of the economy. In this respect, the securities industry is clearly very important. Moreover, the income and spending of the industry have special significance because of the industry's concentration in New York City. Its expenditures for advertising, printing, and legal and accounting services contribute to the maintenance of such facilities within the city and, together with the industry's importance in the raising of capital, help to make New York the Nation's headquarters for finance and business planning.

From a quantitative point of view, however, when gaged in terms of the number of persons employed, an important measure of size, the securities industry seems less significant. As an illustration, the Special Study estimates that the industry had about 160,000 full-time equivalent employees in 1961,²⁵ a negligible portion of the national total of 57,575,000. To help visualize the size of the securities industry, its full-time equivalent employment may be compared with other categories. For example, it ranks ahead of radio and television broadcasting with 86,000 persons and is in about the same range as motion pictures with 161,000 persons. Within the financial group, it lags behind the 682,000 of banking and the 509,000 of real estate.²⁶ These figures do not include principals of business enterprises unless they also earn salaries.

In contrast to the relatively small employment in the securities industry, its compensation scale is unusually liberal. In 1961, the average weekly earnings of its nonsupervisory employees was \$133.35,

²⁵ The Department of Commerce reports 107,000 full-time equivalent employees in the category of "security and commodity broker, dealers, and exchanges." U.S. Department of Commerce, Office of Business Economics, Survey of Current Business, 29 (July 1962). However, this excludes some mutual fund employees who are classified elsewhere and persons selling both insurance and securities. The figure also excludes persons employed part time solely on a commission basis.

²⁶ U.S. Department of Commerce, Office of Business Economics, Survey of Current Business, 29 (July 1962).

which was the highest reported for any industry and substantially above, for example, the \$69.19 paid by banking.²⁷ Similarly, the securities industry's average annual earnings of \$9,607 per full-time employee in 1961, including commissions, bonuses, and executives' compensation, was more than that of any industry group.²⁸ Within the financial group, it compared with \$4,826 reported by banking. The industry's average annual earnings in 1959 and 1960 were \$8,775 and \$8,358, respectively, which were also the highest of all industries in those years.

6. GROWTH OF THE SECURITIES INDUSTRY

In one form or another, securities have been traded in the United States since its founding but it was not until the sale of Liberty bonds throughout the country during World War I that securities became an accepted investment medium for the American public.²⁹ Before that time, there were approximately only 250 securities dealers in the United States.³⁰ Branch offices appear to have been few in number; indeed, it was not until 1881 that the New York Stock Exchange authorized the establishment of "branch houses."

While the growth of securities business to its present size started in the 1920's, from 1929 until after World War II there was no sustained rise in employment in the securities industry. Since that period, however, there has been a large expansion in the market for securities and an elaborate extension of sales offices and selling efforts.

a. The expansion of markets

During World War II, the market for new securities in the United States virtually disappeared as corporations bent their efforts toward war production and the Federal Government assumed much of the responsibility for financing. With the war drawing to a close a shift occurred; corporations began to look to their civilian outlets once more and found it necessary to raise new money through the securities markets in order to convert their facilities to meet a rising private demand for goods. Reflecting this transformation, the volume of corporate securities which issuers offered for cash sale (excluding private placements and offerings exempt from registration), which had declined to an annual level below \$700 million in 1942 and 1943, increased swiftly in each of the next 3 years to reach \$4,113 million in 1946. (See table IV-1 in ch. IV, below.) From 1947 to 1950, a period that covered the sharp business decline between late 1948 and 1949, the volume of such securities offered for cash receded somewhat to an average level of slightly over \$3,200 million a year. Thereafter, the figure has remained high with the peak of \$8,171 million attained in 1957.

The growth of the industry may also be seen in the trading markets. During the past 10 years, the number of individuals owning shares in public corporations has almost tripled, from as estimated 6.5 million people in 1952 when the New York Stock Exchange undertook its first census of shareowners, to an estimated 17 million in 1962. This

²⁷ U.S. Department of Labor, Bureau of Labor Statistics, Employment and Earnings, 130 (June 1962).

²⁸ U.S. Department of Commerce, Office of Business Economics, Survey of Current Business, 29 (July 1962).

²⁹ See report of Capital Issues Committee, H. Doc. 1485, 65th Cong., 3d sess. (1918).

³⁰ *United States v. Morgan*, 118 F. Supp. 621, 638 (S.D.N.Y. 1953).

growth is reflected in the increasing number of publicly owned listed companies and the greater number of shares available for trading on exchanges. Between 1940 and 1962, with hardly a break, the number of companies with stocks listed on the NYSE has risen from 862 to 1,186 and the average number of shares listed from 1,445 million to 7,374 million (table I-16). Changes in annual stock volume, which reflect many economic and psychological factors have been more jagged but in general have traced a rising line, and reached a record of 1,021 million shares in 1961, a figure that was previously exceeded only in 1929.

It should be noted, however, that volume has not increased in proportion to the growing number of shares listed each year. In 1929, when only an average of 942 million shares were listed, 1,125 million shares were traded, with an annual turnover of 119 percent. Even in 1945 and 1950 when volume was considerably below its present level, more than 20 percent of the shares were traded each year. In the past several years, the turnover rate has fluctuated between 12 and 15 percent.

The volume of over-the-counter sales also has grown. The study estimates that in 1949, this volume was \$4.9 billion, compared with \$38.9 billion in 1961, a gain of almost eight times. Another basis for gaging the growth of the over-the-counter markets is by the number of different stocks appearing in the daily sheets published by the National Quotation Bureau. This number, which includes various foreign, investment company, and exchange-listed issues, has expanded quite steadily from approximately 3,700 on January 15, 1939, to 8,200 on January 15, 1963.

b. The growth of broker-dealer firms

The expansion of the broker-dealer community has been characterized less by an increase in the number of firms than by a sharp rise in the size of these firms, as is shown by the number of their sales employees and branch offices. Thus, while the number of member organizations of the New York Stock Exchange has increased only slightly, the number of salesmen employed by these firms has risen from 7,989 at the end of 1945 to over 32,000 on December 31, 1962; the NYSE member firms' branch offices have increased from 841 to 2,737 over the same period (table I-17). The NASD, whose membership has increased over 100 percent in the years since 1945, can boast a similar rapid growth: from about 25,000 to 95,000 registered representatives and from 790 to 4,713 branch offices over the same period (table I-18).

The industry's growth has been reflected in the expansion of the large broker-dealer firms. The number of salesmen employed by Merrill Lynch, Pierce, Fenner & Smith (Merrill Lynch), the industry's largest firm in terms of income, increased from 1,038 in 1951 to 2,054 in May 1962. The firm's annual gross income rose from \$44,300,000 to \$181,100,000 during the same period. Bache & Co., since its reorganization in 1945, has increased its capital from \$4 million to \$31 million, its number of salesmen from 100 to 1,414 and its gross income from \$8 million (in 1947) to \$58 million in its fiscal year ending January 1962.

The growth of the securities industry has entailed an expansion of capital requirements and administrative needs. As a result, there has

been a substantial addition to the number of principals affiliated with the registered broker-dealer firms. Between mid-1945 and mid-1962, their number has risen by 87 percent, notably higher than the 41 percent rise in registered broker-dealers (table I-19). This increase, however, hardly measures up to the spectacular gains in the ranks of the salesmen described above.

A segment of the securities business which experienced particularly striking growth in the postwar period is that of the open-end investment companies, or mutual funds. Total net assets held by all mutual funds which were members of the Investment Company Institute³¹ were calculated at \$1,284 million in 1945; by December 31, 1962, this figure had grown to \$21,271 million, and was as high as \$22,789 million on December 31, 1961 (table I-20). The number of stockholder accounts in member mutual funds has grown from approximately 500,000 in 1945 to almost 6 million in 1962.

Along with this vast increase of investor interest in mutual fund shares has come a great enlargement of the sales forces through which most fund shares are distributed. A substantial part of the expansion in the number of salesmen registered with the NASD can be ascribed to the increased number of individuals selling mutual funds. Some of the selling organizations with which they are affiliated have themselves become huge, employing several times the number of salesmen used by Merrill Lynch, the largest retailer of other types of securities. The numbers of salesmen of mutual fund firms and of those working for other firms, however, are not directly comparable because of some basic differences between the two groups, such as the high proportion of mutual fund salesmen who work part time and their more rapid rate of turnover.

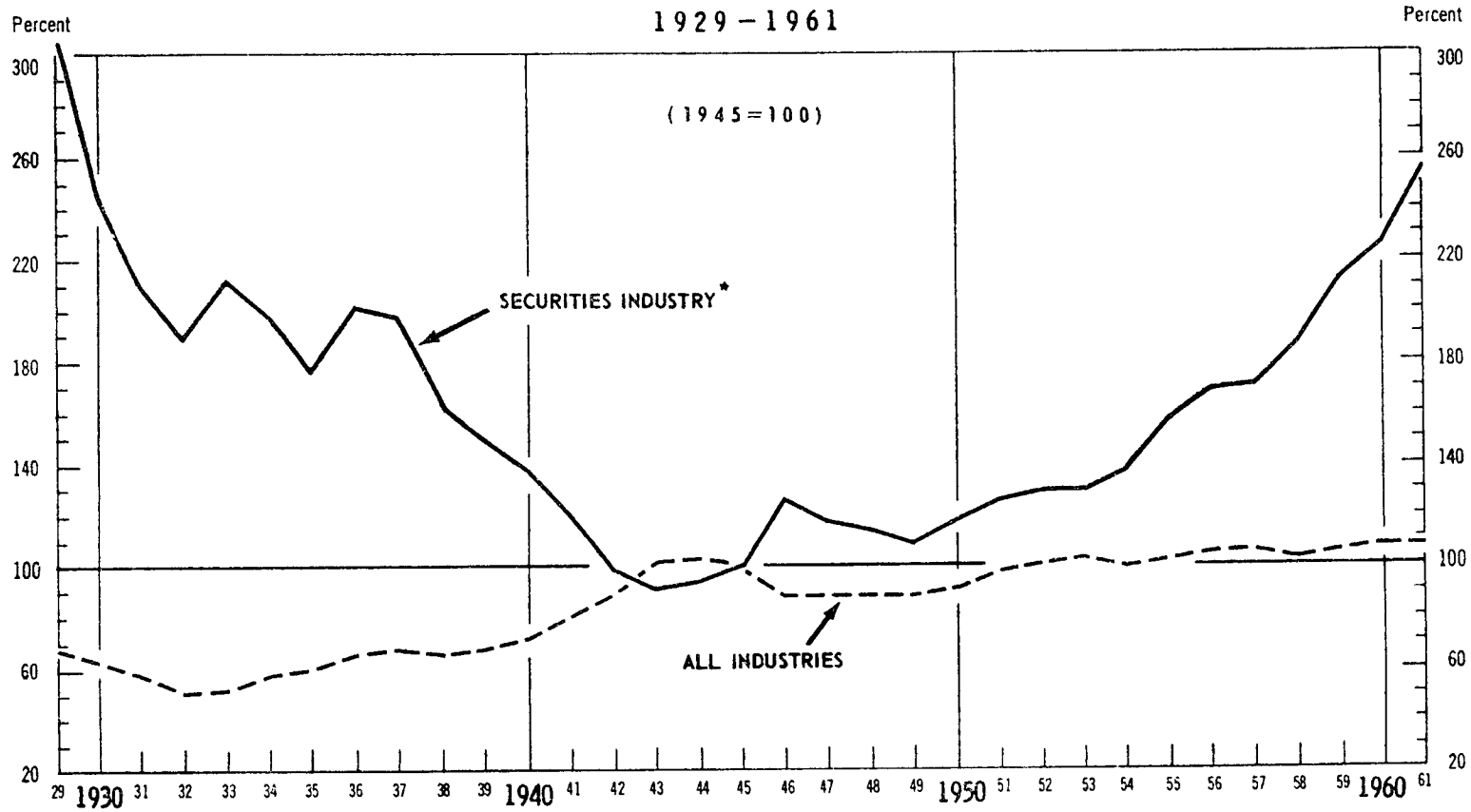
c. The growth of the industry relative to the rest of the economy

As the above discussion suggests, the growth of the securities industry in the period after World War II has been great. In order to place this growth in better perspective, chart I-a compares full-time equivalent employment in the securities industry with that of all industries. For purposes of comparison, the two series are expressed as percentages of their 1945 figures. This is considered a suitable point from which to measure the postwar expansion.

The patterns of the two curves are strikingly different. Employment in the securities industry contracted swiftly from 1929 to 1943, when employment in all industries reached what was virtually a wartime peak. Immediately thereafter, securities employment began to rise while that of other industries was diminishing as industry began to reduce war-inflated staffs. Since 1949, employment in the securities industry has risen at a particularly rapid pace, reflecting to a large extent the considerable augmentation of sales staffs that has been taking place. By 1961, there were about 160 percent more employees in the securities industry than in 1945. Employment in all industries, on the other hand, has shown less than a 10-percent increase in that period.

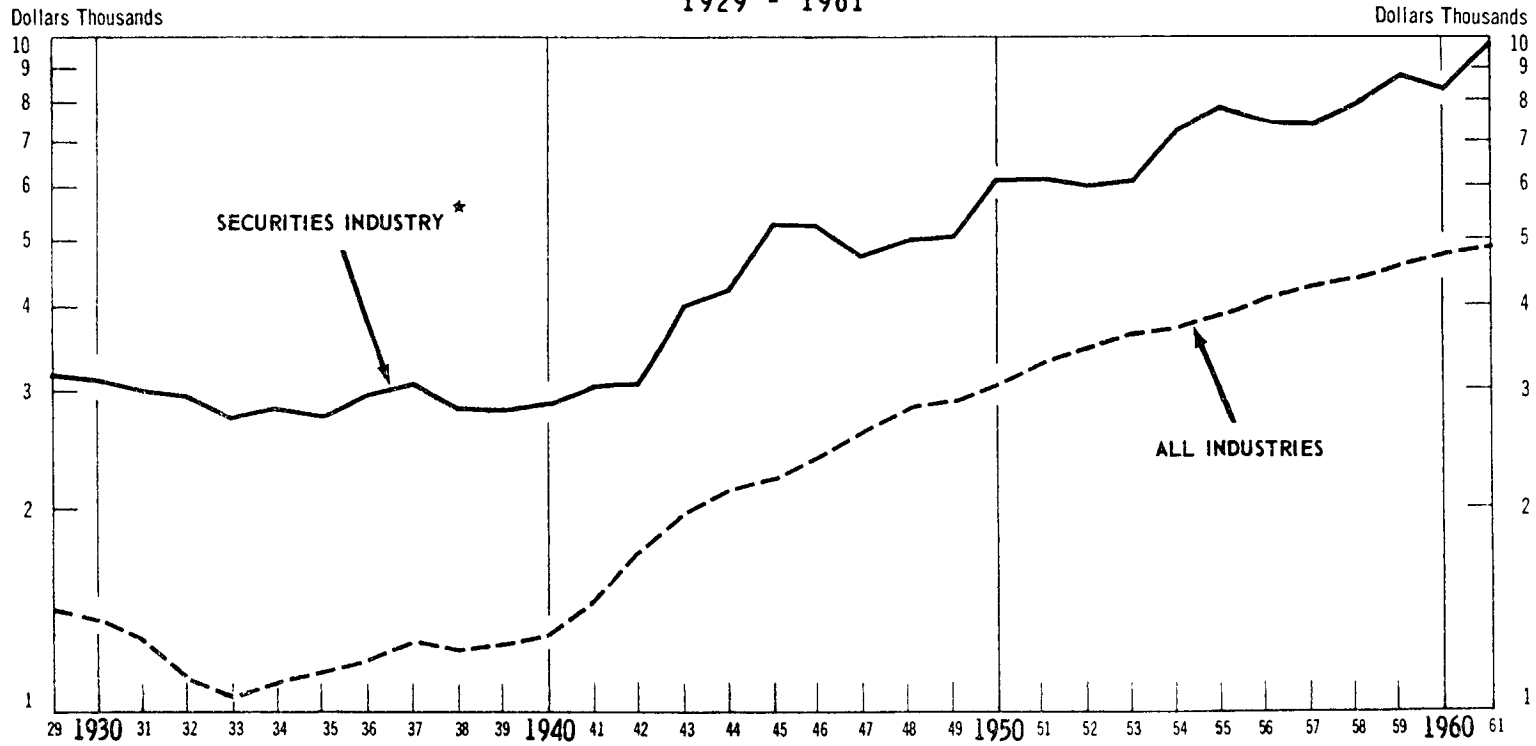
³¹The Investment Company Institute is a voluntary association of management investment companies, their investment advisers and underwriters. The mutual fund members of the institute account for the bulk of the assets of mutual funds. This is true although only 169 of the 342 mutual funds registered with the Commission on Dec. 31, 1962, were members of the institute.

CHART 1-a
 INDEXES OF FULL-TIME EQUIVALENT EMPLOYEES IN SECURITIES INDUSTRY
 AND IN ALL INDUSTRIES
 1929 - 1961



SOURCE: U.S. Dept. of Commerce, Office of Business Economics
 ★ Includes security and commodity brokers, dealers, and exchanges.

CHART 1-b
 AVERAGE ANNUAL EARNINGS PER FULL-TIME EMPLOYEE IN SECURITIES INDUSTRY
 AND IN ALL INDUSTRIES
 1929 - 1961



SOURCE: U.S. Dept. of Commerce, Office of Business Economics
 ★ Includes security and commodity brokers, dealers and exchanges.

Average annual earnings per full-time employee of the securities industry has increased almost steadily since 1942. Chart I-b, which compares these earnings with the counterpart for all industries since 1929, shows that the average earnings in the securities industry have been consistently higher. However, since 1945, the rate of increase in earnings in the securities industry has been somewhat less than the rate of increase in all industries.

7. SUMMARY

Out of this overall picture of the securities industry emerge several preliminary conclusions. On the one hand, the industry contains a small group of large broker-dealer organizations, dominant in their amount of public business, and possessing large numbers of salesmen, supervisors, and branch offices. This group, in turn, consists principally of large firms doing a general business, which are members of the NASD and usually of one or more exchanges, and large mutual fund sales organizations, not members of any exchanges and in some cases not even members of the NASD. On the other hand, there are many small firms, with a much smaller but still significant share of public business, including a large number of mutual fund specialists and also a large group of firms doing a high proportion of their business in over-the-counter securities. Most of the smaller firms are NASD members, and the incidence of exchange membership among them is considerably lower than among the large general firms.

For both groups of firms, many features are the same. But naturally the very differences of size and type of business determine, at least in part, many of the internal and regulatory problems of each group. An examination of the qualifications of those in the industry and the controls for entry, for example, focuses more on the salesmen and supervisors in the case of the larger firms, and more on the firms themselves and their principals in the case of the smaller firms. These are the topics considered in chapter II.

TABLES

TABLE I-1.—Market value of shares available for trading on stock exchange in the United States, selected yearends, 1940-62

| | All exchanges ¹ | New York Stock Exchange | American Stock Exchange | Exclusively on other exchanges |
|--------------------------------------|----------------------------|-------------------------|-------------------------|--------------------------------|
| (a) Amounts (in billions of dollars) | | | | |
| As of Dec. 31— | | | | |
| 1962..... | 374.0 | 345.8 | 24.4 | ² 3.8 |
| 1961..... | 426.0 | 387.8 | 33.0 | 5.2 |
| 1960..... | 335.3 | 307.0 | 24.2 | 4.1 |
| 1959..... | 338.3 | 307.7 | 26.4 | 4.2 |
| 1958..... | 312.7 | 276.7 | 31.7 | 4.3 |
| 1957..... | 224.2 | 195.6 | 25.5 | 3.1 |
| 1956..... | 254.0 | 219.2 | 31.0 | 3.8 |
| 1955..... | 238.8 | 207.7 | 27.1 | 4.0 |
| 1950..... | 111.0 | 93.8 | 13.9 | 3.3 |
| 1945..... | 88.2 | 73.8 | 14.4 | (³) |
| 1940..... | 50.5 | 41.9 | 8.6 | (³) |
| (b) As percent of all exchanges | | | | |
| 1962..... | 100.0 | 92.5 | 6.5 | 1.0 |
| 1961..... | 100.0 | 91.0 | 7.8 | 1.2 |
| 1960..... | 100.0 | 91.6 | 7.2 | 1.2 |
| 1959..... | 100.0 | 90.9 | 7.8 | 1.3 |
| 1958..... | 100.0 | 88.5 | 10.1 | 1.4 |
| 1957..... | 100.0 | 87.2 | 11.4 | 1.4 |
| 1956..... | 100.0 | 86.3 | 12.2 | 1.5 |
| 1955..... | 100.0 | 87.0 | 11.3 | 1.7 |
| 1950..... | 100.0 | 84.5 | 12.5 | 3.0 |
| 1945..... | 100.0 | 83.7 | 16.3 | (³) |
| 1940..... | 100.0 | 83.0 | 17.0 | (³) |

¹ Includes 14 registered exchanges and 4 exempted exchanges.² Estimated.³ Not available.

TABLE I-2.—*Net number of stocks available for trading on stock exchanges in the United States, selected fiscal yearends, 1940-62*

| | All exchanges ¹ | New York Stock Exchange | American Stock Exchange | Exclusively on other exchanges |
|---------------------------------|----------------------------|-------------------------|-------------------------|--------------------------------|
| (a) Number of stocks | | | | |
| As of June 30— | | | | |
| 1962..... | 3,091 | 1,565 | 1,033 | 493 |
| 1961..... | 3,042 | 1,546 | 977 | 519 |
| 1960..... | 3,018 | 1,532 | 931 | 555 |
| 1959..... | 2,961 | 1,514 | 871 | 576 |
| 1958..... | 2,997 | 1,526 | 859 | 612 |
| 1957..... | 3,025 | 1,522 | 867 | 636 |
| 1956..... | 3,038 | 1,518 | 855 | 665 |
| 1955..... | 3,044 | 1,543 | 815 | 686 |
| 1950..... | 3,038 | 1,484 | 779 | 775 |
| 1945..... | 3,139 | 1,293 | 895 | 951 |
| 1940..... | 3,610 | 1,242 | 1,079 | 1,289 |
| (b) As percent of all exchanges | | | | |
| 1962..... | 100.0 | 50.6 | 33.4 | 16.0 |
| 1961..... | 100.0 | 50.8 | 32.1 | 17.1 |
| 1960..... | 100.0 | 50.8 | 30.8 | 18.4 |
| 1959..... | 100.0 | 51.1 | 29.4 | 19.5 |
| 1958..... | 100.0 | 50.9 | 28.7 | 20.4 |
| 1957..... | 100.0 | 50.3 | 28.7 | 21.0 |
| 1956..... | 100.0 | 50.0 | 28.1 | 21.9 |
| 1955..... | 100.0 | 50.7 | 26.8 | 22.5 |
| 1950..... | 100.0 | 48.9 | 25.6 | 25.5 |
| 1945..... | 100.0 | 41.2 | 28.5 | 30.3 |
| 1940..... | 100.0 | 34.4 | 29.9 | 35.7 |

¹ Includes 14 registered exchanges and 4 exempted exchanges.

TABLE I-3.—*Number of members, member firms, allied members, and nonmember correspondents of the New York Stock Exchange, selected yearends, 1940-62*

| | 1962 | 1961 | 1960 | 1959 | 1958 | 1957 | 1956 | 1955 | 1950 | 1945 | 1940 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total number of individual members..... | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,375 | 1,375 | 1,375 |
| Associated with a member firm..... | 1,101 | 1,090 | 1,068 | 1,051 | 1,037 | 1,007 | 1,009 | 1,010 | 957 | 880 | 858 |
| Not associated with a member firm..... | 259 | 265 | 287 | 303 | 315 | 341 | 337 | 346 | 396 | 470 | 485 |
| Held in name of deceased member..... | 6 | 11 | 11 | 12 | 14 | 18 | 20 | 10 | 22 | 25 | 32 |
| Total number of member firms ¹ | 672 | 681 | 667 | 661 | 657 | 655 | 651 | 649 | 620 | 586 | 591 |
| Corporations..... | 99 | 94 | 78 | 66 | 53 | 50 | 42 | 32 | | | |
| Partnerships..... | 573 | 587 | 589 | 595 | 604 | 605 | 609 | 617 | 619 | 585 | 590 |
| Sole proprietorships..... | | | | | | | | | 1 | 1 | 1 |
| Total number of allied members, ² limited/ special partners and holders of nonvoting stock..... | 6,238 | 5,837 | 5,411 | 4,860 | 4,534 | 4,300 | 4,042 | 3,742 | 2,966 | 2,428 | 2,392 |
| Total number of nonmember correspond- ents..... | 3,131 | 2,811 | 2,644 | 2,529 | 2,488 | 2,530 | 2,542 | 2,565 | 2,513 | 2,169 | 3,026 |

¹ A member firm is a broker-dealer firm at least one of whose general partners is a member of the exchange, or if a corporation, at least one of whose directors and voting stockholders is a member of the exchange.

² An allied member is a general partner in a member firm or a holder of voting stock in a member corporation who is not a member of the exchange.

Source: 1955-62, New York Stock Exchange, "Fact Book;" 1940-50, New York Stock Exchange, "Year Book."

TABLE I-4.—Principal activity of New York Stock Exchange members, selected years, 1950-62¹

| Principal activity | 1962 ² | 1961 | 1960 | 1959 | 1958 | 1957 | 1956 | 1955 | 1950 |
|---|-------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Specialist..... | 350 | 351 | 354 | 358 | 353 | 348 | 354 | 348 | 335 |
| Floor broker ³ | 150 | 187 | 168 | 170 | 179 | 177 | 171 | 196 | 210 |
| Floor trader..... | 28 | 30 | 31 | 32 | 28 | 30 | 34 | 22 | 22 |
| Odd-lot broker or dealer..... | 119 | 118 | 114 | 112 | 113 | 111 | 110 | 100 | 103 |
| Member firm partners and stockholders not included elsewhere..... | 666 | 638 | 639 | 638 | 635 | 631 | 638 | 635 | 587 |
| Inactive..... | 53 | 42 | 60 | 56 | 58 | 69 | 59 | 65 | 118 |
| Total..... | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,366 | 1,375 |

¹ As of about May 1 of each year unless otherwise noted.² As of Dec. 31.³ Excludes partners and stockholders of member firms who act as floor brokers for their own firms exclusively.

TABLE I-5.—Distribution of NASD members' offices by geographic area, yearends, 1950 and 1962

| Area | Number of offices | | Percent increase in number since 1950 |
|----------------------------|-------------------|---------------|---------------------------------------|
| | Dec. 31, 1950 | Dec. 31, 1962 | |
| ALL OFFICES | | | |
| United States, total..... | 4,131 | 9,484 | 129.6 |
| Middle Atlantic..... | 1,517 | 3,321 | 118.9 |
| New England..... | 434 | 682 | 57.1 |
| South Atlantic..... | 346 | 1,073 | 210.1 |
| East North Central..... | 640 | 1,165 | 82.0 |
| West North Central..... | 273 | 679 | 148.7 |
| East South Central..... | 122 | 302 | 147.5 |
| West South Central..... | 212 | 578 | 172.6 |
| Mountain..... | 87 | 366 | 320.7 |
| Pacific ¹ | 500 | 1,318 | 163.6 |
| MAIN OFFICES | | | |
| United States, total..... | 2,810 | 4,771 | 69.8 |
| Middle Atlantic..... | 1,173 | 2,282 | 94.5 |
| New England..... | 264 | 284 | 7.6 |
| South Atlantic..... | 203 | 441 | 117.2 |
| East North Central..... | 430 | 452 | 5.1 |
| West North Central..... | 203 | 247 | 21.7 |
| East South Central..... | 76 | 127 | 67.1 |
| West South Central..... | 146 | 277 | 89.7 |
| Mountain..... | 58 | 160 | 175.9 |
| Pacific ¹ | 257 | 501 | 94.9 |
| BRANCH OFFICES | | | |
| United States, total..... | 1,321 | 4,713 | 256.8 |
| Middle Atlantic..... | 344 | 1,039 | 202.0 |
| New England..... | 170 | 398 | 134.1 |
| South Atlantic..... | 143 | 632 | 342.0 |
| East North Central..... | 210 | 713 | 239.5 |
| West North Central..... | 70 | 432 | 517.1 |
| East South Central..... | 46 | 175 | 280.4 |
| West South Central..... | 66 | 301 | 356.1 |
| Mountain..... | 29 | 206 | 610.3 |
| Pacific ¹ | 243 | 817 | 236.2 |

¹ Includes Alaska and Hawaii in 1962.

TABLE I-6.—Distribution of NASD members' offices, by State, as of Dec. 31, 1962

| Rank | State | Total number of offices | Number of main offices | Number of branch offices | Rank of State by population | Median income per family in 1959 ¹ |
|------|------------------------------|-------------------------|------------------------|--------------------------|-----------------------------|---|
| 1 | New York (New York City) | 2,462 (1,824) | 1,863 (1,496) | 599 (328) | 1 | \$6,371 |
| 2 | California | 1,058 | 376 | 682 | 2 | 6,726 |
| 3 | Pennsylvania | 478 | 198 | 280 | 3 | 5,719 |
| 4 | Texas | 394 | 188 | 206 | 6 | 4,884 |
| 5 | Illinois | 390 | 179 | 211 | 4 | 6,566 |
| 6 | New Jersey | 381 | 221 | 160 | 8 | 6,786 |
| 7 | Massachusetts | 353 | 177 | 181 | 9 | 6,272 |
| 8 | Florida | 354 | 117 | 237 | 10 | 4,722 |
| 9 | Ohio | 323 | 124 | 199 | 5 | 6,171 |
| 10 | Missouri | 193 | 81 | 112 | 13 | 2,884 |
| 11 | Minnesota | 192 | 69 | 123 | 18 | 5,573 |
| 12 | Michigan | 189 | 54 | 135 | 7 | 6,256 |
| 13 | Connecticut | 149 | 40 | 109 | 25 | 6,887 |
| 14 | Wisconsin | 143 | 44 | 99 | 15 | 5,926 |
| 15 | Virginia | 138 | 48 | 90 | 14 | 4,964 |
| | 35 other States ² | 2,282 | 992 | 1,290 | | |
| | Total | 9,484 | 4,771 | 4,713 | | 5,660 |

¹ Source: Department of Commerce, Bureau of the Census; 1960 Census of Population; series PC (1).

² Also includes District of Columbia.

TABLE I-7.—All broker-dealers registered with the SEC, classified by exchange membership and NASD status, as of Feb. 28, 1962

[Number of broker-dealers]

| Exchange membership ¹ | Total | NASD members | Non-NASD members |
|---|-------|--------------|------------------|
| All broker-dealers ² | 4,964 | 4,417 | 547 |
| New York Stock Exchange members | 677 | 644 | 33 |
| American Stock Exchange members (not members of NYSE) | 53 | 25 | 28 |
| Regional exchange members (not members of NYSE or AMEX) | 451 | 425 | 26 |
| Nonexchange members, total | 3,783 | 3,323 | 460 |
| Associate members of American Stock Exchange | 20 | 20 | |
| Associate members of regional exchanges ³ | 24 | 24 | |
| No exchange affiliation | 3,739 | 3,279 | 460 |

¹ Refers to regular membership on an exchange unless otherwise noted; primarily includes broker-dealer firms but may include individuals if they are registered separately with the Commission.

² Excludes 821 broker-dealers consisting of 241 new firms which had not yet started business, 400 other inactive firms, and 180 firms which failed to report including 40 foreign firms and 106 firms whose questionnaires were returned by the post office with address unknown.

³ If not already included as "associate members of American Stock Exchange."