highly complex, involving "intricate merchandise" and delicate and changing market mechanisms. Putting aside for the moment questions of motivation and adequate concern for the public interest, persons on the scene and familiar with the intricacies of securities and markets from daily and full-time pursuit of the business can more readily perceive and comprehend some types of problems and more promptly devise solutions than a governmental agency which, however great its collective knowledge and skill, may be able to concern itself only intermittently with specific problems, may become aware of them only after the event, and often must defer decision and action until thorough investigation or study has been completed.

Other benefits of self-regulation especially emphasized in 1938, when the Maloney Act was formulated, transcend mere practicality, expertness and expedition. The ordinary policing effort, whether conducted by a public or private agency, involves the enforcement of established rules of law and thus operates in a somewhat circumscribed and legalistic framework. Self-regulation, however, is thought of as being potentially more positive and constructive. In the words of Mr. Justice Douglas from a speech made in 1938 when he was Chairman of the Commission, it means:

> * * * first, self-discipline in conformity to law—voluntary law obedience so complete that there is nothing left for government representatives to do;—second—* * * obedience to ethical standards beyond those any law can establish.[551]

Both of the aspects mentioned, obviously closely related, warrant brief elaboration.

"Self-discipline" and "voluntary law obedience" can be thought of in terms of the individual or of the industry collectively. In the former sense the terms would mean that all those active in the business would so conduct themselves individually that there would be no occasion to question their activity or to impose sanctions. That kind of voluntary compliance would obviously be Utopian, leaving little for government representatives or anybody else—stock exchange governors or district business conduct committees—to do. Clearly, therefore, Justice Douglas must have used the terms primarily in the second sense of collective industry self-discipline. The latter, nevertheless, tends to foster the former and thus tends to answer the superficially cogent objection that a detailed policing effort too vast to be undertaken by the Government is not made any less vast by being assigned to the stock exchanges and the NASD. To a considerable extent it is, because participation by the regulated in the regulatory process tends not only to make regulation more palatable but also, by making the participants more aware of the goals of regulation and of their own stake in it, to make them individually more likely to discipline themselves and to render "voluntary" obedience.

Justice Douglas' second meaning—"obedience to ethical standards beyond those any law can establish"—is clearly a higher form of self-discipline: In his words—

> [s]elf-regulation of this kind can be pervasive and subtle in its conditioning influence over business practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regula-

[551] Address before the Bond Club of Hartford, Conn., Jan. 7, 1938.

tion but in fact too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas self-government, and self-government alone, can effectively reach.[552]

To the extent that what is still essentially a business of merchandising securities (see ch. III.A) can achieve the high ethical standards found in the best manifestations of the recognized professions, the achievement obviously is devoutly to be wished and represents the highest of all goals of self-regulation. Almost by hypothesis, this goal is beyond the reach of law and regulation in the ordinary sense. Even failing full achievement, effort toward reaching the goal through self-regulation can be counted on to make more manageable the actual regulatory burden: those whose concern about conduct has been directed "beyond the periphery of the law in the realm of ethics and morality" are less likely to give rise to regulatory concern in the narrower sense.

b. Limitations

Self-regulation, nevertheless, is not without its disadvantages and limitations. Initially, in 1934, the "weakness of human nature" was stressed; it was recognized that self-regulators might not always be as diligent as might be desired, might indeed use self-regulation as a device to avoid regulation altogether. The initial concern has, in fact, proved not unwarranted. The history of the NASD's address to the free-riding problem (see ch. IV.B) and the markup policy (see ch. VII.D), for example, is one of response to official prodding; similarly, the adoption by the New York Stock Exchange of floor trading rules in 1945 (see ch. VI.F), the institution of a program of market letter review in 1955 (see ch. III.C), and the Exchange's decision to reimburse customers defrauded by its member firm of Dupont, Homsey & Co., were in large degree attributable to pointed stimuli from the outside.[553]

There have been a good many similar instances since 1934 but the point is broader and deeper than may be suggested by a series of specific examples of this kind. No business is eager for regulation, for self-evident reasons, and it is only natural to expect less zeal for almost any aspect of the job on the part of a self-regulator than may be true of an outsider whose own business is not involved. The former may be complacent about a matter of public concern where the latter is disturbed; may not see any need for an organizational change or a rule change where the latter does; may interpret a rule more narrowly, may be satisfied with a lesser program of surveillance and detection, may be more lenient in imposing sanctions, may have greater concern with avoiding adverse publicity for a specific violation or an industry group, and so on. To the extent that these are matters of degree the self-regulator, absent governmental oversight, is generally and understandably motivated by self-interest to lean toward the lesser degree. Many of the shortcomings of self-regulation documented in prior parts of this chapter and other chapters are undoubtedly explainable in just this way.

It would be an oversimplification, however, to ascribe the shortcomings of self-regulation solely to lack of diligence or motivation; a more adequate view will take cognizance of organizational limits and con-

[552] Ibid.
[553] For a discussion of the total role of the Commission, see sec. 6, below.

flicts that, even granted the best of intentions, can lead to inadequate fulfillment of regulatory needs. A further problem is that of parochialism. Securities regulation entails the adjustment and accommodation of different and sometimes competing aims and policies. The considerations involved frequently transcend the confines of a particular market or market institution, or even of the entire securities business, requiring that more general interest and policies be taken into account. But a group of exchange members or over-the-counter dealers regulating their own market, even assuming the greatest of zeal, may have no awareness of, or may ignore or even flout, these wider concerns of public interest.

Similar considerations apply to the process of strictly intra-agency accommodation. The members of self-regulatory organizations are not homogeneous, and do not constitute a group of identical units whose interests are alike in kind and degree. An exchange, for example, includes floor members who have no direct contact with the investing public and commission brokers who do; and each of these broad categories includes subcategories of members differing in kind and size. Similarly, the membership of the NASD includes underwriters, wholesalers, retailers, and mixed firms; great, national wirehouses, and local individual proprietorships; stock exchange member firms and nonmembers; mutual fund sponsors and mutual fund retailers. Self-regulatory organizations, in short, typically consist of subsidiary groups, quite disparate in interests, needs, size, and strength, so that the performance or lack of performance of an organization in specific areas may ultimately represent the results of the pulling and hauling among the subsidiary groups. For this reason, too, it is essential that regulatory structures and procedures be such that the legitimate rights and interests of no affected group are overridden and that inaction-producing impasses are promptly and appropriately resolved.

Furthermore, self-regulation presents problems of practicality and efficiency similar to those of direct governmental regulation. Even assuming a high degree of achievement of the ideals expressed by Justice Douglas, the tasks of formulating standards, effecting surveillance over a multiplicity of transactions and of firms, and conducting necessary enforcement procedures add up to a gigantic undertaking. The concept of self-regulation ideally envisages that these be performed by members of the regulated business community itself, but the surveys of the principal self-regulatory bodies presented in this chapter make it obvious that, if the ideal is taken literally, it is unworkable in practice. A constantly changing group of part-time volunteers whose self-regulatory activity must be performed at the expense of their business pursuits could not, unaided, hope to supply the unified and continuous organization and the man-hours necessary to accomplish the job. As discussed in prior parts of this chapter, this has inevitably led to compromise with the ideal of self-regulation by industry members—and the special advantages attributed to it—in the direction of increasing reliance on full-time paid staffs. These have been found essential to provide continuity, to help part-time volunteer members to cope with unfamiliar regulatory tasks, and to relieve them of administrative burdens. The need for public, official oversight may be modified, but surely is not lessened, by this intervention of private regulatory staffs made inevitable by inherent practical limitations on the workability of "pure" self-regulation.

Finally, there is a narrower but still important limitation on the capacity of self-regulatory agencies in the enforcement area: their lack of subpena power. While there is a partial equivalent in members' obligation to supply information, there remains a category of situations where essential information from outside may be lacking for want of ability to compel its production. For this and other reasons mentioned, direct enforcement of law, whether expressed in statutes or regulations adopted pursuant to statute, must remain the Commission's own responsibility.

2. THE COMMISSION'S ROLE IN RELATION TO SELF-REGULATION GENERALLY

Justice Stewart's succinct description of self-regulation (p. 693 above) points out that the purpose of the statutory provisions for self-regulation was "to delegate governmental power * * *." It is to this aspect of self-regulation that primary attention must be given in assessing the Commission's role; although self-regulation may sometimes operate at an ethical level beyond the reach of law or ordinary governmental power, it is when a self-regulating agency—a nongovernmental body—is acting as an official arm or delegate of governmental power that the Commission's function of public oversight becomes crucial.

This, in turn, may appropriately be considered in two aspects: an affirmative one of assuring that delegated power is exercised effectively to meet regulatory needs in the public interest, and a more negative one of assuring that delegated power is *not* exercised in a manner inimical to the public interest or unfair to private interests. These two aspects are treated in the two subsections immediately following. A third important aspect of Commission oversight of self-regulatory agencies—where the latter act in a public utility capacity rather than as delegates of regulatory power—is separately considered in subsection c. In each of these aspects of self-regulation there arises the broad and vital question of the proper balance between self-regulatory autonomy on the one hand and the protection of the public interest through regulatory intervention on the other, which is the subject of subsection d.

a. Assuring adequate and effective use of delegated power

A good starting point is the title and preamble to the Exchange Act itself—"An Act *to provide for the regulation* of securities exchanges and over-the-counter markets * * *." The preamble states the necessity of regulation thus:

> * * * transactions in securities as commonly conducted in securities exchanges and over-the-counter markets are affected with a national public interest which *makes it necessary to provide for regulation and control* of such transactions and of practices and matters related thereto, * * * *and to impose requirements necessary to make such regulation and control reasonably complete and effective.* * * * [554] [Emphasis added.]

Self-regulation is resorted to in furtherance, not in derogation, of this basic purpose. The regulatory need is the point of departure, and self-regulation is relied on to fulfill the need to the extent of its ability and willingness to do so. On the other hand, where a recognized need is not fulfilled by self-regulation, whether because of any of the inherent limitations in the scope or effectiveness of self-

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[554] Exchange Act, sec. 2.

regulation or otherwise, the result obviously cannot be to ignore or neglect the regulatory need. Gaps that might otherwise exist must be avoided by governmental intervention, either by bringing about the necessary enlargement of self-regulatory activity or by providing direct regulation.

This principle applies in all areas of regulatory need and at all stages of the regulatory process—rulemaking, surveillance, and enforcement. The governmental power may be delegated to greater or lesser degree, but governmental authority is held in reserve to assure that each regulatory need is met fully and effectively. In the words of Congressman Wolverton at the time of enactment of the Exchange Act, as already quoted in part A of this chapter: "[The] exchanges should be permitted or required to regulate themselves; but there should be a Federal authority holding * * * 'a big stick.'" In his own equally picturesque terms, Justice (then Chairman) Douglas at about the time of enactment of the Maloney amendment in 1938, as quoted in the majority opinion in *Silver*, described the intention of self-regulation as one of "letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." In the more recent words of Justice Stewart, the purpose was to "delegate" governmental power, which necessarily implies full accountability of the delegate to the delegator in the exercise of the delegated authority.

The point is perhaps clearest in those areas where the Commission is expressly given authority and responsibility to provide direct regulation, but where it has deferred to self-regulatory agencies (in this instance, stock exchanges) to act in its stead. Section 11 of the Exchange Act where the Commission was given regulatory powers over the activities of certain types of exchange members is the best example of this. Here, most obviously, it is the Commission's responsibility to see that there is no gap between the regulatory need and the self-regulatory performance. But the same point also applies, even if less obviously, where the Commission is authorized to review and modify self-regulatory rules, as in section 19(b) of the act. At still another level, where a national securities association is required to have rules fulfilling certain regulatory needs, as in section 15A(b)(7) of the act, and the Commission is authorized to suspend or revoke registration of an association for violation of the act (sec. 15A(l)(1)), it would still seem that the same principle applies. In all these situations, whether or not the Commission is also authorized to act directly, there is imposed upon it the responsibility to see that self-regulatory rules are fully responsive to regulatory needs.

Similarly, in the enforcement area, duties are imposed upon exchanges and securities associations to enforce compliance by their members with the law and regulations thereunder, including their own rules,[555] and, expressly in the case of associations, it is within the Commission's authority to suspend or revoke registration for failure to enforce their rules. Even though the sanction may seem too drastic to be useful—the "big stick" provided here may be too big—the principle of ample governmental authority in reserve is again evident.

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[555] *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *Baird* v. *Franklin*, 141 F. 2d 238, 244 (2d Cir. 1944), cert. denied 323 U.S. 337.

b. Guarding against misuse of delegated power

The delegated power of self-regulation, like any other important power, is capable of use for good or ill. In the latter as well as the former case, self-regulation in the securities markets has great potency and scope, vitally affecting the persons and firms directly within its discipline and potentially affecting many others. Supervision by Government is essential to assure that the power of self-regulation is not used to accomplish extraneous or improper purposes and that, within its proper purposes, it is not used unfairly toward those affected. Another way of saying this is that a self-regulator may not exercise great powers affecting matters of vital public and private concern without having its actions subject to appropriate oversight and review.

This aspect of the governmental role was alluded to by Justice (then Chairman) Douglas in his 1938 speech from which quotation has already been made:

> *By self-regulation I do not mean private law making. By self-regulation I do not imply a private club whereby the few can control the many. By self-regulation I do not mean a guild system operating above the law. By self-regulation I do not mean monopoly nor monopolistic franchise.* * * * I mean groups organized under Federal auspices and operated under Federal supervision with ample contractual powers over members to enable them to take a hand in enforcing the law. These groups would be voluntarily organized and have only such powers as the Federal Government deemed it wise to give them. *The Government would retain such power as was necessary or appropriate to make certain that their justification was adequately delimited, their activities properly circumscribed, their powers appropriately curtailed.* [Emphasis added.]

The point here discussed is well illustrated, although not fully encompassed, by the recent case of *Silver* v. *New York Stock Exchange*,[556] already mentioned above. Silver, the principal of two Dallas over-the-counter brokerage firms, but not a member of the New York Stock Exchange, had obtained private wire connections with certain Exchange member firms and ticker service from the Exchange itself. Rules of the Exchange require its approval of such wire connections and provide that member firms must discontinue connections with nonmembers whenever so instructed by the Exchange. The ticker service is provided subject to a similar right in the Exchange to discontinue it at any time. In Silver's case the Exchange's approval had been "temporary," pending completion of its usual investigation of the nonmember applicant's character and business repute. After 7 months, however, the Exchange, without prior notice to Silver and refusing to divulge the reasons for its action,[557] ordered the wire connections severed and discontinued its ticker service. Silver thereupon sued for an injunction and damages under the Sherman Antitrust Act [558] and on other grounds. The Supreme Court decided that the Exchange was liable to Silver under the Sherman Act for causing its members to discontinue their wire connections with him (the only aspect of Silver's charges it had occasion to consider). It based its decision on the unfairness of the procedure the Exchange had fol-

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[556] 373 U.S. 341 (1963).

[557] During the course of the litigation that ensued the Exchange revealed part of what it asserted had been its reasons. See the discussion of these reasons in the opinions of both the district court, 196 F. Supp. 209, 216–217, 225–227 (S.D.N.Y. 1961) and the court of appeals, 302 F. 2d 714, 716 (2d Cir. 1962).

[558] 15 U.S.C. 1, 2. The forms of relief sought are provided under secs. 4 and 16 of the Clayton Act; 15 U.S.C. 15, 26.

lowed, including the absence of notice to Silver, and the refusal to afford him an opportunity to meet the "charges" against him.

In the present context, however, it is the Court's underlying rationale that is most pertinent. The Court squarely held that removal of the wire connections "would, had it occurred in a context free from other Federal regulation, constitute a per se violation of section 1 of the Sherman Act." [559] Hence the Exchange violated that act, "absent any justification derived from the policy of another statute or otherwise," and the Court considered at length whether the justification might be found in the self-regulatory obligation imposed by the Exchange Act. It found the difficult problem of the case to arise—

> from the need to reconcile pursuit of the antitrust aim of eliminating restraints on competition with the effective operation of a public policy contemplating that securities exchanges will engage in self-regulation which may well have anticompetitive effects in general and in specific applications.[560]

It was crucial in the Court's reasoning, in deciding how these two public policies were to be reconciled under the facts of the particular case, that the Exchange Act, although giving the Commission power—

> to request exchanges to make changes in their rules * * * and impliedly, therefore, to disapprove any rules adopted by an exchange, * * * does not give the Commission jurisdiction to review particular instances of enforcement of exchange rules.[561]

The absence of Commission review was crucial because, apart from jurisdictional reasons—

> [t]here is nothing built into the regulatory scheme which performs the antitrust function of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends.[562]

The Court's opinion expressly left open the question of exemption from antitrust laws "[w]ere there Commission jurisdiction and ensuing judicial review for scrutiny of a particular exchange ruling, as there is under the 1938 Maloney Act amendments * * *." [563] In the absence of such regulatory jurisdiction and judicial review, the Court found that the antitrust laws are "peculiarly appropriate as a check upon anticompetitive acts of exchanges which conflict with their duty to keep their operations and those of their members honest and viable." On the other hand, the Court acknowledged that—

> the absence of power in the Commission to review particular exchange exercises of self-regulation does create problems for the Exchange. The entire public policy of self-regulation * * * contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act. Without the oversight of the Commission to elaborate from time to time on the propriety of various acts of self-regulation, the Exchange is left without guidance and without warning as to what regulative action would be viewed as excessive by an antitrust court. * * * [564]

In summary, the Court agreed with Chairman Cary's statement that "some Government oversight is warranted, indeed necessary, to insure

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[559] 337 U.S. at 347. The Court explained:
"The concerted action of the Exchange and its members here was, in simple terms, a group boycott depriving petitioners of a valuable business service which they needed in order to compete effectively as broker-dealers in the over-the-counter securities market." Ibid.

[560] Id. at 349.

[561] Id. at 357.

[562] 373 U.S. at 358.

[563] Id. at 358, note 12.

[564] Id. at 360.

that action in the name of self-regulation is neither discriminatory nor capricious." [565] This being so, and in the absence of provision for Commission oversight of the particular action involved in the case, the Court found that application of the antitrust laws is not incompatible with self-regulation but "peculiarly appropriate."

The Court stayed aloof, of course, from the underlying question of legislative policy: Is it more appropriate for governmental oversight in this area to be vested in the Commission or the antitrust courts? For reasons expressed in section 4.a, below, the Special Study is of the view that primary jurisdiction in this area should reside in the Commission.

c. Regulating public utility aspects of self-regulatory agencies

The stock exchanges and the NASD are "self-regulatory" agencies in the usual sense of the term, in that they are member organizations having authority and responsibility to regulate conduct of their members. Although this chapter is primarily concerned with self-regulation in this sense, it is not to be overlooked that the exchanges and the NASD themselves perform certain functions and operate certain mechanisms vital to the marketplace. The Commission's regulatory role must encompass this aspect of the self-regulatory agencies' business as well, if the public interest is to be publicly represented.

When the NASD operates a quotation system, for example, it is conducting an activity of utmost importance to the operation of a public institution, the over-the-counter markets. Even more clearly perhaps, when a stock exchange actually conducts a public market—when it (i.e., its membership acting through its constitution) adopts a rate schedule applicable to the general public or when it makes a decision about automation of its facilities—it is operating essentially as a public utility.[566] That the NASD or a stock exchange is a private enterprise acting through its membership and its management does not differentiate it from other privately owned public utilities for this purpose, and it would seem that the contents and procedures of regulation should be no less effective than those for other public utilities.

d. "Cooperative regulation"—The need for restraint in exercise of governmental power in reserve

The immediately preceding pages emphasize the need for ample governmental power in reserve to assure that regulatory needs are met adequately and fairly through the self-regulatory agencies. It is equally necessary to emphasize that the workability of self-regulation is dependent on restraint in the Commission's exercise of its reserve power.

In the *Silver* case, Justice Goldberg referred to "the type of *partnership between Government and private enterprise* that marks the design of the Securities Exchange Act of 1934." [Emphasis supplied.] [567] The same concept of partnership has sometimes been expressed in the phrase "cooperative regulation." For example, the Senate Banking

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[565] Id. at 359.

[566] This concept of stock exchanges as public utilities was enunciated in 1934—the NASD was not yet in being—by the House Committee on Interstate and Foreign Commerce: "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." H. Rept. 1383, 73d Cong., 2d sess., p. 15 (1934).

[567] 373 U.S. at 366.

and Currency Committee had the following to say about the bill which became the Maloney Act:

> This program is based upon cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation.[568]

Under either expression the thought seems to be that the roles of the self-regulatory agencies and the Commission are essentially complementary, and it would follow that self-regulatory agencies must enjoy such degree of autonomy as will enable them to act as responsible, dynamic partners in a cooperative enterprise. It would follow even more from Justice Douglas's 1938 expression, immediately before his "shotgun" metaphor, of an ideal going beyond cooperation:

> My philosophy was and is that the national securities exchanges should be so organized as to be able to take on the job of policing their members so that it would be unnecessary for the Government to interfere with that business, and that they should demonstrate by action that they were so organized. Now, that is something more than cooperation. That is letting the exchanges take the leadership with Government playing a residual role.[569]

From the very beginning of the reliance on self-regulation it had been recognized that detailed governmental control of a self-regulatory body would be inadvisable. Thus the Dickinson Committee reported in 1934:

> It is not proposed that the Government so dominate exchanges as to deprive these organizations of initiative and responsibility, but it is proposed to provide authority to move quickly and to point when the necessity arises.[570]

And in the same vein the House Committee stated:

> Although a wide measure of initiative and responsibility is left with the exchanges, reserved control is in the Commission if the exchanges do not meet their responsibility. It is hoped that the effect of the bill will be to give to the well-managed exchanges that power necessary to enable them to effect themselves needed reforms and that the occasion for direct action by the Commission will not arise.[571]

There is no reason for any less emphasis today on the importance of self-regulatory initiative and responsibility. The Government's role calls for vigilant awareness of what is going on in the marketplaces and of developments and trends in the industry; constant liaison with the self-regulatory agencies and cognizance of the policies and methods utilized in the conduct of self-regulation; but a high degree of restraint in exercising the ultimate power to alter or supersede their actions in particular situations. Ample power in reserve—"big stick" or "shotgun"—is the ultimate safeguard, not the medium for domination. Thus the Commission's nonexercise of its direct powers under section 11 and infrequent exercise of its powers under section 19(b) by no means indicate that the powers are unnecessary but do clearly demonstrate that the existence of governmental powers

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[568] S. Rept. 1455, 75th Cong., 3d sess., p. 4 (1938).

[569] Id. at p. 82. At this point of time the program ultimately embodied in the Maloney amendment was under consideration. Self-regulation had been in effect for several years on the exchanges, but there was considerable dissatisfaction with past NYSE administration, leading to the Conway Committee reforms. See pt. B, above.

[570] Report of the Commitee on Stock Exchange Regulation to the Secretary of Commerce, transmitted with letter from the President to the chairman of the Senate Committee on Banking and Currency, Jan. 25, 1934, at p. 6.

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

in reserve need not be an impediment to initiative and responsibility of the self-regulatory bodies—it may indeed be a stimulus to initiative and responsibility.

The relationship between self-regulatory autonomy and governmental power may be expressed in another way: A nongovernmental agency having responsibility to carry out public regulatory objectives cannot be expected to exercise the full measure of responsibility if the Commission is looking over its shoulder and directing or second-guessing each individual action that it takes. Furthermore, the existence of the power of oversight, and the risk that in the exercise of that power its own standing and prestige may be tarnished by having its performance called into question, provides strong compulsion for the assumption and proper discharge of the self-regulatory function. Thus, the very nature of the self-regulatory role points, at the same time, to the need for autonomy and the sufficiency of thorough oversight and broad powers in reserve.

3. THE STATUTORY PATTERNS OF SELF-REGULATION

The statutory provisions establishing the relationships between the Commission and registered exchanges on the one hand, and registered associations (i.e., the NASD) on the other—in other words the respective frameworks within which the Commission exercises its supervision over the two kinds of self-regulatory agencies—exhibit many similarities but also marked differences. The latter are attributable in some measure to differences in the natures and historical backgrounds of the two types of agencies and, in some measure, to the fact that the two sets of provisions were not enacted together but with a few years' interval. It is appropriate, in any event, to reexamine them in the light of experience and subsequent developments, including the critically important *Silver* decision.[572]

a. Exchanges: Sections 6, 11, and 19

Under the Exchange Act all securities exchanges, unless exempted by reason of insignificant size, are required to register with the Commission. In so doing they must (1) file copies of all their rules; (2) satisfy the Commission that their rules "are just and adequate to insure fair dealing and to protect investors" and provide sanctions against conduct inconsistent with just and equitable principles of trade, including violation of the act or rules thereunder; (3) agree to comply with the act and rules thereunder and, within the limits of their ability, to enforce compliance by their members; and (4) agree to furnish to the Commission copies of any rule amendments "forthwith upon their adoption" (sec. 6 (a), (b), and (d)). Once an exchange becomes registered, it can, without Commission approval, adopt any rule not inconsistent with the statute or a Commission rule (sec. 6(c)).

The act also vests in the Commission the direct power to alter or supplement exchange rules, under a defined procedure, "in respect of such matters as" 12 specified areas of exchange operations and "similar

[572] See subsec. 2, above.

matters" (sec. 19(b)).[573] Further, the Commission is empowered to suspend or withdraw the registration of an exchange for violation of the act or rules or for failure to enforce member compliance with respect thereto (but without express reference to enforcing compliance with the exchange's own rules); to suspend or expel members and officers for violations of the act or rules; and to suspend summarily, when in the public interest, trading in any registered security for periods of 10 days and, with the approval of the President, to suspend all trading on an exchange for a period of 90 days (sec. 19(a)).

The statute does not expressly require new exchange rules or amendments to be filed before effectiveness or expressly authorize the Commission to prevent a new rule or amendment from becoming effective.[574] While it can discipline an exchange member for violation of the Federal securities laws, it cannot take action against a member for violation of exchange rules as such.

In contrast to the situation as to the NASD, discussed below, the statute contains no provisions as to an exchange's procedures in disciplinary matters and no provisions for Commission review, on its own motion or on application of an aggrieved person, of an exchange's enforcement actions. As shown above, the arbitrariness of the NYSE's procedure and lack of review were found crucial in the Supreme Court's disposition of the *Silver* matter.

Complementary to the provisions giving the Commission powers with respect to exchanges and their self-regulatory activities are important powers of direct rulemaking. Without employing the channel of self-regulation at all, the Commission may enact rules directly affecting exchange members and mechanisms in the vital areas of floor trading, off-floor trading by members, and operations of specialists and odd-lot dealers (sec. 11 (a) and (b)), and also with respect to short sales, stop-loss orders and manipulative or deceptive devices (sec. 10). In actual practice the Commission has used these powers sparingly; in fact it has never adopted a rule under section 11 but has chosen instead to suggest the adoption of pertinent rules by the exchanges. Moreover, on only one occasion [575] has it formally resorted to its section 19(b) powers over exchanges' rules, discussed above.

b. The NASD: Section 15A

The Maloney amendment of 1938, which first provided for national securities associations as official self-regulatory agencies, was described by then Chairman Douglas as providing for the same general kind

[573] "The Commission is * * * authorized * * * to alter or supplement the rules of * * * [an] exchange * * * in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnership; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy, or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters."

[574] Note, however, the Supreme Court's statement in the *Silver* case, quoted on p. 700 above, to the effect that the statute impliedly gives the Commission power to disapprove exchange rules.

[575] See *In the Matter of the New York Stock Exchange*, 10 S.E.C. 270 (1941).

of organization which the exchanges had evolved "but with 1938 improvements." [576] While the amendment follows the earlier pattern in requiring registration of associations with the Commission and the filing of all rules at the time of registration (sec. 15A(a)), it contains a considerably more detailed specification of criteria as to which the Commission must be satisfied in permitting registration. Among other things, these relate to inclusion and exclusion of members, fair representation of members in an association's functioning, procedures in disciplinary matters, and the association's substantive or regulatory rules (sec. 15A(b)). As to the latter, the Commission must be satisfied that—

> the rules of the association are 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; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges; [577]

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An important departure from the original 1934 pattern, applicable to exchanges, is that associations are required to file subsequent rule changes with the Commission before they can become effective and the Commission can prevent them from taking effect by entering a simple order of disapproval (sec. 15A(j)). The Commission is further authorized to "abrogate" an association's rule if necessary to assure fair dealing, fair representation, or otherwise protect investors or effectuate the purposes of the act (sec. 15A(k)(1)). Again, the Maloney amendment expressly empowers the Commission to suspend or revoke the registration of an association for failure to enforce compliance with its own rules or for engaging in activity "tending to defeat" the statutory provisions (sec. 15A(1)). As in the case of exchanges, the Commission is without express authority to impose sanctions against a registered association short of suspension or withdrawal of the association's registration or to proceed directly against a member for violation of an association rule. However, the Commission may proceed against an officer or director of the association for wilful failure to enforce the association's rules or wilful abuse of authority.

A significant departure from the exchange pattern is the power the Commission is given to review disciplinary actions taken by an association against a member, or in denial of membership, on its own motion or upon application of a person aggrieved. In so doing, the Commission may reduce but not increase a penalty imposed by the association (sec. 15A (g) and (h)).

Despite the broader scope of some of the Commission's powers over registered associations as compared with exchanges, however, there is one important area where its direct statutory powers are more limited. Unlike the Commission's broad power to alter or supplement exchange rules under section 19(b), the Commission's authority to alter or supplement a registered association's rules is restricted

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[576] See note 551, above.
[577] Sec. 15A(b)(7).

to four areas, all of which relate to organizational aspects of the association and do not touch on substantive rules of conduct applicable to members (sec. 15A(k)(2)).[578]

Again, as in the case of exchanges, apart from the Commission's powers of supervision of self-regulation by registered associations, the Commission has important direct rulemaking powers in respect of substantive matters of conduct in the marketplace (sec. 15(c)). These powers may be said to serve roughly the same function as those under sections 10 and 11 in the case of exchange markets but are not necessarily equivalent in breadth of coverage. Whereas section 11, for the important areas covered by it, confers powers to adopt rules deemed "necessary or appropriate in the public interest or for the protection of investors," section 15(c) uses this broad standard only in respect of rules as to financial responsibility of broker-dealers. However, the Commission is given general and broad rulemaking power to outlaw conduct defined by it as fraudulent, deceptive, or manipulative or as involving fictitious quotations, and to "prescribe means reasonably designed to prevent" any of these.

In light of this summation of similarities and differences in statutory patterns, it is appropriate to turn to separate discussions of the Commission's role in relation to the exchanges and the NASD.

4. THE COMMISSION AND THE STOCK EXCHANGES

In considering the Commission's exercise of its powers under sections 6, 10, 11, and 19 the role of the Commission in relation to the stock exchanges generally, it must be borne in mind that there are 14 registered exchanges—not just one, as in the case of registered securities associations and section 15A—and thus it may be said that there are 14 sets of relationships rather than 1. In practical significance, however, it is obvious that those relating to the NYSE are by far the most important, and those relating to the Amex more important than even the largest of the other exchanges. Because of the relative importance, in the case of the major regionals, of multiple as compared with sole trading and multiple as compared with sole memberships, much of the business of these exchanges and their members is conducted within operational and self-regulatory frameworks circumscribed by those of the NYSE and Amex, but the importance of the separate regulatory functioning of the other exchanges still should not be undervalued. The following discussion inevitably concentrates on the NYSE and the Amex, but much of it applies in theory and some of it in practice to the other exchanges.

a. Enforcement and discipline

Although it is the last rather than the first step in the self-regulatory mechanisms of exchanges, of principal importance today is the Com-

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[578] In respect of the latter section as well as certain of the other provisions of sec. 15A summarized above, the Commission's current legislative program embodied in S. 1642 and H.R. 6789 (also numbered 6793) includes a number of proposed amendments, designed primarily to enable an association or the Commission to reach individuals associated with a member firm as distinguished from the member itself, but not otherwise significantly changing the provisions in the respects above summarized. In the course of formulating such legislative program, the Commission took up with industry representatives a possible amendment to sec. 15A(k)(2) that would have added an enumeration of substantive matters with respect to which the Commission would have power to alter or supplement an association's rules. This change was not, however, included in the Commission's program as submitted to Congress.

mission's role—or lack of it—in relation to exchange enforcement and disciplinary matters. As pointed out earlier, while an exchange must have rules for disciplining members for conduct inconsistent with just and equitable principles of trade, there is no statutory provision designed to assure fairness of procedures—fairness to members, applicants for membership, registered representatives, or outsiders who may be affected—and there is no provision for Commission or judicial review. The importance of these omissions, at least in respect of nonmembers but perhaps also in a broader sense, was brought into sharp focus in the *Silver* case.[579] From the point of view of the individual plaintiff, arbitrariness of the NYSE's action and the absence of Commission review were found to be decisive, with the result that the antitrust laws were held applicable to what the Exchange asserted to be a necessary exercise of its self-regulatory responsibilities. From the latter point of view, which must be the prime concern here, a grave threat to the scope and vitality of self-regulation is presented, one that should be promptly corrected.

The process of balancing and accommodating the demands of securities regulation and other demands of public concern is often a delicate and complex one, as the facts of *Silver* concretely demonstrate. On the one hand, if self-regulation is to be viable and vigorous, exchanges ought not to be subject to the inflexible and potentially harsh sanctions of ordinary lawsuits, particularly treble damage suits, in performing what they may in good faith regard as necessary self-regulation. On the other hand, the Supreme Court has emphatically pointed out the need to assure, through outside review, that what is done in the name of self-regulation is genuinely such and is not inimical to other aspects of the public interest. If self-regulation is to function effectively and with due regard for *all* aspects of the public interest, including the interest in vigorous self-regulation, the forum for review of self-regulatory action should be the agency already established as the official, expert guardian of the public interest in the field of securities; i.e., the Commission.[580] With its broad responsibility and concern for the entire area, it is in the best position to comprehend and reconcile—in the first instance and subject to judicial and congressional oversight of its own activities—the diverse factors and considerations that may constitute or bear upon the total public interest in the manifold and complex circumstances where the question may arise. This is true of questions of competition and all other aspects of the public interest, as well as questions of reconcilement of private interests. For an orderly and coherent regulatory scheme, with self-regulation playing its intended role, needed governmental oversight ought to be fragmented as little as possible. This is, indeed, one of the basic roles of a specialized agency created to deal with a particular industry affected with a public interest.

There being no present requirement for Commission review, the exchanges have followed varying practices in reporting their disciplinary actions to the Commission. The practice of the NYSE is discussed in part B.3.c(4) of this chapter. Generally, it calls for informing the Commission staff by letter of formal disciplinary action

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579 See discussion in subsec. 2.b, above.

580 Another aspect of the *Silver* case is considered below in connection with exchanges' rulemaking.

taken against a member, allied member, or member firm shortly after the disposition of the matter, usually with a summary of the facts involved. Cases involving registered representatives are reported monthly, the facts of each case being summarized in a single sentence. In reporting disciplinary cases against members to the Commission, the Amex has adopted the practice of furnishing a copy of the charges and the member's response. The larger regional exchanges generally advise the Commission of disciplinary action against members shortly after the disposition of the case, but the factual statements are usually not as complete as in the reports of the major New York exchanges. Some of the smaller regional exchanges merely report that a particular member has been disciplined for violating a particular section of the exchange's constitution or rules without supplying any of the underlying facts.

Upon receipt of letters from exchanges regarding disciplinary actions, the Commission staff circulates copies among interested staff members. Infrequently, the staff may ask to examine an exchange's file in a specific disciplinary matter. This is usually done to assist in a current or proposed Commission investigation, and only rarely does it relate to the adequacy of the investigation conducted or penalty imposed by the exchange.

There is no regular method of reporting by any of the exchanges to the Commission, or ascertainment by the Commission in any other way, concerning other aspects of self-regulatory enforcement and discipline that would seem as important, for adequate Commission oversight, as reports of formal disciplinary action taken: for example, the disposition of disciplinary matters on an informal basis, at the staff level. Nor, apparently, does the Commission have an effective system of surveillance that would necessarily bring to its attention serious deficiencies in the self-regulatory functioning of an exchange.

In the latter respect, the recent experiences involving the Re and Gilligan, Will firms and others on the Amex, while exemplifying forceful and effective governmental intervention at a point of serious breakdown of the self-regulatory functioning of an important exchange,[581] also exemplify what must be considered ineffective supervision of self-regulation prior to the point of breakdown.[582] If the Amex's self-regulatory functioning had not seriously deteriorated long previously, the virulent abuses disclosed in those cases could never have occurred. On the other hand, if the Commission had had adequate programs of its own for oversight of the Amex's self-regulation, it might have been able to correct the process of deterioration long before the stage of breakdown and, if necessary, would have been in a position to take its own measures against the malefactors.

The history as it actually occurred demonstrates that the Commission's concepts and mechanisms for surveillance and oversight in this area have been essentially of a passive, ad hoc kind, rather than of an active and continuous character. In this general area the Commission has equipped itself, in personnel and procedures, essentially only for

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[581] See pt. C and app. XII–A.

[582] In this and all subsequent comments on the performances of the Commission's role, no criticism of any individual—Commissioner or staff member, present or past—is intended. The problems discussed are institutional ones, reflecting patterns and habits of administration that have developed over many years and are more susceptible of objective reexamination in the course of a special study than in the course of routine administration.

the minimum role of routinely surveying whatever is brought to its attention through the reporting systems established, perhaps years ago, with the various exchanges; it has not equipped itself for what the Amex experience conclusively shows to be its necessary affirmative role. The Amex experience ought never to be repeated on that exchange or elsewhere. But it could happen again—in one place or another, in one form or another, or in greater or lesser degree—if the Commission does not reexamine and strengthen its total concept and program for surveillance and oversight in respect of each individual exchange in proportion to its importance and present self-regulatory status.

It is impossible to define here the specific kinds of measures to be undertaken, but it is possible to say generally that they should encompass programs for more direct and continuous awareness of actual happenings in the marketplace, stronger and more continuous liaison with each exchange as to its self-regulatory problems, policies and methods, and fuller and more systematic accounting by the exchanges as to their self-regulatory progress and results. The Re matter, in particular, illustrates that the division between regulatory and self-regulatory responsibilities must not be permitted to exclude the Commission, and thereby desensitize it, with respect to problems arising in areas generally committed to the responsibility of self-regulatory bodies.

One special aspect of the Re and Gilligan, Will cases, and hence of the Commission's role in relation to self-regulation generally, deserves special mention—the problem of surveillance with a view to the prevention of illegal distributions under the Securities Act of 1933. The problem of enforcement of the Securities Act is, of course, much broader than the marketplace of any particular exchange and typically involves both factual and legal complexities that are difficult to cope with through self-regulatory procedures alone. On the other hand, both of the cases mentioned involved flagrant violations of the Securities Act through use of the very mechanisms of the exchanges. It would seem that either the exchanges must recognize a more positive obligation of detection and enforcement or the Commission must have more positive means of market surveillance in respect of Securities Act violations accomplished through exchange mechanisms.[583] The problem is not capable of simple solution in any case, but it would seem that a joint Commission-industry effort to define responsibilities and methods is called for.

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[583] The Commission in recent years has adopted certain rules under the Securities Act which it is believed have made difficult, if not impossible, some of the massive securities frauds of the type encountered during and following the 1954–55 period. The Commission amended rule 133 under the Securities Act to make clear that stock acquired in a statutory merger is not necessarily so-called "free" stock, and that under certain circumstances, stock acquired in a merger with a view to distribution must be registered under the act prior to the time of such distribution. The Commission also promulgated rule 155, which provides that a public distribution of securities acquired by the conversion of other unregistered securities must be registered, with certain exceptions. See Securities Act release Nos. 4115 (July 16, 1959) and 4450 (Feb. 7, 1962).

Under present rules the Commission receives no formal notification at or prior to the time of admission to listing of additional shares of a class of stock already registered on an exchange. See rule 12d1–1 under the Exchange Act. Prior to a 1954 amendment to this rule, however, the issuer of the additional shares being listed was also required separately to register these shares with the Commission prior to issuance. The Commission may still receive after the fact notice of the issuance of such shares through current reports on form 8–K (to the extent that any 5-percent increase in the shares outstanding is involved). The Commission also receives from the exchanges on an informal basis copies of listing applications. The Commission should review the adequacy of its current procedures for detection of Securities Act violations taking place through the facilities of an exchange mechanism and make such changes as are found appropriate.

Part of the difficulty apparently has been that, to a greater or lesser degree, the various self-regulatory agencies, including the NASD,[584] have tended to disclaim responsibility for Securities Act enforcement. Thus, quite apart from the question of actual use of exchange mechanisms, they may not feel any obligation to advise the Commission of Securities Act violations disclosed or indicated in their examinations of members' books and records.[585] The Exchange Act expressly provides that violations of that act are to be deemed conduct inconsistent with just and equitable principles of trade, and it would seem that the same concept might apply to Securities Act violations even though not expressly so stated. But whether or not a Securities Act violation becomes the basis for self-regulatory discipline, the self-regulatory agency would presumably be under obligation to advise the Commission promptly as to apparent Securities Act violations coming to its attention. To the extent that the Commission relies, and may in the future increasingly rely, on self-regulatory inspections in lieu of its own, the need for cooperative effort regarding Securities Act matters becomes more obvious. In any event the responsibilities should be more clearly defined than they now appear to be, and this again would seem an appropriate subject for early Commission-industry conferring.

There is a final question of considerable importance in relation to enforcement of exchanges' (or other self-regulatory agencies') rules of conduct—whether and in what circumstances the Commission itself should be empowered to enforce self-regulatory rules. As already seen, self-regulatory agencies have the affirmative obligation to enforce their own rules; the Commission may bring disciplinary action against a member of a self-regulatory body for violation of the securities laws or rules thereunder; but there is no express authority for the Commission to bring proceedings of violation of self-regulatory rules.[586] This leaves a significant regulatory gap, the anomaly of which is most apparent in relation to rules adopted by a self-regulatory body in lieu of rules that the Commission might itself have adopted, and rules of an exchange which the Commission could alter or supplement under section 19(b).[587] That the Commission has given maximum scope to self-regulation in the adoption of such rules seemingly should not, in logic, affect the Commission's ability to enforce them, since the exchanges' rules are in lieu of Commission rules.

Nevertheless, the Special Study makes no recommendation for statutory amendment in this direction at this time. While the possible need for such an amendment should not be overlooked, it is apparent that the Commission's past concept and exercise of its role of self-regulatory oversight has by no means exhausted its existing

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[584] See pt. G, above, and sec. 5, below.

[585] In a recent instance, the staff of the NYSE, in the course of investigating conduct of a specialist firm that ultimately led to disciplinary action against the firm, uncovered an apparent violation of the Securities Act by corporate insiders and recommended that the matter be immediately turned over to the Commission. This recommendation was not followed, and it was not until 6 months later, when the disposition of the specialist disciplinary matter was routinely reported to the Commission, that the facts concerning the apparent Securities Act violation were first brought to the Commission's attention.

[586] The Commission's power to suspend or withdraw the registration of a national securities association, and presumably also of an exchange, for failure to enforce its own rules, is far too drastic to be useful except in very extreme circumstances.

[587] For example, the Commission has historically called upon the exchanges themselves to adopt rules concerning specialists and floor trading instead of exercising its own direct authority to regulate these matters. If the Commission had, instead, adopted its own rules, there would be explicit power to enforce them directly.

powers. Thus there is no experienced need of the additional power to enforce self-regulatory rules in order to bring about improvements in self-regulatory performance or in supervision of that performance.

b. Rulemaking

It has been seen above that, whereas the Exchange Act requires national securities associations to file rule changes with the Commission 30 days before effectiveness, during which time the Commission may enter a disapproving order, it requires exchanges to file amendments to their rules only "forthwith upon their adoption" (sec. 6(a)(4)) with no express provision as to disapproval.[588] The different exchanges follow varying practices in regard to informing the Commission of rule changes in advance of actual adoption or formal filing.

The current arrangement between the NYSE and the Commission is that, except in "unusual circumstances," the Exchange undertakes to give the Commission's Division of Trading and Exchanges notice of any "material change in Exchange rules or stated policy at least 2 weeks before such change is publicly announced." This undertaking is contained in a letter dated February 17, 1956, from NYSE President Funston to the Director of the Division, which had the effect of formalizing a practice previously followed by the Exchange "as a courtesy." The letter also confirmed a prior understanding of several years that responsibility for the adoption or modification of Exchange rules rested with the Exchange and that the Commission did not wish to give advance approvals or disapprovals. The Commission staff had expressed the belief in a letter dated February 13, 1956, that misunderstandings could be averted by preliminary review, "perhaps by the making of mutually agreeable changes." The Exchange took the position that suggestions by the Commission or its staff regarding rule or policy changes would be considered by the Exchange, "but the Exchange will feel free to decide whether or not to follow such suggestions." The freedom of the Commission to initiate proceedings to change existing rules under section 19(b) was, of course, reserved.

This agreement was partially modified in March 1959, in respect of rules relating to commission rates, when the NYSE agreed to advise the Commission of any developments looking toward amendment of such rules and of the recommendations of any Exchange committee on this subject at least 30 days before the recommendations were submitted to the board for action. At the request of the Commission staff, an additional 30-day delay will be granted before board action is taken if the proposal is "complex or controversial." This modification was agreed upon after an incident in March 1958 when the Exchange presented proposed changes in the commission rate schedule only 1 week before submission to the board.[589]

Apart from the above agreements, for the past year the Exchange has followed a policy of discussing all rule changes informally with the Commission staff shortly before submission to the board. Be-

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[588] But see the Supreme Court's "impliedly" remark in the *Silver* case, quoted on p. 700 above. It is not clear whether this was intended to apply only in a 19(b) setting or more broadly.

[589] See ch. VI.I.

fore this policy was adopted, the Exchange sometimes consulted with the Commission staff regarding proposed rule changes and supplied copies in advance of their adoption by the board, but frequently the staff learned of a rule change for the first time after adoption and before publication.[590]

The American Stock Exchange has no written agreement with the Commission or its staff regarding proposed rule changes, but since the new administration of the Amex took office in 1962 it has adopted the practice of discussing such matters in advance with the staff. The regional exchanges generally do not discuss rule changes in advance but merely file them pursuant to the statute after adoption.

Rule changes presented informally in advance of adoption and filing are ordinarily taken up with the Director of the Division of Trading and Exchanges. On occasion, if a major policy change, such as a new commission rate schedule, is involved or if a change in Commission rules is required for the exchange to take its proposed action, the matter is discussed with the Commission. Rule changes not presented informally in advance are reviewed in the first instance by the Branch of Exchange Regulation and the Assistant Director in charge of the Branch and, if particular problems are presented, by the Director. All changes in the rules of exchanges are summarized either monthly or bimonthly in memorandums circulated among the Commission staff; these memorandums do not purport to analyze the changes or discuss their impact but merely summarize their provisions.

The Commission has no program for regular or systematic review of existing rules (with the exception of floor trading rules, which have been the subject of recurrent studies) to consider their adequacy in light of possibly changed circumstances or new data or experience since their original filing. In other words, the Commission's role has been essentially the passive one of reviewing newly filed rule changes, to the extent indicated above, and its power to alter or supplement rules under section 19(b) has not generally been thought to require its taking initiative in considering whether subsequent developments or experience might indicate a need for exercise of such power.

For rules of importance to the public interest or for the protection of investors—particularly exchange rules adopted in lieu of Commission rules under sections 10 or 11 or exchange rules within the ambit of section 19(b)—the arrangements and procedures described above hardly seem sufficient to assure needed continuous oversight on the Commission's part. In these areas, even granting the fullest measure of initiative and responsibility to the self-regulatory agencies, the Commission has the ultimate responsibility to guard the public interest and protect investors, and inaction on its part may be equivalent to affirmative approval. Under a system of responsible self-regulation, Commission approval of exchange-sponsored rules would presumably be normal and usual, but it should not come about simply for lack of active and informed scrutiny on the Commission's part.

The doctrine of the *Silver* case also has relevance here. As the Supreme Court pointed out: "The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers

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[590] Since there might be an interval of 2 weeks or more between a rule's adoption by the board and its publication, the agreement for filing 2 weeks before publication does not necessarily afford the staff any greater opportunity for advance study of a change than under the statutory requirement of filing forthwith upon adoption.

to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act." [591] This observation applies to many types of rules as well as actions taken to enforce rules. In light of the rationale of the majority opinion, an exchange and its members may stand in jeopardy if restrictive rules are adopted without the sanction of Commission review, but may be protected by such review. If the Commission's review does provide such protection, this is but an additional reason why it should take the form of active and informed scrutiny and not mere passive acceptance of a filing or passive assumption that a rule once filed remains appropriate.

While these views suggest the need of broad revision of the Commission's procedures and programs in respect of self-regulatory rules, the most obviously needed change is to provide for filing of all proposed rules with an adequate interval before effectiveness, as is now required in the case of NASD rules. It seems anomalous that an exchange, which may not lawfully do business until its rules have undergone official scrutiny in relation to statutory standards, should be free to change those rules at any time thereafter without similar advance scrutiny. But apart from this seeming anomaly, advance filing of rule changes would make for a more orderly and thorough performance of the Commission's responsibility. It would not only serve the obvious purpose of giving more ample time for analysis, but could also be expected to have the important consequence, as experience in connection with NASD rules has demonstrated,[592] that the attention of the Commission and its staff would be effectively focused on each substantive rule change and the responsibility entailed in the Commission's review power.

c. Exchange mechanisms and automation

As shown in various places in the report, the actual mechanisms by which exchange transactions are accomplished and publicly reported are in many respects affected with a public interest. This was, to some extent, recognized in 1934 when, among other subjects as to which the Commission was empowered to amend or supplement exchange rules (sec. 19(b)), there was included "the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange * * *" and "similar matters." The serious matter of lateness of the tape, with its far-reaching consequences for public investors,[593] is merely the most obvious example of the public importance of exchange mechanisms.

The actual and potential inroads of automation greatly widen the area where such mechanisms may be affected with a public interest. The coming years are likely to witness broad new applications of electronics to the securities industry, including the exchanges, that may not merely change the modes of performing present functions but may actually modify some of the functions themselves. Of many possible examples, one is the possibility of automation of the odd-lot function as discussed in chapter VI.E; another is the development of varieties of electronic quotations systems. Still other important possibilities

[591] 373 U.S. at 360.
[592] See sec. 5, below.
[593] See ch. XIII and numerous references in other chapters.

exist in connection with accumulation of market data and self-regulatory procedures.

If the potential of automation is to be used in the public interest and the inevitable adjustments in rules and practices are to be made consistently with the public interest, the Commission as representative of that interest ought to be an informed observer at all stages, rather than learning about changes (or avoidance of change) after the fact. It should be equipped in program and personnel to keep abreast of developments and potential applications of electronics, to engage in industry-governmental cooperative efforts, to represent the public interest in reviewing plans and projects and, where necessary, to prod into action. This does not mean that ultimate engineering, business, or financial decisions on automation should be made or even shared in by the Commission. It does mean that, insofar as the public interest is involved, the Commission should be in a position to voice the public interest and to recognize and report actions or inaction contrary to the public interest.

5. THE COMMISSION AND THE NASD

Some of the observations in the previous section concerning the Commission's role in relation to the exchanges are also generally applicable in respect of the NASD, and will not be repeated here. For example, the discussion of the absence of a residual power in the Commission to enforce self-regulatory rules would seem equally applicable to the NASD, and the discussion of Securities Act enforcement substantially so. Likewise, the discussion of the public interest in mechanisms of exchanges has its counterpart in the NASD's operation of an over-the-counter quotations system or of other industrywide mechanisms or arrangements such as clearing arrangements.

On the other hand, largely because of inherent and historical differences between the two types of organizations that in turn partially account for statutory differences, as summarized in section 3, there are important respects in which the Commission's role and its performance of that role in the case of the NASD differ from what has been described in the previous section. The present section will be confined essentially to these points of difference.

a. Enforcement and disciplinary matters

The Exchange Act requires that in connection with disciplinary actions NASD rules must provide for a fair and orderly procedure, including the obligation to give notice and an opportunity to be heard. The act also provides for Commission review of such actions on its own motion or by petition of an aggrieved person. As noted above, the majority opinion in the *Silver* case referred to the provision for review of NASD disciplinary action as possibly differentiating the latter from the problem presented by the *Silver* case itself.

If a disciplinary action is appealed, the Commission considers the matter, usually after hearing oral argument from the NASD and the respondent, upon the basis of the record before the NASD and "such other evidence as it [the Commission] may deem relevant." [594]

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[594] See Exchange Act, sec. 15A(h)(1). In 1962, 12 appeals from NASD disciplinary actions were docketed with the Commission. Most of these cases involved violations of the markup policy, Regulation T, and the Commission's net capital rule and failure to keep proper books and records.

Through the process of appellate review, the Commission not only determines whether the evidence warrants the NASD finding or the severity of the penalty imposed, but it is also able, within the limits of appealed matters, to observe the disciplinary processes of the NASD—the fairness of the conduct of the hearings, the uniformity of penalties, and the kind of violations pursued and those not pursued.

The Commission also considers so-called "member continuance" proceedings in which the Commission determines whether an NASD member may be continued in membership if he, or any controlling or controlled person, is under any of the specified disabilities in the Exchange Act or the NASD bylaws.[595] A Commission order approving or directing admission to or continuance in NASD membership is generally entered only after the matter has been submitted initially to the NASD by the member or applicant for membership. Where, after consideration, the association is favorably inclined, it ordinarily files an application on behalf of the broker-dealer.[596]

Most NASD disciplinary actions are not reviewed by the Commission, because no appeal is taken. Although the Exchange Act provides for review of disciplinary actions upon motion of the Commission, there has been only one instance in which the Commission has exercised this power.[597]

All final dispositions of NASD disciplinary actions, whether or not reviewed by the Commission in any of the ways mentioned, are routinely reported by filing copies of the final opinions. These are circulated among Commission staff members and are reviewed primarily by enforcement personnel to determine whether further investigatory or enforcement action by the Commission is warranted on the basis of the particular violations revealed in the opinions. There is no program for broadly or systematically surveying and evaluating the total operation of the NASD disciplinary system—as reflected in filed opinions or matters not resulting in such opinions—from the point of view of its total effectiveness or conformity with the statutory objectives.

b. Rulemaking

In respect of the Commission's role in relation to substantive rulemaking by the NASD the situation may be said to be broadly the reverse of that described in the case of exchanges; in that case there were problems of procedure but not of substantive rulemaking authority, whereas here there are no procedural questions but possibly substantive ones. Thus, in the case of the NASD (or any other association), there is a statutory requirement for filing rules and rule

[595] See Exchange Act, sec. 15A(b) and pt. G., above.

[596] In 1962, the Commission received four requests for continuance from NASD members. In two cases reviewed in 1962 the Commission remanded NASD approvals of continuance of firms in membership. See Securities Exchange Act release No. 6798 (May 4, 1962); Securities Exchange Act release No. 6817 (June 8, 1962).

[597] In 1941, the Commission announced that it would call up for review, on its own motion, 6 representative cases of disciplinary actions by the NASD against some 70 members. These actions involved findings by various district business conduct committees and the board of governors that the members had violated high standards of commercial honor and just and equitable principles of trade in transactions in the first mortgage bonds of the Public Service Co. of Indiana during an original distribution of $38 million of such securities in a public offering made Dec. 7, 1939. The decisions rested on a finding that the failure of a member to observe a contract voluntarily entered into for the purpose of maintaining a uniform offering price during the course of a distribution was a violation of sec. 1 of art. III of the Rules of Fair Practice. The Commission held that enforcement of a rule specifically requiring adherence to price maintenance agreements would be contrary to sec. 15A(b)(7), which states, among other things, that NASD rules must be designed to remove impediments to a free and open market and must not be designed to impose any schedule of prices or of commissions, allowances, discounts, or other charges. See *In the Matter of NASD*, 19 S.E.C. 424 (1945).

changes 30 days in advance of effectiveness, and in the interval the Commission is empowered to enter a disapproving order. There is, however, no provision corresponding to section 19(b), expressly authorizing the Commission to amend or supplement substantive rules after effectiveness. In the case of an association (i.e., the NASD), the corresponding provisions extend only to procedural and organizational matters (sec. 15A(k)(2)); with respect to substantive matters the Commission has the more limited authority to "abrogate" (sec. 15A(k)(1)).

The original bill that ultimately became the Maloney Act had specified eight additional subjects, together with "similar matters," as to which the Commission would have authority to amend or supplement an association's rules, and was thus parallel to section 19(b), of the act already applicable to the exchanges. The enumeration of subjects (following those now in sec. 15A(k)(2)) was as follows:

(5) the prevention of fictitious quotations; (6) the prevention of fraudulent or manipulative acts or practices; (7) safeguards against unreasonable profits or unreasonable rates of commissions or other schedule of minimum or maximum prices, discounts, commissions, allowances, or other charges; (8) safeguards against unfair discrimination between customers, or issuers, or brokers or dealers; (9) safeguards with respect to the financial responsibility of members and against the evasion of financial responsibility through the use of corporate forms, special partnerships, or other devices; (10) the manner, method, and place of soliciting business; (11) the time and the method of making settlements, payments, or deliveries; (12) the collection, recording, and dissemination of information relating to the over-the-counter markets; and (13) similar matters.

Industry sponsors of the legislation urged, however, that the existence of the power to change substantive rules of an association, applicable only to its members, would be an obstacle to the membership recruitment effort they anticipated, and that the additional subjects ought to be dealt with by direct rules of the Commission applicable to all broker-dealers rather than only to members. An amended bill was then prepared to confer direct rulemaking power on the Commission regarding the same subjects. At this point, however, the objection was urged, by the same spokesman who had suggested transfer of the enumeration from section 15A(k)(2), that the industry ought to be free to develop its own program without interference from or supervision of the Government.[598] Three of the subject matters previously listed in the bill—the prevention of fictitious quotations, the prevention of fraudulent or manipulative acts or practices, and

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[598] Following are the more relevant portions of the testimony:
"It is a job to form this association * * *.

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"I think that there would be plenty of time to do what is proposed in sec. 2 [conferring broader rulemaking power on the Commission] if sec. 1 [authorizing the creation of self-regulatory associations] does not work. I think that sec. 1 has a better chance of going if sec. 2 is not in * * *.

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"I feel that if you offer to this business what they have wanted, which is the first portion of this bill, the next thing to do is to let them start out and try to perform. It will not be a matter of performing overnight * * *. You have got to get it agreed to. It is a job to do that. While that is going on, I really do not think it would be helpful to say to them: 'if you don't do it, the bogeyman is going to get you.' I think that is the wrong way to set it up.

"I think that if this self-regulation does not move as the Securities and Exchange Commission thinks it ought to during this first period, the Securities and Exchange Commission has full right to approve or reject the rules proposed by every association that applies for membership. During that period, I do not think you need the second section of this bill. Afterward, however, if it does not work, and if Congress is in session, you can ask for whatever you want."

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safeguards with respect to financial responsibility of broker-dealers[599]—were added to section 15(c), so that the Commission now has direct rulemaking power over them. Another safeguard, the one against unreasonable profits or commissions (including prohibition of price or commission schedules),[600] was added to section 15A(b)(7), so that an association is required to have rules to deal with this matter. The others, including "similar matters,"[601] were omitted from the final legislation.

As of today it would appear that the Commission's power over association substantive rules is less complete than in the case of exchanges—either because some subjects originally contemplated in 1938 have been omitted, or because new needs have been disclosed, or because reliance on section 15A(b)(7) might not be practical where reliance on section 15A(k)(2) procedures might be. On the other hand, the Commission's direct rulemaking authority under section 15(c) is quite broad and may be broad enough to encompass all or substantially all regulatory needs—a legal question that the Special Study has not attempted to explore. The principle of adequate power in reserve, discussed above, would seem to apply in any event, and further study is called for to determine whether any, and what kind of, amendment may be needed.[602]

The stronger procedural provisions existing in respect of association rules, as compared with those applicable to exchange rules, has tended to result in a working relationship between the Commission and the NASD quite different from that between the Commission and any of the exchanges in respect of their rules. Proposed changes in rules, including policies and interpretations of general application, are usually discussed by the NASD executive director with the Director of the Division of Trading and Exchanges in advance of filing, which itself must occur prior to effectiveness. If the proposed changes are significant, they are discussed by the staff with the Commission. In the course of informal conferences with the staff, amendments are sometimes suggested by the staff and adopted by the NASD before filing. In other instances NASD proposals or portions of them may be abandoned after such informal discussion. The effect is that the Commission staff and sometimes the Commission itself have the opportunity to consider—and the occasion to analyze—NASD rules and rules changes even before filing, and the NASD has informal indication of at least the staff's attitude on the merits of each change.

On important occasions over the years, but not frequently, initiative for NASD rule changes has come from the Commission side. This may sometimes have taken the form of a direct suggestion of a needed association rule or amendment, but in some of the more conspicuous examples, such as the NASD's markup policy and its "free-riding and withholding" policy, it has taken the form of NASD response to a Commission proposal to adopt its own rule under section 15(c). Thus,

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[599] Clauses (5), (6), and (9) in the earlier draft of sec. 15A(k)(2); see subsec. 3.b, above.

[600] Clause (7).

[601] Clauses (10), (11), (12), and (13).

[602] In this connection, it would seem that a difficulty originally envisaged—a possible impediment to recruitment of members if the Commission's rulemaking authority extended to them but not to nonmembers—has become largely obsolete. In any event, it would become irrelevant if all broker-dealers were required to be members of a self-regulatory association as provided in pending legislative proposals. If any problem remains the conferring of any additional rulemaking authority, if thought to be needed, might take the form of amendment to sec. 15(c) rather than 15A(k)(2).

in both of the instances mentioned, representing two extremely important areas of present NASD activity, the Commission's residual power was availed of, but only as an important stimulus to the NASD's dealing with the same subject matter.

Although the importance of Commission stimulus to self-regulatory action has been often demonstrated, the Commission presently has no program for regular or systematic review of existing NASD rules or policies to consider their adequacy in light of new knowledge or experience or possibly changed circumstances since their filing. Nor does it have a program or procedures for using its own working experience, for example, its review of registration statements or its enforcement activities, as a guide or aid in general oversight of NASD rules and policies. Thus, the problem of excessive underwriters' compensation was not acted upon by the NASD until December 1961, when the new issues boom was waning; although the Commission had seen the problem in numerous registration statements, the action taken by the NASD was in lieu of action that the NYSE had undertaken for its own membership, rather than representing initiative of the NASD or suggestion of the Commission. Another area where NASD action would seem to have been appropriate, and that might have been suggested on the basis of the Commission's enforcement experience in the same period, concerned failures to deliver stock certificates in offerings of new issues.[603] The ideal of cooperative self-regulation—self-regulatory initiative and responsibility with governmental oversight to assure fulfillment of regulatory needs—would again seem to call for a more affirmative and continuous Commission role that would include bringing to the NASD's attention needs observed by the Commission but best dealt with through self-regulatory rules or standards.

c. Other areas

In an important area where the NASD has been engaged in the operation of a mechanism of the securities markets—its retail quotation systems—the Commission has tended to take a passive role. No studies or analyses of retail quotations similar to those made in chapter VII have been made by the Commission in almost two decades.

On the other hand, in the area of enforcement and surveillance there has been a close working relationship with the NASD. As an example, in late 1961 the Commission and the association worked out a cooperative program for maintaining current employment information with respect to the location of salesmen with questionable securities backgrounds. The Commission has also arranged to be informed of pending association complaints with respect to individuals or firms against whom the Commission has initiated proceedings. And, under an arrangement of long standing, the association advises the Commission of all instances where it has reason to believe that a member has misused customers' funds or securities or the financial condition of any member is so impaired that a question of compliance with the Commission's net capital rule is raised. The Commission, in turn, refers some matters to the association where it has evidence of departures from rules or standards of conduct (such as "free-riding") but does not find the institution of broker-dealer proceedings to be appropriate.

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[603] See ch. IV.B.3.b(2)(e).

Although the Commission's program of routine inspection of broker-dealer firms excludes NYSE member firms, it covers all other NASD members. Cooperative arrangements assure that the routine inspections do not take place within 6 months of each other, but there remains a major duplication of effort.[604] It would seem preferable and more in keeping with the ideal of self-regulation for the Commission and the NASD to work together to improve and expand the NASD program to the point where the Commission would have full confidence in its thoroughness, so that the Commission could devote more of its resources to special problems disclosed by NASD inspections and to general oversight of the working of the inspection and other self-regulatory programs.

As a broad generalization, in light of the entire discussion in this section and section 4, it may be said that liaison and working relationships between the Commission and the NASD—the backbone of cooperative self-regulation—seem to be more firmly established than in the case of exchanges generally, including the NYSE. The generally good lines of communication and cooperation should not, however, obscure a significant limitation: The Commission's working relationship with the NASD has tended, with some very important exceptions, to operate within and thus to reflect the NASD's conception of its self-regulatory role as described in part G; to the extent that that conception has been narrower in scope than, for example, the NYSE's conception of its role, the total regulatory result has been affected accordingly. On the other hand, within the limits of self-regulatory concern, in each case, the Commission has taken a more positive role, and greater responsiveness has been apparent, in the case of the NASD than in the case of exchange self-regulation.

6. SELF-REGULATION AND THE COMMMISSION'S TOTAL ROLE

The Commission's functions and responsibilities under the two basic securities laws are broadly of two types: first, to preside over the processes of disclosure, especially by issuers of securities, upon which these laws so basically rely; and second, to regulate substantive conduct in the securities markets, both directly and by supervision of industry self-regulation. Over the years the Commission has administered the disclosure provisions for issuers with marked success, providing ever-increasing protection for investors as the quantity and quality of disclosures have been improved. Except for relatively limited items, there appears to be no reason to recommend changes with respect to this part of the Commission's statutory role.

It is difficult to escape the conclusion that the Commission has been somewhat less successful, on the whole, in the exercise of its powers and responsibilities to regulate conduct in the securities markets, directly or by supervision of self-regulation. In this area some reorientation of emphasis seems to be called for, so that efforts now perhaps excessively concentrated in limited sectors may be applied to others that seem to have had inadequate attention in relation to their importance.

A good deal of the Commission's total attention and energies have very productively been devoted to enforcement of the laws and regula-

[604] See pt. J. 1, below.

tions through administrative, injunctive and criminal proceedings against violators. Many of these enforcement cases undoubtedly must remain the Commission's own responsibility, because subpena and/or injunctive powers must be employed, because criminal prosecution for fraud or manipulation is indicated, because persons outside any self-regulatory jurisdiction are involved, because important new questions are involved, or the like. The Commission must, in the final analysis, be responsible for enforcement of the law, including rules having the force of law. It would seem, however, that some part of what is now a major Commission effort to deal with specific violations might appropriately be taken over by one or another of the self-regulatory agencies, and such a shift of responsibility should be encouraged to the extent possible.[605] In the long run, the raising of standards for entry into the business, as recommended in chapter II, offers the best promise of reducing both the Commission's and the self-regulatory agencies' burden of enforcement.

Another important part of the Commission's energies has been directed to matters—such as inspections—where there is considerable overlapping of effort with self-regulatory agencies or, alternatively, where there is an apparent reluctance to depend on the agencies' programs. It is to be hoped that over a period of time the latter may be strengthened to a point where independent Commission programs would be essentially duplicative and unnecessary. In the general effort to establish a more effective and economical division of labor among all the regulatory agencies (see part J), areas such as these seem very appropriate ones for handling by self-regulatory agencies with minimum direct participation by the Commission.

On the other hand, it appears to the Special Study that an insufficient portion of the attention and energies of the Commission and its staff in the postwar years have been devoted to other responsibilities of fundamental importance, such as continuous examination of changing market circumstances and regulatory needs, appraisal and reappraisal of the adequacy of the existing regulatory measures, and in particular, evaluation and oversight of the operation of the self-regulatory agencies. These responsibilities are at the heart of the Commission's role of protecting public investors and the public interest, and the Commission alone is in a position to discharge them. It is not meant to suggest that the Commission has by any means been unmindful of these responsibilities, but rather that it has not equipped itself in personnel and program to fulfill them in a degree commensurate with their vital importance.

The Commission's Division of Trading and Exchanges is one of the most important of its operating divisions and it has been manned by persons of great competence and dedication. However, it does not appear to be adequately staffed or organized to deal with the areas mentioned. For example, there is a very small Branch of Exchange Regulation to handle both direct regulatory activities and supervision of self-regulatory activities for the entire group of exchange markets.

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[605] See pt. J, below. The Commission's emphasis upon enforcement in recent years was a response to conditions in certain areas of the securities markets which threatened to get out of hand. While this seems to have resulted in some sacrifice of policy aspects of regulation, it must nevertheless be recognized that the enforcement effort was generally successful in averting a possible breakdown of control in certain areas. It was also a practical necessity in light of the reduction of the Commission's staff from 1,149 employees in 1948 to 666, an alltime low, in 1955. The Commission currently has a staff of 1,360 permanent employees.

For the over-the-counter markets there is not even an established branch; direct regulatory activity is handled by the offices of the director and chief counsel, while liaison with and oversight of the NASD are handled by a single individual. The Division's expert economic and statistical personnel have been confined to quite narrow subject matters regarding the trading markets, although devoting considerable attention to general statistical data of broad economic interest.

The foregoing remarks are not intended to be critical of the accomplishments of the Commission and the Trading and Exchanges Division in the areas where their attention has been most heavily concentrated—quite the contrary. Nor is it meant to suggest that a drastic change in the pattern of regulation is called for. What is involved is essentially a question of balance and emphasis: while there may well be room for deemphasis in areas where the self-regulatory bodies can and should play a larger part, such as broker-dealer inspections, there appears to be need for stronger emphasis in areas of ultimate Commission responsibility such as broadly surveying market developments and regulatory needs, expressing standards and interpretations for the guidance of the industry in respect of areas of uncertainty or change, and supervising and evaluating the activities of the self-regulators.

The Commission's relative inattention to these latter areas is mirrored in the contents of its annual reports and other public pronouncements. For example, with respect to matters of continuous and routine administration—registrations, suspensions, delistings, etc.—its annual reports are storehouses of information as to its activities. But with respect to such vital matters as the performance of specialists, the stock exchange commission rate structure, the over-the-counter quotations systems, automation of market or ancillary mechanisms, competitive markets, or the achievements and deficiencies of self-regulation, the reports are virtually silent.

The Exchange Act expresses many of its great goals in very broad language. What is a "fair and orderly" market, or a "free and open" one? What are the standards for measuring "reasonable" rates of commission in exchange transactions or "unreasonable profits" in over-the-counter transactions? What kinds of quotations are "fictitious"? What is "unfair discrimination between customers or issuers"? Many of these words and concepts have been clothed with considerable meaning and substance through a quarter-century of history but they remain largely unreflected in official or public expressions by the Commission.

The lack of public expression in some instances may reflect a lack of involvement by the Commission. In others, there may have been involvement without expression, but that may not be enough. If, for example, the NASD basically changes its retail quotations system after consultation with the Commission, it would seem that the public and the Congress are entitled to know of the Commission's approval and something of its reasons. If the Commission accepts a rate structure as "reasonable" or suggests a modification to make it so, the Congress and the public should know what criteria the Commission has applied. If the Commission changes its procedures regarding applications for unlisted trading privileges or its views or policies on multiple trading and the role of regional exchanges,

a public expression would seem to be in order. Indeed, it would seem that the self-regulatory bodies themselves should have the benefit and protection of official expressions by the Commission.

In some instances, moreover, there may be need for more than public expression of results already reached. Where fundamental issues are involved—where there are likely to be conflicting interests and opposing positions within the financial community itself, where public investors have a direct and important concern with the outcome or where the public interest is otherwise basically affected—it may sometimes be inappropriate to dispose of such issues on an ex parte basis, with only a particular organization's views presented. It would seem that greater use might well be made of public hearings or publicly announced conferences in dealing with some of the problems that arise from time to time in the changing market scene.

It would seem desirable, in short, in the public interest, for the guidance of the industry including the self-regulatory agencies, for the information of Congress, and even for the benefit of the Commissioners, their successors, and present and future staff members, that Commission determinations on matters of large import be publicly reported, and that, for the more far-reaching and controversial of these, greater use be made of open hearing procedures prior to decision.

7. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

Because self-regulation is such an important and integral part of the regulatory pattern for the securities markets, and because the Commission at the same time has powers of direct regulation and responsibilities of oversight over self-regulation, a study of the adequacy of the rules of self-regulatory agencies finally involves an inquiry into the Commission's role in relation to those agencies. An appraisal of that role, in turn, compels analysis of the scope and limits of the self-regulatory concept itself, in theory and in practice.

Self-regulation as a part of the total regulatory pattern of the securities industry involves certain advantages that have been recognized since the concept was first introduced. The expertness and immediacy of self-regulation often provide the most expedient and practical means for regulation. By making those regulated actual participants in the regulatory process they become more aware of the goals of regulation and their own stake in it. In some areas the self-regulatory bodies can promote adherence to ethical standards beyond those which could be established as a matter of law.

On the other hand, self-regulation inherently has certain disadvantages and limitations as compared with governmental regulation, the most obvious of which was early identified as the "weakness of human nature." Thus, self-interest on the part of the regulators may result in complacency concerning matters of public concern, leniency in imposing sanctions, or a desire to avoid adverse publicity for the business being regulated. Furthermore, self-regulation presents its own problems of practicality and efficiency, not unlike those of direct governmental regulation.

Certain fundamental concepts concerning the relationship between the self-regulatory institutions and the Government stem from the

fact that, in important respects, the self-regulatory body is an official arm or delegate of governmental power. The crucial function of public oversight, vested by Congress in the Commission, involves assuring that the delegated powers are exercised effectively and not in a manner inimical to the public interest.

The need for assuring that self-regulation is effective applies in all areas of the regulatory process—rulemaking, surveillance, and enforcement. Governmental authority—from the outset described as "a big stick" or as a "shotgun * * * well-oiled [and] ready for use"—is held in reserve to assure that each regulatory need is met fully and effectively. This applies both in those areas where the Commission is given authority to regulate directly but has deferred to self-regulatory agencies and those where the Commission is authorized to review and modify self-regulatory rules.

The problem of assuring that there is no misuse of the power delegated to the self-regulatory organizations is well illustrated in the recent Supreme Court case of *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). In that case the Court decided that the Exchange was liable to the plaintiff broker-dealer under the Sherman Antitrust Act for causing its members to discontinue their wire connections with him. The Court stated that the difficult problem of the case arose from the need to reconcile the policy of the antitrust laws with the policy of encouraging self-regulation, which could have anticompetitive effects in application. Because of the absence of a review power in the Commission to insure that an exchange's enforcement of its rules is not arbitrary and does not injure competition without "furthering legitimate self-regulative ends" the Court thought it proper for an antitrust court to perform this function. The opinion expressly left open the question of application of the antitrust laws in those areas where the Commission has a review power over self-regulatory actions, as under the Maloney Act in respect of disciplinary proceedings of the NASD.

Another important area of governmental oversight involves those aspects of the self-regulatory organizations' activities which resemble those of public utilities. An exchange's setting of uniform commission rates and the NASD's operation of a retail quotation system are examples of such activities, as are programs for automation of market mechanisms.

Although governmental oversight of self-regulation is essential, the workability of self-regulation depends also on restraint in the Commission's exercise of its reserve power. The relationship between the Commission and the self-regulatory organizations has at times been referred to as a "partnership" or "cooperative regulation." Under either expression the roles of the Commission and the self-regulatory agencies are essentially complementary, and the self-regulatory agencies must enjoy such autonomy as will enable them to act as responsible, dynamic partners in a cooperative enterprise.

The statutory provisions of the Exchange Act establishing the relationships between the Commission and the stock exchanges and between the Commission and the NASD are broadly similar but also exhibit marked differences. The latter are attributable to differences in the natures and historical backgrounds of the two types of organizations and to the fact that the two sets of provisions were not enacted

together but with a few years' interval. Both groups of statutory provisions, sections 6, 11, and 19 for the exchanges, and section 15A for the NASD, require that the self-regulatory organizations register with the Commission and that the Commission not permit their registration unless their rules meet certain requirements. Some of the major differences between the two sets of provisions are that the Commission is expressly given power to amend exchange rules dealing with substantive matters of regulation while in the case of the NASD it is given that power only concerning organizational matters; that exchanges are not required to file rule changes with the Commission before they become effective while the NASD must file in advance; and that the Commission does not have express power to review exchanges' disciplinary proceedings but has that power in the case of the NASD.

The Commission also has certain direct rulemaking powers in regard to practices on the exchanges (secs. 10 and 11) and in the over-the-counter markets (sec. 15). The Commission has never adopted rules under section 11, but has chosen instead to suggest the adoption of pertinent rules by the exchanges themselves.

With reference to the Commission's role of oversight toward the exchanges, the most pressing question today is that arising out of the *Silver* case, in relation to exchange enforcement and disciplinary matters. The *Silver* case pointed out the need to assure, through outside review, that what is done in the name of self-regulation is genuinely such and is not inimical to other aspects of the public interest. In the absence of Commission review, the antitrust court was found to be the appropriate forum. It is the belief of the Special Study that if self-regulation is to function effectively and with due regard for all aspects of the public interest, including the interest in vigorous self-regulation, the forum for review of self-regulatory action should be the agency already established as the official, expert guardian of the public interest in the field of securities; i.e., the Commission.

In the absence of provisions for formal Commission review the exchanges have followed varied practices in reporting their disciplinary actions to the Commission. The Commission has not established an effective system of regular surveillance of the exchanges' enforcement and disciplinary activities. In general, it has equipped itself, in personnel and procedures, only for the more passive role of surveying whatever is brought to its attention through reporting systems established, perhaps years ago, with the various exchanges.

To prevent recurrence of the kind of self-regulatory breakdown that took place on the Amex in recent years, the Commission must reexamine and strengthen its total concept and program for surveillance and oversight of self-regulatory discipline. In general the strengthening of its program should include more direct and continuous awareness of actual happenings in the marketplace, stronger and more continuous liaison with each exchange as to its self-regulatory problems, policies and methods, and fuller and more systematic accounting by the exchanges as to their self-regulatory progress and results. The question of self-regulatory responsibilities and procedures in connection with violations of the Securities Act of 1933 should be the subject of separate attention.

A further important question is whether the Commission itself should be empowered to enforce self-regulatory rules, particularly in

those areas where the Commission has direct authority under the Exchange Act to make and enforce its own rules but instead has allowed the exchanges to adopt rules as part of their self-regulatory activities. While it appears that a regulatory pattern of reliance on self-regulation with effective governmental oversight should logically include such a power, no recommendation to this end is made at this time since it cannot be said that the Commission has found its existing powers insufficient in this respect.

As indicated, the Exchange Act does not require exchanges to file rule changes prior to adoption. The NYSE in 1956 formally agreed to give the Commission notice of material changes at least 2 weeks before public announcement, except in "unusual circumstances." For the past year, moreover, both the NYSE and the Amex have followed the practice of discussing proposed rule changes with the Commission staff prior to submitting them to their respective boards of governors. The regional exchanges generally do not discuss rule changes in advance, but merely file them pursuant to the statute after adoption. For rules of importance to the public interest or for the protection of investors, the Commission's present arrangements and procedures for review do not seem sufficient to assure the needed continuous oversight on the Commission's part. The most obviously needed change is to provide for filing of all proposed rules with an adequate interval before effectiveness, as is now required in the case of NASD rules.

Unlike the situation with respect to exchanges, the Commission has authority to review NASD disciplinary actions. Resembling the situation with the exchanges, however, the Commission has no program for broadly or systematically surveying the operation of the NASD disciplinary system—from the point of view of its total effectiveness or conformity with statutory objectives.

Since NASD rule changes are required to be filed in advance and may be disapproved by the Commission before effectiveness, the Commission's staff, and often the Commission itself, reviews and analyzes them substantively to a greater degree than is necessarily true of exchanges' rule changes. However, the Commission has no program for regular or systematic review of existing NASD rules or policies, nor has it fully made use of its experience gained from its review of registration statements or from its enforcement activities as a guide to oversight of NASD rules and policies.

The Commission's total role under the Securities Act of 1933 and the Securities Exchange Act of 1934 may be broadly divided into two main categories: (1) administering disclosure requirements for issuers, and (2) regulating conduct in the securities markets, directly or by supervision of self-regulation. As a broad generalization it appears that the Commission has been more successful in exercising its powers and responsibilities in the former area than in the latter. While efforts have been very productively devoted to enforcement of the laws and regulations through administrative, injunctive, and criminal proceedings against violators, it appears to the Special Study that an insufficient portion of the attention and energies of the Commission and its staff in the postwar years have been devoted to other important responsibilities such as continuous examination of changing market circumstances and regulatory needs, appraisal and reappraisal of the adequacy of the existing regulatory measures, and evaluation

and oversight of the operation of the self-regulatory organizations. Although the Commission's Division of Trading and Exchanges is one of the most important of its operating divisions and has been manned by persons of great competence and dedication, it does not appear to have been adequately staffed or organized to fulfill its potential and necessary role in respect of the types of responsibilities mentioned.

In addition to placing stronger emphasis on its responsibilities in the area of regulation and supervision of self-regulation, the Commission should, to a greater extent than has been its practice, publicly record the substantive results of its administration of regulatory and supervisory powers. Actions or policy determinations of importance, even though not reflected in formal decisions, should be more regularly recorded for the information of the public and the Congress and for the guidance of the industry, the self-regulatory bodies and future members of the Commission and its staff.

The Special Study concludes and recommends:

1. Regulation in the field of securities should continue to be based on the principle of giving maximum scope to self-regulation, wherever and to the extent that a regulatory need can be satisfactorily met through self-regulation. As a corollary, it is an essential role of Government; i.e., the Commission, to assure that there is no gap between the total regulatory need and the quantity and quality of self-regulation provided by the recognized agencies. However, broad or narrow this gap may be in particular areas or at particular times, governmental power and performance must be sufficient to assure that the self-regulatory agencies are performing in the manner and degree expected of them and that direct regulation is available and effective where a self-regulatory agency is unwilling or unable to fulfill a regulatory need. Governmental participation is necessary also to assure that action taken in the name of self-regulation fairly serves a valid public purpose and is not for a purpose inimical to antitrust or other public policies; and conversely, that bona fide self-regulatory action is not inhibited because of a risk of liability in the absence of Commission review (cf. *Silver* v. *New York Stock Exchange*). While the Commission must have ample powers to accomplish these purposes, as more particularly set forth in the following paragraphs, they should continue to be regarded essentially as residual powers, to be exercised as needed but in such manner as to allow maximum initiative and responsibility to the self-regulators. Regulation in the area of securities should, in short, be a cooperative effort, with the Government fostering maximum self-regulatory responsibility, overseeing its exercise, and standing ready to regulate directly where and as circumstances may require.

2. In the present statutory scheme there are marked differences between the provisions defining the Commission's powers in respect of exchanges (particularly secs. 6, 11, and 19 of the Exchange Act) and those applicable in respect of the NASD and any other "national securities associations" (sec. 15A). These differences may in part reflect differences in the origins and natures of the two types of agencies, and may in part reflect the time interval

of several years in the enactment of the two sets of provisions. In any event reexamination of these differences and of related Commission responsibilities is now warranted in light of subsequent experience and developments, including the *Silver* decision. In this reexamination the principles set forth in paragraph 1, that there should be maximum reliance on self-regulation but with ample governmental powers in reserve, should apply.

3. In respect of rules (in the broadest sense) of the self-regulatory agencies, it is one of the important continuing responsibilities of the Commission to examine them upon initial promulgation and to reexamine them from time to time in light of changing circumstances. To provide reasonable opportunity for examination of exchange rules prior to their initial effectiveness, the pattern now applicable to the NASD, calling for 30-day advance filing and Commission power to disapprove before effectiveness (sec. 15A(j)), should be made generally applicable to rules of exchanges, with appropriate provision for longer or shorter intervals to be established in respect of particular types of rules or in special circumstances. As recommended in paragraph 7, the Commission should be equipped in personnel and program to make adequate preeffective study of new rules and to maintain general oversight over the existing bodies of rules in changing circumstances.

4. The present statutory pattern applicable to exchanges, under which the Commission has comprehensive power to adopt its own rules as to major substantive matters (secs. 10 and 11) and to amend or supplement exchanges' rules as to other matters to assure fair dealing and protection of investors (sec. 19(b)), has no direct counterpart in respect of over-the-counter markets. The Commission does have very considerable substantive rulemaking power under section 15(c), but has no authority to amend or supplement NASD rules on substantive matters. The Special Study has been unable fully to explore the legal question of the potential scope of section 15(c) in relation to the scope of possible regulatory needs and objectives. Further study of this question should be undertaken promptly and, if and to the extent such study indicates that the section 15(c) powers are insufficiently broad in these respects, the regulatory gap should be closed through legislation giving the Commission the necessary direct rulemaking power or, alternatively, the power to amend or supplement an association's rules.

5. In respect of disciplinary proceedings, minimum requirements of "due process" should be applicable to proceedings of exchanges that may result in denial of membership or employment or in imposition of fines, suspensions, or expulsions of members or employees, or that may affect the right of specific nonmembers to do business with members. It may be possible to accomplish this without statutory amendment by voluntary exchange action or by the exercise of the Commission's power under section 19(b) (as suggested by the Supreme Court in *Silver,* footnote 16 to majority opinion) or alternatively under section 23. In the same manner, or by statutory amendment if necessary, another imperative need indicated by the *Silver* decision, but extending beyond

the facts of that case, should be met promptly: to provide for Commission review of at least certain types of exchange disciplinary matters in the manner now applicable to associations (sec. 15A(g)).

6. Consistent with giving maximum scope to self-regulation (par. 1) and avoiding duplication in the total regulatory effort so far as possible (see pt. J), the Commission should seek to reorient its own regulatory effort in respect of trading and markets, as rapidly as circumstances justify, in the direction of reducing its direct participation in areas that are, or can and should become, adequately covered by self-regulation; e.g., periodic examinations of books and records of broker-dealers, and giving greater emphasis to (i) continuous oversight of the self-regulatory performance of exchanges and national securities associations in all areas in which reliance is placed upon them, (ii) regulation of such exchanges and associations in areas where they themselves are operating in a quasi-public-utility capacity; e.g., in their own operation of market mechanisms, (iii) enforcement proceedings in areas that self-regulation cannot or does not effectively reach, including Securities Act cases, cases involving novel and important issues, cases involving persons other than or in addition to members of self-regulatory bodies, cases involving need for subpenas and/or the need for immediate injunctive action, and cases of a serious or flagrant nature involving fraud or manipulation or in which criminal prosecution is indicated, and (iv) enunciation of rules and standards of conduct arising out of its continuing awareness of market developments and its enforcement experience.

7. The Commission's Division of Trading and Exchanges, perhaps renamed "Division of Trading and Markets," should be enlarged and strengthened in keeping with the foregoing. It should be so organized and staffed that it will be in a position to maintain more effective liaison with all of the self-regulatory agencies, examine their rules and rule changes, keep informed as to their enforcement activities, and generally oversee and evaluate their performance on a continuous basis and advise the Commission with respect thereto. Its Branch of Economic Research should be expanded so that considerably greater emphasis can be given to compilation, analysis and, where appropriate, publication of data concerning important aspects and developments of the trading markets.

J. The Total Regulatory Burden—The Need for Increased Coordination—The Role of the States

Previous parts of this chapter have examined the regulatory roles of the major industry self-government groups and the Commission. This part is concerned with present patterns of coordination, or lack of them, and the extent of duplication of effort among the various agencies, both industry and governmental, charged with regulatory responsibilities. It also focuses on the role of the States in the regulatory pattern.

The subject of coordination is of great importance if only because of the substantial number of broker-dealers with memberships in more

than one self-regulatory body. Over 90 percent of all exchange member firms also belong to the NASD. The percentage of NYSE firms is even greater—as of February 28, 1962, 644 of 677 NYSE member firms,[606] or 95 percent of the total, were also members of the NASD. Among the exchanges themselves multiple memberships are common. Over one-third of all regional exchange member firms also belong to one or both of the two major New York exchanges.[607] Moreover, although each self-regulatory body has its own area of special concern, their spheres of regulation are not mutually exclusive. On some matters, such as their member firms' compliance with capital ratio requirements or Regulation T, their interests may largely overlap or coincide, and there is considerable overlapping in other areas where the regulatory concern of a particular agency extends beyond a particular market.[608]

For the firm with multiple memberships, any unnecessary duplication of regulation, or lack of coordination in regulatory efforts, produces added costs and burdens that should be avoided to the extent possible. This is at least equally important for the regulatory agencies—with large tasks and limited budgets, it is obviously desirable to avoid duplication and achieve coordination and division of labor to the maximum extent consistent with the fulfillment of their respective responsibilities. Since there have been significant, if limited, developments toward coordination of efforts within recent months (at least partly in response to expressions of interest in this subject by the Special Study), the situation will first be summarized as it has existed until recently and thereafter the measures undertaken in recent months will be described. The participation of the States in the overall regulatory scheme will then be discussed, with particular emphasis on the degree of coordination between them and the self-regulatory agencies.

1. DUPLICATION AND COORDINATION

The exchanges and the NASD, to the extent permitted by the Exchange Act, have each formulated their own entry standards without regard for the requirements of other regulatory bodies. Until recently, the NASD and NYSE separately administered their respective written examinations for prospective salesmen and the examinations themselves differed. Each self-regulatory body makes its own investigation of applicants and generally does not disclose its findings to any of the others, with the important exception that the Amex and certain of the regional exchanges, under practices of long standing, accept the registration of salesmen who have been registered by the NYSE. The same recognition is not given to salesmen registered by the NASD, and the NASD, for its part, does not recognize compliance with the qualification standards of any exchange as satisfying its own standards.

There is a marked lack of uniformity between the substantive rules of conduct of the exchanges on the one hand and the NASD on the other. While some of the variations result from differences in the markets regulated and others from efforts of certain of the regula-

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[606] See table I-7.
[607] See table VIII-66.
[608] It has already been pointed out in pt. B that the NYSE, for example, considers its responsibilities to extend to all activities of its members.

tory organizations to demand more exacting standards from their members, there are also important differences where it would seem that rules and standards might be coordinated and unified to a greater extent than they have been. For example, the NASD has a rule principally directed at the suitability of recommendations made to customers,[609] whereas the NYSE's "know your customer" rule, while apparently embracing this concept, has had primary emphasis in protecting member firms from irresponsible customers.[610] Another example is in the area of market letters, sales literature, and advertising, where each body has its own requirements and administers them in different ways. There are various other places where rules or standards of conduct of the NASD and the NYSE, although dealing with the same general subject matter, are couched in different language. This is also true as to the rules of the NASD and the other exchanges. In practice, this has meant that members and registered representatives must be familiar with several sets of rules and standards and that the self-regulatory agencies may apply somewhat different standards to judge the same conduct of multiple members or their registered representatives.

The principal surveillance device of the various regulatory bodies is the examination of books and records conducted in members' offices. The NYSE examines its member firms approximately once annually, while the NASD examines its members, including NYSE firms, on a cycle of once every 3 years (or somewhat longer in practice).[611] The larger regional exchanges generally examine their sole members once a year,[612] while the Commission has a 3-year cycle of inspecting all registered broker-dealers, except NYSE members. Some States also conduct examinations of firms located within their borders. All of these bodies may also conduct special examinations of firms if particular problems arise. The potential for duplication with so many interested regulatory groups is obvious.

The extent of coordination of efforts in this area is an informal arrangement entered into by the Commission, NYSE, NASD, Amex, Midwest, Pacific Coast, Boston, Philadelphia-Baltimore-Washington, and Pittsburgh Stock Exchanges,[613] under which it has been agreed that as a general proposition a firm should not be examined by more than one of the agencies during any 6-month period unless special problems exist. No program has been undertaken for the standardization of examination procedures or, until recently, for interchange among agencies of information uncovered in the course of an examination,[614] even where one of them was in effect relying on another's examination. In view of the 3-year examination cycles of the Commission and the NASD, there is the additional possibility, notwithstanding that both cover the same firms, that any particular non-exchange firm may not be examined for a period of as long as 2½

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[609] NASD rules of fair practice, art. III, sec. 2.

[610] NYSE rule 405.

[611] The NASD inspection cycle in its New York district where most NYSE firms have their offices has been significantly longer than 3 years. See pt. G.3.c(3)(a).

[612] The major regional exchanges have all adopted the practice of not examining their members who are also NYSE members.

[613] This program for the "Coordination of Broker-Dealer Inspections" was instituted in 1954.

[614] The NASD has followed the policy over the years of notifying the Commission of situations where it has reason to believe that a member is in violation of the Commission's net capital rule or a member has misappropriated funds or securities. In certain instances, the Commission refers enforcement matters, such as free-riding cases, to the NASD.

years. Until quite recently, moreover, all examination programs were largely concentrated on main offices to the exclusion of branches.

With regard to disciplinary activities, the self-regulatory agencies have pursued largely independent courses from each other and, for the most part, from the Commission and the States. They make their own investigations, bring their own proceedings, and none of the organizations informs other interested agencies as to action which is planned or taken, except if the results of a disciplinary action are otherwise made public. An NASD official testified:

> There is no formal communication, no formal exchange of information between our office and any other agency which might be described as being in the regulatory area.

Nor does it appear that there has been significant informal communication between the agencies in the disciplinary area or any significant measure of cooperation in the conduct of investigations.

As a result of the lack of communication, problems of duplication have faced member firms and the regulatory authorities. Members of the NASD's New York staff cited instances where problems have occurred:

> Q. Have you ever run into a situation where you found you have duplicated what the [NYSE] has done?
>
> A. Yes, we have.
>
> Q. What was that?
>
> A. That was a salesman named * * * who was fired by * * * I believe, on the basis of the customer's complaint, and the account had been churned and we proceeded to take an action, and I believe it was somewhere in the proceedings we discovered that the exchange had already acted and had suspended him for a period of time, which suspension had * * * already run, I believe, prior to the time we began our hearings.
>
> So we found ourselves duplicating the job that had been done by the New York Stock Exchange.
>
> Q. Were there any other instances where this kind of situation has arisen?
>
> A. We had another in connection with investigation of * * *. We penalized them and I think in this case the penalty imposed by the stock exchange had already run, had been completed, and then a new one was instituted so they were again suspended.

There has also tended to be an absence of coordination on disciplinary activity as between exchanges. Part B.3.c(4) points out an instance where the NYSE did not advise another exchange of a disciplinary action taken against a specialist firm on that exchange stemming from the firm's specialist activities.

A question of some perplexity and considerable importance arises in determining which of several agencies, or whether more than one, should undertake to conduct a disciplinary proceeding for conduct in violation of the rules or standards of each of them—for example, if there are indications of selling abuses and lack of supervision in a branch office of a registered broker-dealer which is an NASD member and also a member of the NYSE and other exchanges. In such a case, the facts indicating the need for a proceeding, or at least of further investigation to determine the need for a proceeding, may have come to light as a result of complaints received by the Commission and/or any of the self-regulatory agencies, or perhaps as a result of routine inspections conducted by one of the latter. The securities involved may be listed or unlisted ones or a combination of both. The applicable rules or standards may differ somewhat among the

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different agencies. The self-regulatory agencies are without the power to compel the appearance of persons outside of their regulatory authority, while the Commission has subpena power. Finally, and perhaps most important, the nature and result of the proceedings—the procedures followed and the sanction imposed—may vary considerably, depending upon which agency or agencies actually handles the matter.[615]

It would seem highly desirable, to say the least, that a situation such as that described above (and there are, of course, innumerable variations and combinations of facts) be the subject of a single, sufficient proceeding rather than multiple proceedings, and that if possible it be conducted by an agency having the capacity to deal with the particular kind of case and to impose a fitting penalty. For many reasons it would not be easy to establish hard-and-fast allocations and it is not suggested that this should be undertaken. The very limited efforts toward allocation that have been initiated during recent months, as described below, are of particular importance because they represent an attempt to deal with the problem in an orderly manner. It would seem that the Commission might undertake to bring together the important self-regulatory agencies to consider whether clearer understandings and arrangements could be evolved.[616] At the least, it would seem that such a conference might consider possibilities of creating better lines of communication as to disciplinary matters of common interest that one of the agencies intends to pursue or believes another should pursue and as to steps taken or to be taken in particular matters.

2. RECENT DEVELOPMENTS

Since the commencement of the Special Study progress has been made in coordinating efforts in some of the areas discussed above. The need was recognized by NYSE President Funston at the Special Study's public hearings in May 1962:

> One of the things that I think, or an area that you might well look into and I think we all have a problem, is that there is some way we have to figure out better ways of cooperation between the several disciplinary and regulatory bodies.
>
> In other words, if we are all going to be more active in this regard, the SEC, the NASD, the New York Stock Exchange, the regional stock exchanges and any other regulatory bodies, we all have to figure out some way to work together a

[615] The NASD or the NYSE, for example, may impose a censure or fine or may revoke or suspend membership in their respective organizations, but not directly in each other's. Suspension or revocation of membership on an exchange, if for conduct inconsistent with just and equitable principles of trade but not otherwise, automatically results in equivalent suspension or revocation from the NASD, but the reverse is not true. The Commission may not impose a fine or censure against a member or any other broker-dealer but may revoke (but not suspend) registration as a broker-dealer or may revoke or suspend membership in the NASD or in an exchange. A broker-dealer whose registration is revoked by the Commission is precluded from membership in the NASD but not necessarily in an exchange. In these and perhaps other ways it can be seen that the actual outcome of a case may greatly depend on which agency conducts it. As indicated in the text, other differences may arise from differences in rules or standards applicable to particular sets of facts or in the ability or willingness of particular agencies to pursue necessary lines of investigation.

[616] Liaison between the individual self-regulatory agencies and the Commission has generally not extended to consultation as to the appropriateness of particular disciplinary matters being handled through the Commission or self-regulatory proceedings, although recent efforts have been undertaken in this direction. The NYSE has requested to be advised of matters which the Commission considers appropriate for the Exchange's handling and the Commission has undertaken to do so. Also see note 614, p. 730, above.

little bit better so that we don't duplicate each other's activities on the same offenses. I don't know how that is but I can pledge that we will do our best to work in that area.

NASD officials in private hearings similarly recognized this need:

Q. Do you think it would be helpful to have a greater exchange of information with the stock exchange?
A. Certainly.
Q. Do you know if the members of your committee ever interceded to obtain any information for you [from the NYSE]?
A. No, they haven't interceded to obtain information for me. I feel that they are quite dissatisfied with the lack of liaison and duplication that results.

In recent months, significant steps have been taken. In March 1963 the board of governors of the NYSE approved the following program as a "first step" in effecting better coordination of industry regulatory efforts:

(1) *Customer Complaints*

Such complaints will be referred to the agency having primary responsibility. For example: If the NASD or the [Amex] received a complaint on the handling of an order in an NYSE stock, the complaint would be referred to the NYSE. If the NYSE received a complaint about the execution of an OTC stock or about a recommendation of an OTC stock, it would be referred to the NASD. If the complaint involved the handling of an [Amex] order, it would be referred to [Amex].

(2) *Underwriting Compensation*

The NASD had set up a procedure for reviewing this and it is our understanding that it is working satisfactorily. Accordingly, it is proposed that the NYSE drop its review of compensation to member organizations in low priced speculative issues.

(3) *Financial Control*

NYSE member organizations are exempt from the SEC capital requirements because ours are greater requirements. Therefore, this area is outside NASD jurisdiction. On the other hand, the [Amex] has capital requirements identical to ours, and [Amex] accordingly also has a primary responsibility. Rather than [Amex] obtaining and analyzing financial questionnaire answers from our dual members, it is proposed that NYSE will, each month, supply [Amex] with (1) a list of those firms called upon to furnish financial questionnaire answers as of the month end, and (2) a list of those firms visited by our examiners during the preceding month.

If the [Amex] is interested in the financial condition of a particular firm, [Amex] would communicate with the NYSE and obtain the facts in that case.

However, this would not preclude [Amex] from obtaining directly financial information concerning a specific dual member organization, particularly those firms who are specialists on the [Amex] or carry accounts for or finance [Amex] specialists.

(4) *Regulation T*

At present both NYSE and NASD make examinations to determine whether or not this regulation is being violated by mutual member organizations. It is proposed that the NYSE take primary responsibility in this area.

* * *

The board also approved continuing discussions by the staff with other stock exchanges to bring about similar results and approved continued exploration by the staff of other areas of jurisdiction designed to satisfy the same objectives.

Important changes have also taken place in the area of entry requirements. On July 1, 1963, the NYSE, Amex, and NASD inaugurated a coordinated qualifications examination program under which procedures for examining candidates for registration with the 3 organi-

zations have been combined in the 67 NASD testing centers located throughout the United States. The program required extensive revision of the individual examination systems of the three organizations. Its objective is to provide the three systems with a degree of uniformity, along lines recommended in chapter II of the report, and it should result in greater convenience to candidates as well as economy and efficiency to the agencies.

3. THE ROLE OF THE STATES

There has not been and should not be Federal preemption in the field of securities regulation. State "blue sky" laws antedate Federal regulation, and both the Securities Act and the Exchange Act specifically provide that nothing therein shall affect the jurisdiction of any State regulatory agency.[617] As indicated in other parts of the report, the problems of attempting to regulate locally an industry of such national scope as the securities business have handicapped State efforts, but the regulatory role of the States is nevertheless significant. State regulation not only provides investor protection where the intrastate or other exemptions of the Securities Act preclude Federal regulation, but also provides a second line of protection where Federal law is applicable. Generally speaking State regulation supplements Federal, in that State administrators have considerably more authority to utilize regulatory controls to deal with questionable offerings and questionable broker-dealers. On the other hand, few State securities administrators have the resources to administer disclosure requirements or to engage in enforcement activities such as those of the Commission.

The "blue sky" laws in effect in 49 States [618] show broad variations in scope and effectiveness. Most prescribe qualifications for broker-dealers and salesmen, and some do the same for investment advisers.[619] Many of the qualifications of broker-dealers and salesmen are more restrictive than those contained in the Exchange Act. Most States have imposed capital or bonding requirements on broker-dealers.[620] Almost all the "blue sky" laws contain provisions which prohibit, or permit the State securities administrator to prohibit, certain selling practices.[621] Many administrators, acting under these provisions, have set limits upon the amount of underwriters' compensation,[622] and some have prohibited "front-end load" contractual plans for the purchase of investment company shares.[623] Some "blue sky" laws control offerings of securities by a "regulatory" approach, under which the State securities administrator can prohibit the public sale of securities which do not meet certain statutory standards. New York State has developed separate requirements for intrastate offerings of real estate equity securities.[624]

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[617] Securities Act, sec. 18, and Exchange Act, sec. 28(a).
[618] Since Nevada adopted a "blue sky" law which became effective on July 1, 1963, Delaware is the only State which has no such statute.
[619] See ch. II, pts. B.2.e, C.3.e, and E.3.b.
[620] See ch. II.B.3.a(5).
[621] See ch. III.B.6.b(5).
[622] See ch. IV.B.2.c(2)(3); Loss & Cowett, "Blue Sky Law," p. 77 (1958).
[623] See ch. XI.B.6.d.
[624] See ch. IV.E.2.c.

The activities of the North American Securities Administrators, an association of State securities administrators and securities officials from Canada and Mexico, also deserve mention. This association has formulated policies on the acquisition of warrants and options by underwriters and on reciprocal business practices of investment companies, which many of the administrators have enforced. The association has also supported the recent trend toward uniformity of "blue sky" laws and procedures. The association and the Conference of Commissioners on Uniform State Laws have indicated support for the enactment of the Uniform Securities Act, which has been adopted in whole or modified form in 16 States, and parts of which have been adopted in 10 other States. The association has been the prime mover in the preparation of the uniform application to register securities, for use by States to register interstate offerings of securities which have also been registered with the Commission. Thirty States recently indicated they would accept this application.

The Midwest Securities Commissioners Association is another organization active in this field. As of April 1, 1962, the association had representatives of 17 member States. In April 1960 it adopted a statement of policy regarding options and warrants to underwriters; and in February 1963 it adopted a uniform form of corporate resolution and a uniform consent to service of process to be used in applications for broker-dealer registrations with the various States, and a statement of policy for variable annuity companies and trusts, providing, among other things, that such companies should generally comply with the rules and regulations applicable to investment companies.

This picture of State regulatory activity indicates that the importance of the States in any broad-based program of cooperation among all regulatory bodies. In general they have welcomed efforts in this direction and there are good working relationships among the States themselves, as represented by the North American Securities Administrators, and between the States and the Commission, which frequently refers enforcement matters to the States for action and whose personnel often confer with State officials on specific problems.[625]

There would appear to be possibilities for greater cooperative efforts between the States and the self-regulatory institutions, particularly the NASD. In some areas, both the exchanges and the NASD have materially assisted the States in carrying out their regulatory obligations. For example, the NYSE, Amex, and NASD make their testing programs available to the States and they are attempting to bring the States into their joint examination program.

There is considerably less cooperation, however, in the area of enforcement problems of mutual concern. According to some State officials the NASD will not furnish information concerning disciplinary proceedings it has taken against members. For example, the securities administrator of the State of Washington, at the public hearings conducted by the Special Study in May 1962, noted that the local NASD

[625] The North American Securities Administrators has established a committee for liaison with the Commission.

office refused his request for information concerning an alleged embezzlement by a broker-dealer in his State on the ground that the NASD was a "private association organized in Delaware." The commissioner of the Texas Securities Board, at the same public hearings, described his relationship with the NASD in this way:

> We have received very good cooperation from other States.
> We have received excellent cooperation from the SEC.
> We have received excellent cooperation from the Investment Bankers of America. We received no cooperation from the NASD.

He made reference to the report of a committee to the 1958 Convention of the North American Securities Administrators which stated that the committee was unable to obtain from the NASD information concerning the "names of salesmen of specified members of the National Association of Securities Dealers violating * * * States' Securities Acts by boiler-room activities."

The chairman of the board of the NASD, at the Special Study's public hearings, explained the association's position on furnishing information to State officials. He recognized that, under the NASD's bylaws, the association has responsibilities to (1) encourage and promote among its members observance of Federal and State securities laws and (2) provide a medium through which its membership may confer, consult, and cooperate with governmental and other agencies in the solution of problems affecting investors, and the securities business. He then mentioned that in pursuing these objectives, the association sends its manual to the securities administrators of 45 States and others upon request.[626] He stated that the association will also provide to "anyone interested" a weekly list showing changes in membership, copies of the NASD News and other publications of the association. In general, he observed that the association's district secretaries—

> have over the years maintained excellent informal working relationships with many State administrators. Their discussions of amendments to rules, policies, and various laws have been satisfactory to both parties.

He conceded, however, that the association has a general policy of "refusing to furnish any agency other than the SEC with information concerning examinations, complaints, and decisions." He gave the following reasons for the policy:

> There are, however, certain other factors which may affect our activities in this area. The association is a membership corporation financed by members and registered representatives. There are many complaint actions taken against members and registered representatives during the course of each year. Many result in penalties imposed against the respondents while some are dismissed. Because we believe that disciplinary actions taken by the association are of a confidential nature, unless they result in suspension or expulsion of a member, the board has adopted a general policy of refusing to furnish any agency other than the SEC with information concerning examinations, complaints, and decisions.[627]

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[626] The chairman of the board noted that in addition to a list of all members of the association, the manual also lists members who had been expelled and registered representatives who have been revoked and suspended. He stated: "One need only read the periodical supplements covering these subjects to be up to date on the NASD disciplinary actions of these kinds."

[627] The formal statement of the NASD's policy in this area is set forth in a guide used by district committee members in the performance of their duties:

"The NASD maintains an absolutely independent position in respect to State authorities in securities regulation. No attempt has ever been made to enforce State laws. The board of governors reviewed this position at its January 1959 meeting and expressly forbade the furnishing to State authorities of any information not made public through the press. Members of district committees must, therefore, be on guard against disclosing any information regarding disciplinary proceedings to any State official."

Weighing the respective positions, it would seem that, on balance, where investor interests must be protected, the nondisclosure policy of the NASD should give way to a more flexible one which would at the least permit the district secretaries in their discretion to exchange information with the State securities administrators.

4. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

The burden of securities regulation is borne by the various exchanges, the NASD, the Commission, and the States. Each of the bodies with regulatory duties is concerned with the conduct of those firms and individuals under its authority, and frequently this results in overlapping responsibilities and duplication of effort. Duplication and a lack of coordination of regulatory activity necessarily results in added costs and burdens to those firms with multiple memberships, which represent a substantial percentage of those doing business in the securities industry. From the point of view of the regulatory bodies themselves, overlap and lack of cooperation inevitably means that available personnel and resources are not utilized to achieve maximum performance.

Until recently, each of the self-regulatory agencies administered its entry and qualification requirements with little regard for the standards of the other bodies. In July 1963, three of the major institutions, the NASD, NYSE, and Amex, established a joint testing procedure for registered representatives. No such cooperative program has been undertaken, however, for the purpose of standardizing rules of conduct of various self-regulatory groups.

The examination programs of some of the major regulatory bodies, which are extremely important detection devices, have been the subject of a limited amount of coordination. The NASD, the major exchanges, and the Commission have coordinated their examinations so that no broker-dealer is examined by more than one of them in a 6-month period, unless special problems exist. This program contributes to the elimination of the most obvious form of duplication. However, no efforts to standardize examination procedures or, until recently, to exchange information obtained through examinations have been made. Furthermore, until recently, none of these groups had given any significant amount of attention to branch office inspection.

The various self-regulatory bodies have pursued independent courses in connection with disciplinary matters. There has been little formal or informal communication among the groups as to investigations which are contemplated or in progress. Even the results of disciplinary actions have not been made available to interested agencies.

There is the further and more difficult question of which agency should pursue an investigation and punish the violator if the matter falls within the jurisdiction of more than one regulatory body. In practice, the answer may depend on the manner in which the violation came to light, the kinds of securities involved, the applicable standards of conduct, the investigatory power of the particular agency, its willingness to prosecute the matter, and the sanctions available to the respective agencies. It seems clear that stronger lines of communication between the different bodies would be desirable and that greater effort should be made to clarify responsibilities. Recent moves in this

direction should be encouraged and the Commission should take the initiative in bringing interested agencies together to formulate appropriate guidelines.

There has been a recognition among industry leaders in recent months that a reduction in duplication and an increase in coordination can contribute to more effective regulation. Important cooperative steps have been taken by some of the agencies in respect to customer complaints, underwriters' compensation, financial responsibility, Regulation T enforcement, and qualification examinations for salesmen.

Despite the national character of most of the securities regulation discussed in this report, the States occupy an important position in the overall regulatory scheme. They provide a means of handling certain essentially local problems and they complement Federal regulation in important ways, although there is considerable variation in the scope and effectiveness of the regulatory activities of the various States. The activities of the State administrators, through the North American Securities Administrators and the Midwest Securities Commissioners Association, have been useful in developing higher standards in certain important substantive areas as well as in attempting to achieve uniformity of regulation among the States.

There appear to be successful cooperative programs for the exchange of information among the various States and between the States and the Commission. In some respects the self-regulatory agencies have cooperated with the States, particularly as to examinations for salesmen. However, a special problem appears to exist between the NASD and the States in that the NASD is unwilling to furnish information to State administrators regarding association disciplinary actions. In the interest of strengthening the total regulatory effort it would be desirable to give local NASD officials broader discretion to cooperate and coordinate their disciplinary activities with State officials.

The Special Study concludes and recommends:

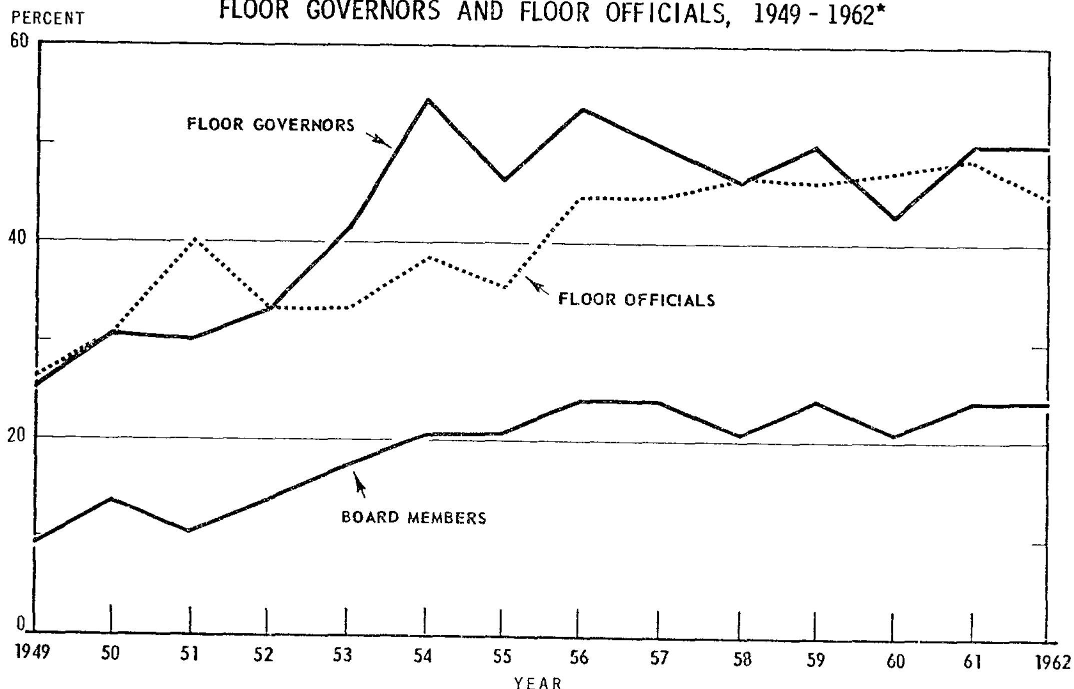
1. This report indicates various ways in which the quantity and quality of self-regulation and/or governmental regulation need strengthening. On the other hand, available mechanisms, budgets, and personnel of some agencies already seem overtaxed, and at the same time there appears to be considerable duplication of effort among the various agencies in certain respects, adding to the burdens on the agencies themselves and on broker-dealers subject to multiple regulation. In the interests of the public, the regulatory agencies and the securities industry, further and continuing attention should be given to possibilities for coordinating efforts and allocating responsibilities in a more efficient and productive pattern, without limitation on any self-regulatory agency's freedom to have special measures or programs for its own membership. Among such possibilities would be further standardization of application and report forms for firms and individuals, to be used by all interested agencies with appropriate supplementation by each to serve its special needs; further development of centralized examining and investigating procedures, again with appropriate supplementation to meet special needs of each agency; coordination of efforts in defining standards of conduct in areas of common concern; clearer recognition of one agency or another as having primary enforcement responsibility

in respect of particular categories of firms or subject matters; and stronger lines of communication among agencies to facilitate channeling of information relevant to the interests of each. In the Federal regulatory scheme, as recommended in paragraph 8 of part I, the Commission's role should involve greater emphasis on oversight of self-regulators and on regulatory matters that self-regulation cannot effectively reach, avoiding, so far as possible, direct duplication of effort with self-regulatory agencies. This will necessarily require the self-regulatory bodies to refer promptly to the Commission those disciplinary matters which they are unable to prosecute effectively.

CHARTS

Chart XII-1

PERCENT OF SPECIALISTS AMONG NYSE BOARD MEMBERS, FLOOR GOVERNORS AND FLOOR OFFICIALS, 1949 - 1962*

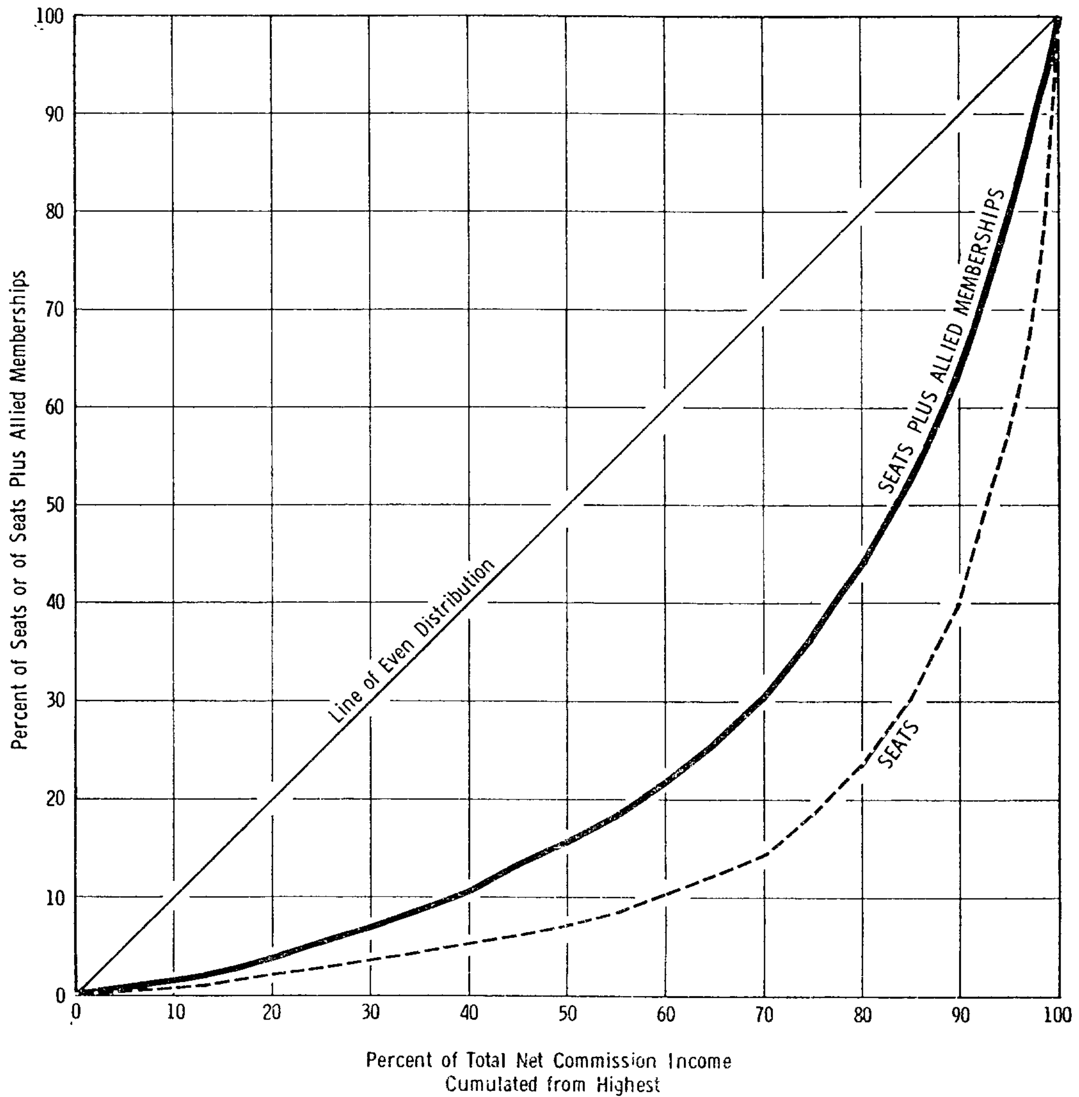


* Based on NYSE annual registration statements filed with the Commission.

Chart XII-2

DISTRIBUTION OF SEATS AND ALLIED MEMBERSHIPS AMONG NYSE MEMBERS RANKED BY NET COMMISSION INCOME

1961



* Based on NYSE records furnished to the Special Study

TABLES

TABLE XII-1.—*Departmental expenses of New York Stock Exchange and subsidiary companies (1957–61)*

Department	1957	1958	1959	1960	1961
Executive	$976,977	$930,864	$1,013,889	$1,960,956	$1,114,711
Operations:					
Floor department:					
Operations	2,514,117	2,807,650	3,119,548	3,208,566	3,639,246
Procedures	230,100	225,076	243,017	252,286	295,103
Member firms—Liaison	471,507	523,634	644,880	753,010	1,053,155
Member firm examiners	311,224	328,887	356,666	400,835	468,257
Secretary's department	242,850	282,141	277,765	280,863	312,900
Stock list	494,255	513,976	545,769	567,276	638,080
Administration and finance:					
Controller's	203,019	234,293	267,907	231,413	259,101
Central records	54,132	52,454	56,745	71,224	82,971
Mailing	89,383	95,109	107,016	112,391	124,223
Purchasing	49,945	54,075	70,638	85,181	101,301
Operational development and planning				36,344	74,641
Personnel	74,394	82,362	104,285	141,791	164,800
Messengers	58,355	63,295	70,947	67,827	72,106
Ticker, quotations, telephone	1,750,854	2,128,058	2,597,634	2,711,202	3,066,295
Treasurer's				41,338	51,176
Public relations and market development:					
Advertising and promotion	1,657,946	1,641,651	1,729,240	1,883,911	1,749.261
Investors' information	285,969	219,817	230,289	292,304	326,329
Public information and press relations	553,577	347,386	397,019	435,558	462,196
Special services		263,576	249,039	239,474	262,614
Gallery	65,541	66,699	72,015	75,875	84,967
Research and statistics	278,422	347,279	451,473	412,333	501,281
General (not allocated to specific departments):					
Depreciation	171,832	235,924	218,482	219,382	221,039
Miscellaneous taxes	104,674	141,784	254,905	189,371	309,763
Rent:					
20 Broad St. premises	88,874	105,522	105,387	105,577	105,585
11 Wall St. and 37 Wall St. premises	1,873,204	1,897,206	2,201,114	2,348,093	2,370,692
Insurance, general office supplies, etc.	77,450	86,013	95,591	89,719	191,939
Employee benefits, not otherwise allocated to specific departments—(separation and military allowances, cafeteria expense, employee recruiting and training, etc.)	77,372	57,837	91,799	103,737	109,086
Total New York Stock Exchange	12,755,973	13,732,568	15,573,059	17,317,837	18,212,818
Subsidiary companies:					
New York Stock Exchange Building Co.	2,487,249	2,509,496	2,718,248	2,813,610	3,018,212
Newex Corp	226,996	193,265	188,227	183,708	178,638
Newin Corp					504
New York Quotation Co.	633,308	11,075	14,580	3,862	3,866
Stock Clearing Corp	1,020,535	1,197,411	1,664,820	1,608,271	2,054,020
Total consolidated	17,124,061	17,643,815	20,158,934	21,927,288	23,468,058
Less: Intercompany charges	2,517,714	2,300,713	2,638,172	2,853,378	2,922,119
Net consolidated	14,606,347	15,343,102	17,520,762	19,073,910	20,545,939

NOTE.—Payroll taxes, insurance and annuity plans and other employee benefits are allocated to New York Stock Exchange departments based on percentages of salary and wage expense.

Source: Based on information supplied by the New York Stock Exchange.

TABLE XII-2.—*Cumulative distribution of registered representatives, branch offices, seats, and allied memberships in each category of NYSE commission income (1961)*

Commission income [1]		Registered representatives [2]		Branch offices		Seats		Seats and allied memberships	
Dollars	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
92,444,300	13.16	2,217	8.16	145	5.97	11	.81	117	2.10
116,657,300	16.60	3,900	14.35	237	9.77	20	1.46	164	2.94
147,946,800	21.06	4,905	18.05	323	13.31	30	2.20	226	4.05
176,240,000	25.08	6,162	22.67	454	18.71	37	2.71	310	5.56
216,843,000	30.86	7,569	27.85	554	22.83	50	3.66	400	7.17
252,317,600	35.91	9,163	33.71	694	28.59	61	4.47	499	8.95
284,421,600	40.48	10,569	38.88	817	33.66	74	5.42	606	10.87
316,428,100	45.04	11,607	42.70	897	36.96	82	6.00	746	13.38
351,501,800	50.03	13,085	48.14	1,024	42.19	97	7.10	871	15.62
387,268,900	55.11	14,005	51.52	1,103	45.45	119	8.71	1,026	18.40
424,219,900	60.37	15,003	55.19	1,182	48.70	144	10.54	1,229	22.04
456,978,100	65.03	16,323	60.05	1,312	54.06	167	12.23	1,441	25.84
492,429,600	70.08	17,904	65.87	1,467	60.44	198	14.50	1,702	30.52
527,936,600	75.13	19,855	73.04	1,657	68.27	254	18.59	2,039	36.56
562,435,500	80.04	21,307	78.39	1,806	74.41	321	23.50	2,438	43.71
597,387,600	85.03	22,900	84.25	1,983	81.71	413	30.23	2,923	52.41
632,573,600	90.03	24,344	89.56	2,123	87.47	551	40.34	3,529	63.27
667,560,200	95.01	26,019	95.72	2,310	95.18	782	57.25	4,417	79.20
674,598,700	96.01	26,423	97.21	2,366	97.49	839	61.42	4,643	83.25
681,523,300	97.00	26,762	98.45	2,394	98.64	909	66.54	4,862	87.18
688,591,100	98.01	27,002	99.34	2,420	99.71	1,003	73.43	5,096	91.37
695,573,400	99.00	27,075	99.61	2,421	99.75	1,129	82.65	5,283	94.72
702,601,300	100.00	27,182	100.00	2,427	100.00	1,366	100.00	5,575	100.00

[1] Members and member firms have been cumulated according to their commission income from the largest to the smallest. Each line accounts for approximately an additional 5 percent of commission income except the first 4 lines, which include the largest commission firms; and the last 5 lines, each of which represents an additional 1 percent of commission income.
[2] Excluding regular and allied members.

Source: Based on NYSE and NASD records.

TABLE XII-3.—*Types of disciplinary actions involving NYSE registered representatives (Jan. 1, 1957 to Sept. 30, 1962)*

[Number of violations]

Violations	1957	1958	1959	1960	1961	1962 [1]	Total
Misstatements or omissions on applications	13	5	7	8	20	3	56
Unauthorized compensation	7	2	2	1	3	2	17
Improper handling of accounts	--------	--------	--------	7	--------	2	9
Regulation T and margin violations	9	--------	7	4	32	26	78
"Poor judgment"	--------	--------	4	3	3	--------	10
Actions contrary to employer's interest	5	9	21	6	19	8	68
Guarantee of loss or profit	1	--------	3	6	7	--------	17
"Know your customer"	--------	--------	--------	4	27	7	38
Character and background	9	13	4	8	8	4	46
Misappropriation of funds	1	2	1	1	3	--------	8
Unauthorized transactions	3	5	9	11	7	4	39
Outside connection not approved	--------	1	3	2	1	--------	7
Violation of NYSE proxy rule	--------	3	--------	--------	--------	--------	3
Miscellaneous (including violations of various NYSE and SEC regulations)	13	5	6	11	10	11	56
Total number of violations	61	45	67	72	140	67	452
Total number of actions	51	41	[2] 66	[3] 60	120	58	396

[1] Through Sept. 30.
[2] Not including 4 reconsiderations.
[3] Not including 3 reconsiderations.

TABLE XII-4.—*Disposition of disciplinary actions involving NYSE registered representatives (Jan. 1, 1957 to Sept. 30, 1962)*

[Number of actions]

Disposition	1957	1958	1959	1960	1961	1962 [1]	Total
Application disapproved	15	12	15	7	7	2	58
Approval withheld	1	4	4	6	13	7	35
Approval withdrawn	13	7	8	3	8	3	42
Suspended	19	8	9	18	25	31	110
Censured	1	14	31	39	73	18	176
Application withdrawn	1	1			1		3
Admonished			1		5		6
Warned			1	2	2		5
No action	1		2				3
Total number of disciplinary actions [2]	51	46	71	75	134	61	438

[1] Through Sept. 30.

[2] Totals do not match those in table XII-3 due to 42 cases with dual penalties:

Suspension and censure	29
Approval withheld and censure	11
Censure and warning	2
Total	42

TABLE XII-5.—*Types of violations in disciplinary actions taken by 8 registered exchanges (1953–62)*

[Number of actions]

Type of violation	Boston	Cincinnati	Detroit	Philadelphia-Baltimore-Washington	Pittsburgh	Salt Lake	San Francisco Mining	Spokane
Actions of other regulatory bodies	2			6	1		1	
Books and records improperly maintained				1				
Careless execution of order	1							
Credit violations		1		14	1			
Effected off-floor transaction in listed stock			4	5		3		
Inaccurate or late financial reports		1		1		1		
Failure to supervise office			1					
Fraud	1							
Minimum commission schedule violations				3			1	
Net capital violations	2			2		8		
Miscellaneous				1	1			
Total	6	2	5	33	3	12	2	0

Source: Reports by these exchanges to the Commission.