August 28, 1962

TO: Milton H. Cohen, Director
Ralph S. Saul, Associate Director
Richard M. Paul, Chief Counsel
Herbert G. Schick, Assistant Director

FROM: Eugene H. Rotberg
RE: Over-the-counter Interviews

The attached memorandum is a summary of interviews held in Chicago, Milwaukee, Denver, Los Angeles and San Francisco with broker-dealers named below. The memorandum represents a transcription of tape recordings prepared on the basis of notes taken at the interview. Exhibits which relate to the subject matter of certain of the interviews are attached immediately following the interviews to which they refer. Other records which were deemed too extensive to be reproduced are maintained under separate cover.

This memorandum and later exhibits should be supplemented by the transcripts of certain trading houses whose testimony we have on stenographic record (Troster, Singer & Co.; Gregory & Sons; Bean & Mackie Inc.; Gold, Weissman Co.; Frankel & Co.; Carl M. Loeb Rhoades; Hayden, Stone & Co. etc,), (b) memorandum of interviews conducted by Mr. Richard Meyer and Dr. Robert Tucker and (c) Mr. Myer's memorandum of August 15 reflecting his interviews of brokers-dealers in Cincinnati, Atlanta, Dallas and Boston.

The Interviews reported herein are as follows:

Swifts Henke & Co. (Exhibit)

Doyle O'Connor & Co., Inc.
Loewi & Co. Inc.

A. G. Becker & Co. (Exhibit)

Peters, Writer & Christensen, Inc.(Exhibit)

Boettcher & Co. (Exhibit)

Dean Witter & Co. (Exhibit)

First California

J. S. Strauss & Co. (Exhibit)

Currier & Carlsen

Evans MacCormack & Co. (Exhibit)

Staats & Co.

Barth & Co.

SWIFT, HENKE.& CO.
(First Interview)

This refers to an interview with Mr. Blumenthal of Swift, Henke & Co. of Chicago, Illinois. The interview took place on July 23, 1962, in Chicagos Ill. I was accompanied by Mr. Martin King, chief investigator of the Chicago Regional Office, Mr. Blumenthal advised me as follows:

Swifts Henke makes approximately 170 to 180 markets in OTC securities. He stated that it is often difficult to be able to make markets in new companies since he cannot obtain information about those companies which is as up-to-date and as reliable as the information he gets from his older, seasoned companies. He says that if his firm has a good relationship with management (as it does in many instances) that he can call management and get their views and ideas on such matters as dividend policy expected earnings and matters of that sort. He says generally that Swift, Henke uses this information so that they might be able to make better markets.

Generally the firm does not perform any retail function. It does well over 95% of its business with other broker-dealers. It is a wholesale trading house, whose chief competitor in the Chicago area is Doyle O'Connor. Swift, Henke has but one line open (to Eberstaat and Co. of New York) who lays approximately 100 markets in New York. These are duplicate markets.

Swift, Henke also repeats those markets in the sheets. The service charged by Eberstaat is 5 cents for every share bought or sold over $5 and 3 cents per share for every share bought or sold in those securities priced less than $5. Swift, Henke does not lay any Eberstaat markets and Eberstaat merely gives up Swift, Henke's name. Blumenthal said that some correspondent systems involve what he calls a joint account system, whereby the participants jointly agree to share the profits and losses of the activities. I did not pursue this matter further with him since he says he is opposed to such accounts, and he does not have any and he does not know all of the details as to how they operate.

Generally, his traders are compensated on a basis whereby they will receive 1/3 of the gross profit they make. He does not take off or charge the traders with any of the expenses such as clearing or overhead. He gave the following example. He said if a trader during a given month made a $10,000 profit, (which considers the beginning and closing inventories of a particular security) he will get 1/3 of that amount or $3,333. If on the next month there is a loss of $10,000, then the trader will only get his monthly draw, which is $700. However, on the following month the trader must make up the entire loss before he will be able to collect on his over-ride of 1/3. That is, he must make up the $10,000 loss before he will be able to share the 1/3 profit. Mr. Blumenthal took the position that when the trader “gets into the hole" that he tends to because more conservative in his activities. He said that certain firms paid their salesmen on a straight salary basis but that he felt that you had to provide a salesman with incentive and with motivation and with motivation and therefore commission compensation was the best method to assure proper result. With respect to general market activities prior to the market break he has prepared a six-page memorandum which is incorporated by reference into this memorandum. He made the following points in answer to our inquiries and in further clarification of that memorandum.

He said that when the market broke he was out of town and he was called by one of his partners. His immediate advice was to sell out the inventories as much as possible in selected securities and take the available cash and reduce the bank loans. He said that by this process he was able to reduce bank loans from approximately $800,000 to about $200,000. He said that he thought that this was appropriate since he had substantial inventories which he had not seen fit to liquidate prior to the market break. He thought that it was appropriate to do so immediately after the 28th and he so advised his traders who followed those instructions. Generally, he said that the decision to sell was across the board and that he only bought stocks if he felt he could do so with "impunity." The others, he felt, should be liquidated in varying amounts, although in certain securities with which he was affiliated for five or ten years through his market making activities, he made somewhat fuller markets and perhaps may have bought some small amounts on balance after the 28th of May. He described those stocks on which he bought on balance as those in which he knew he could get out of because of sizeable widespread buying interest. Those which he did not feel he could liquidate easily, he did not purchase. He said that if you looked at the market, however, which he was quoting for the next week after the market break, that you would notice that he was quoting practically everything that he had previously quoted. However, he said he was dropping his bid, increasing the size of spreads, making subject markets and in smaller amounts. These four techniques, he felt, were necessary because he did not wish to leave the sheets: he said he could not leave the sheets and be a broker-dealer; yet he could not continue to buy stocks. He said that it was through the thinner markets and making subject markets that he was best able to sell on balance and prevent his firm from buying sizeable amounts. He said that he had to make some kind of a market in companies whose securities bad been historically quoted by his firm, but he did not feel that he had any responsibility since it was his money and it was only tampered by some sense of loyalty.

On the question of competitors he said that he rarely deals with his competitors in the sheets in a particular security and that the major occasion on which he deals with them is when he must dispose of inventory. He said that when a decision is made to dispose of inventory that he cannot afford to wait around for an incoming call from a retail wire house and to sell to them at a bid price. He, therefore, will sell directly into the market to a competitor at their bid price and lose his spread.

With relation to questions 5 and 6, Mr. Blumenthal stated that the figures of his firm were not too meaningful because there were certain large individuals who sold sizeable blocks of American Marietta which distort the picture. He said that there were few retail customer involved though the dollar amounts are fairly significant. He said that in his opinion there was more buying by the public in the spring of 1961, than in the spring of 1962. His figures don't show that because they represent a very limited sample. He said that he does not know if banks were selling collateral on the days of the market break. He mentioned that one of the largest banks in Chicago has not called him for over a year to sell out collateral. He believes that the sale of collateral at least from Chicago banks was quite limited.

Referring back to the Eberstaat functions, he stated that he was able to get Morgan Guaranty and Chase Manhattan business because those banks had an interest in securities in which he had markets. However, Morgan Guaranty and other banks would not call him in Chicago but his correspondent Eberstaat would receive the inquiries. His business, therefore, increased because of this correspondent arrangement. He thinks that the correspondent system in OTC markets is a fairly recent but widespread development. He would not object to an identification of the fact that a given broker-dealer was appearing for another.

Mr. Blumenthal stated that the laws of survival were as important in his business as in any other; that he had no obligation when the market broke or before that point to do something which he felt would cause him to lose money. Mr. Blumenthal stated that the larger wire house firms make the worst markets. He described their activities during the time of the market break as "most pathetic." He said they made the worst possible markets, and that their personnel were inexperienced and poorly trained. He blamed this primarily on the fact that they are not in the business of trading as principal historically and that they, for the most part, use order clerks or inexperienced personnel to conduct trading markets. He said that because of their size, a partner in New York will merely advise the traders to stop buying at times of decline because the retail department will be unable to function in times of declining markets. That is, the salesman do not go out and sell the securities. Therefore, any inventories purchased will probably lay on the shelf. As a result, their markets are even worse than the markets made by the wholesale trading houses even though the latter certainly are far from saintly during times of stress. The wholesale house, he contends, at least must do something to retain wire house business in the future. He said that there is no control of the big firms over the activities of the traders, that this is a most disgraceful situation in connection with their activities and that the customer from his experiences practically always suffers because of their inability and inexperience.

Blumenthal stated that the public is much better off if the trading wholesale houses have sizable inventories because then the firms will have to make some semblance of decent market to protect its long posit it will have to stabilize.

He said that at the present time markets are quite thin, subject; that firms have lost sizeable amounts in trading and capital amounts and don't want to lose any more. They are most reluctant to buy.

He mentioned that the NYSE advised Cruttendin Podesta to liquidate an over-the-counter stock because its long position in that particular security made it appear that the company had assets, in X-amount, which in fact was not the case because of the thin markets, etc.

The firm "makes markets" in certain securities in which it does not appear in sheets; it does not appear in sheets primarily because of inactivity of the stock.

[Exhibit to Interview #1]

Swift, Henke & Co.
Members Midwest Stock Exchange
135 South LaSalle Street
Chicago 3, Illinois

July 18, 1962.

Securities & Exchange Commission
105 W. Adams Street
Chicago 3, Illinois

Attention - Mr. Thomas B. Hart

Gentlemen:

We have obtained the following data from our records to enable us to answer to the best of our ability the questions raised in your memorandum in connection with the conference to be held with representatives of the Commission on July 23, 1962.

[Firm Inventory table omitted]

The above involved no "sponsored" issues as we interpret the term. All of the above could be classified as speculative stocks.

1.(B) In the first four months of 1962 no active effort was made to reduce inventory and it was hear its high for the year at the end of April when the market began to drop so severely. In May a belated and not too successful effort was made to reduce our holdings only motivated by the apprehension that the Stock Market might further deteriorate substantially

(2) see answer to 1.(A)

(3) Inventory reduction was effected by reducing buying and mainly by sales in the open market at prices that were not too far out of line with previous quotations. No inventory was disposed of by so-called retail efforts and consequently no extra compensation was paid to traders for sales. In other words, most sales were made in the open market to other dealers.

(4) There was no significant change in the number of markets made during May 1961, January 1962 and May 1962. However, in May 1962 bids in most cases were reduced in size and spreads of quotations were widened because of the defensive dropping of bid prices. In some cases no bids were made and some few issues were quoted offered at a price with no quoted bid.

(5) & (6) [tables omitted]

(7) No known short selling by customers and no way to determine if other dealers made short sales to us:

[table omitted]

(8) [table omitted]

Sales from collateral loans by banks cannot be identified.

(9) Because it is neither practical nor feasible to keep a daily record of the constant changes in prices and sizes of markets, we cannot at this late date furnish detailed or accurate figures covering our quotations on May 28, 29 and 31, 1962. However, at times during these days our quotations, during periods of sharply dropping listed markets, were in many cases nominal and without firm bids. In other cases our bids were limited to 100 shares. In other instances we would qualify our quotations by stating that the market was "small," the implication being that the bid was less than 100 shares. However, when general market conditions steadied we reinstated and restored and improved quotations on many issues. We total our inventory at the end of each month and we don't keep a daily total. However, it is our considered opinion that there was no significant change in the amount tied up in inventory on May 28, 29 or 31, 1962.

(10) The markets quoted by other trading firms were generally characteristic of our own. Sizes were reduced and quotation spreads were-widened and it was difficult to effect sales of any appreciable amounts of stock except at substantially reduced and/or declining prices.

(11) We feel somewhat obligated to maintain markets on a number of issues, particularly those with which our firm has been identified over a period of years.

(12) In early June, markets were generally badly demoralized by an absence of good bids and the continued pressure of selling. Later in the month after prices had considerably declined, quotations became fairly stabilized at the lower levels. We felt in a number of instances that certain securities were selling at least temporarily below their realistic values and also a number of individuals seemed to arrive at the same conclusion.

At the June lows it was our impression that interest on the buying side of the market on many issues outweighed the selling side and a rally in the market appeared to be more likely to occur than a further sell-off.

Any additional information of a more detailed character will have to be obtained by an audit of our records which will require a reasonable length of time to accomplish.

Very Truly Yours,
Swift, Henke and Co.

[signed by] Harold Blumenthal

Addendum for #9 [table omitted]

DOYLE O’CONNOR AND CO., INC.
Chicago, Illinois

This is the second interview it represents an interview held on the afternoon of July 23, 1962, in the offices of Doyle O'Connor & Co., Chicago, Illinois. The interviewee was Mr. Doyle O'Connor makes markets in approximately 100 securities.

Mr. Doyle stated that he has two correspondents -- Houston Hill & Co., and Stern, Frank, Meyer & Fox both of which are in California. He stated that both of these brokers-dealers enter appearances in "pink (Pacific Coast Section) sheets" for approximately 30 securities in which Doyle O’Connor makes markets. In addition, Doyle O’Connor makes appearances in NQB sheets for securities of such firms. There is a reciprocal arrangement whereby the charges for the service ($4 per hundred share execution) are set off against each other. That is if Doyle O’Connor receives an order for a hundred shares for a Stern, Frank security, it "gives up" Stern, Frank's name and is compensated $4 and vice versa. At the end of the month that correspondent which owes funds to the other clears the account by a balancing check. Mr. Doyle stated that, as a practical matter, rather than Stern, Frank or Houston Hill shopping around for a market for a customer in a security quoted by Doyle, they use the open wire and usually execute with Doyle. It is also expected that Houston Hill and Stern, Frank will execute orders for other brokers with Doyle O’Connor if they are a primary market maker. Doyle O’Connor states that every change in its quotation is immediately flashed to its west coast correspondents and that no discretion is left to the correspondent as to price in a Doyle's security. If one of the correspondents executes a transaction for a broker with someone other than Doyle O’Connor in one of the Doyle O’Connor securities, Doyle is notified as to price, number of shares and identification of parties.

Doyle stated that in many respect his traders are paid in the same way as other traders in OTC houses; that is, they are given a commission on their gross profit. They are given a draw each month which is fairly low. Some of his traders made upwards of $50,000 or $60,000 in 1961. Some of them made as much as $14,000 in one month. He said that the compensation system is as follows: the trader gets 25% of the profits made. The profits, of course, are two fold. First, there are the realized profits which represent the gains or losses within a given month, arising from the actual trades. However, these profits may be lowered or lost if the closing inventory is lower than the opening inventory in terms of the price of the security multiplied by the number of shares then on hand. He stated that if the traders, for example, make $4,000 or $5,000 within the month but at the end of the month show a $10,000 loss because of a high inventory and a late month market-drop, then they are charged with that loss and the securities are marked down to market to begin the next month. It is a charge against future earnings. Doyle stated that the trader does not get his draw so long as that charge is not liquidated. The result is that some traders are unable to extricate themselves from sizeable charges because they must make up all losses before they can receive commissions <u>or draw</u>. Doyle said that to a significant extent one of the reasons why a decision had been made to cut inventories was because of the fear that long inventories in the hands of the traders would cause, them to be in personal financial difficulty in event of a sharp market break and would make it impossible for them to ever make up the losses which they would have incurred with sizeable long positions in the event of market decline.

Doyle O'Connor says about 2% of its business is to retail customers. Therefore, it stated that it could not expect to liquidate any of its inventories to such persons. It has to rely on its competitors to liquidate who generally are in the same position as they are, or to the other wire houses whose purchases will reflect the buying power of their retail customers. Mr. O’Doyle said that his firm follows the typical policy of dropping inactive securities as does other firms in the sheets and that he will not make markets in stocks which do not trade actively unless a trader has some overriding reasons for doing so. He stated that in his opinion one of the reasons for his success, particularly in the 20’s was because of a policy to keep down inventories. In this connection, it appears that Mr. Doyle is one of the founding fathers of the OTC business, having set up one of the first firms in that enterprise on a purely agency basis sometime before the "pink sheets" were developed.

Mr. Doyle advised us that there was a firm decision in early 1962 to cut back its inventories. The firm sold on balance across the board in securities in which it made markets but for the most part tried to cut down those securities in which they had sizeable inventories. Schedules have been prepared by Doyle which show the reductions in long position for the months ending December 31, 1961 through June 30, 1962.

Those exhibits are attached to this memorandum. Of significance is the fact that the firm aggregate long position was about $1,189,000 in December 1961 and was $606,000 at the end of June 1962. In January the firm reduced its inventory by $104,000; in February by $229,000 more. In March, however, their inventory went up $443,000 because of heavy buying in two securities -- E. F. MacDonald and Controlled Data Systems. We were told that if there had not been heavy buying in those two particular securities, there would have been a definite deficit for the month of March 1962. In April there was a $168,000 further cut-back; in May $59,000; and in June a cutback of $487,000, which for the most part was the sell-off of the MacDonald and Controlled Data stock.

Mr. Doyle advised us that he does not believe his firm is a "sponsor" of any security; that he feels no obligation to fix, peg, hold or retard price declines, that his is a profit-making-organization without such responsibilities. He distinguished this attitude from that of a managing underwriter, whom he says often takes the position that he has such a duty. He said that on occasion a managing underwriter has come to him and has asked that he peg or hold the price on the bid side to, for example, 6 3/4. He mentioned the stock Hurletron in such connection. The underwriter said that it would take a certain amount off his hands on a generally continuing basis if Doyle O'Connor would perform that function. I did not pursue the matter to determine whether or not the desired activity actually occurred.

Mr. Doyle stated that there was heavy trading on the 28th, 29th and 31st of May. There was about quadruple the normal trading on those days. In this connection, he supplied us with all of his transactions in all securities for those three days. He stated that in his opinion his firm and Singer Bean's were the only two firms which did not make "subject" markets for the first 100 shares. He stated that he stood by his market for 100 shares and then lowered his quotation or refused to take any more. He also widened his spreads constantly, but he made a better market in his opinion than anyone else on LaSalle Street. He said that he is now making some subject markets but these are only in securities in which he has no inventories. That is, he appears in the sheets but has no inventory and when he gets a call he makes a subject market hoping to find a buyer or seller on the other side of the transaction. He does not make subject markets in securities in which he has inventories. He says that this probably puts him into a unique category since most firms in the market-break period were making all subject markets and now make no markets or do not even attempt to try to place securities which are not in their inventories. Doyle stated that he bought and sold significant amounts of securities when the market broke. He was not able to advise us as to whether he made profit from these transactions. He said that he lowered his quote on no selling volume in some securities; that he dropped his quote sometimes because he knew there was volume which was about to hit the market if he retained his bid, and that he would look around for a buyer for blocks of stock, buy it cheaper and then sell it to someone who was willing to pay something over what he purchased it for. He says that the reason for the subject markets was to allow a firm to "shop around" for a buyer, quote a lower pries to the seller, and then execute with the discovered new buyer. He said that his period for liquidation occurred months earlier in which very slow liquidation occurred in just a few blocks of securities per day and which could not possibly have affected price, because of the slowness with which they were distributed. He said that on the day the market broke, the worst markets were made by the retail houses. He said that when the market broke their markets were "terrible", there were significant time delays in executions, there were subject markets; they were backing off their quotations, they were not even making market for 100 shares irrespective of their size of the broker-dealer. He said that the retail houses are novices in the business shouldn't be in the business, and do not perform a useful function in times of market break. He says his business in volume has fallen off from the hectic, market break days. He stated that his firm is beginning to get some over-the-counter business through the retail houses which indicates there is some solicitation and some buying power at the present time from customers. He stated that he expects to be able to reciprocate to such firms by giving listed business to those houses in proportion to what he gets from them. He stated that the most competition for his firm obviously comes from the wholesale trading houses. He said that the retail houses posed no competition at all and they are like "clay pidgeons" waiting to be knocked off at the expense of their customers who get the mediocre execution.

He said that in his opinion it is not ethical for a dealer who receives an order for one thousand shares to take a part of that block and advise the rest of the "street" that a buyer or seller, as the case may be, is about to buy or sell a sizeable quantity. However, if an individual does not give the order to a wholesale dealer but rather tests the market through his retail houses wholesale firms immediately will call each other up and determine whether the individual in question is a buyer or a seller and will call each other to "watch out for Merrill Lynch, they're shopping." As a result of this they will raise their price on Merrill Lynch when Merrill Lynch calls for a quotation, and therefore will damage what could have been a good market. If he had placed the entire order with one broker at one time and given that broker the discretion to work it off, the Merrill Lynch customer would have received a far better price.

Mr. Doyle feels that the worst thing about the over-the-counter market is the pink sheets. Ha says that a very significant number of the quotations are fictitious, that after a quotation is put into the sheets, the broker refuses to execute or will not make a market even for 100 shares. He often will beg off by saying that he is "too long" or "short." Although he is in the market on a two-way quote, he just can't do both. He said the atmosphere of friendliness is so prevalent on the street that this is the normal practice and is accepted.

Mr. Doyle said that he had complained to Mr. Walker about the caliber of the broker-dealers in the sheets and the fact that many of them cannot or will not make a two-way market. He stated that he has reported some firms for their lack of talking a market consistent with their quotations. He says that OW-BW quotations are inappropriate and unjustified. He stated that in his opinion there is fundamental conflict between making a market and having a retail department and he said that he would never "earn a living" that way because be considers it to be improper. He thinks that if you have an inventory that you shouldn't dispose of it to the public through a practice which may mean “it is not good enough for me but it's good enough for you." Therefore, he believes that those two things should never mix or be mixed. Doyle stated that a retail house has sizeable advantage over him in this connection because they can dispose of inventories. However when the going gets rough in a declining markets he believes that it is only the solely wholesale dealer who performs a decent function. He admits, however, that in times of stress that function of being a market maker is not very effective in any form. We discussed these matters generally and did not detail his transactions because he said that he was not familiar with them on the 28th, 29th, and 31st. Doyle stated they would become quite apparent by reviewing his detailed trading records which we will do in our study as expeditiously as possible. I think that this will be particularly valuable since those records are an excellent barometer of what the retail houses in the street are doing. It is a complete picture of most of the large retail houses as they operated in the over-the-counter market and through one of the largest primary wholesale trading market makers.

Since the completion of this memorandum, I have done some preliminary work on their reported transactions. It appears that on May 28th of the 98 securities in which they made markets, they bought on balance 45 and they sold on balance 43 and they were flat in 10.

It should be noted that these were securities traded on that day and does not include securities in which they make markets and/or appeared in the sheets but did not trade. On May 29th, of the securities traded, they bought on balance 29 securities and sold on balance 50 and were even in 5. On May 31st they sold 74 securities on balance, bought 19, and were flat in 2. This would indicate that in the rising market the firm was a much better seller on balance than it was a buyer in a falling market. The firm sold on balance 11 different securities in each of the three days May 28, 29, and 31. It did not buy any securities on balance on each of the three days. I expect to complete the dollar buying and selling on balance as a supplement to this report.

LOEWI & CO., INC.

This is the third interview. The interview is with Loewi and Co., July 25, 1962, at their office in Milwaukee, Wisconsin. Present were Mr. Loewi, Sr., Mr. Loewi, Jr. and Mr. Liebman, principals of the firm.

Loewi & Co. is a member firm of the NYSE. Their correspondent on the floor of the NYSE is Carl M. Loeb Rhoades & Co. I was advised that Loewi does not have any correspondents in the sense of other dealers who lay markets for them in the NQB sheets. They advised me that they had some joint account transactions with other broker-dealers many years ago but that these have been discontinued. I was advised, generally, that they had three or four telephone lines which were open to Chicago brokers which permitted Chicago brokers to call into the open number in Chicago and execute orders with Loewi. The cost of the line was shared between the Chicago firm and Loewi.

Generally, the firm is a mixed retail and wholesale house. According to OTC-3 it was making markets in about 80 securities. It decided sometime in January or February 1962 to reduce the number of securities in which it made markets. They did this because of a firm decision to take positions and make markets only in securities in which they had done significant research or in which were acquainted with the management, or had reason to believe that up-to-date reliable information about the company was forthcoming. They therefore decided to drop certain securities in which they made markets. They now make markets in 40 stocks. However, this was not actively done until May 1 when one of their two traders resigned from the firm and went elsewhere. Since he had given notice, however, prior to this time, the firm was able to liquidate positions in the unwanted securities on a slow basis and thereby avoid depressing the market.

Loewi does not pay its traders on a commission basis as was the case with Swift, Henke and Doyle O'Connor. Rather, they pay their traders on a salaried basis plus a commission or bonus at the end of the year based upon the company's over-all profit-making activity. I was advised that the trading department is not as significant in the firm as is the retail department. In the retail department there are over 70 employees. The traders are very closely supervised. They may not pick or choose their own securities. They may trade only to rapidly turn over the securities and not for long-term profit potential. If a trader knows of a situation in which it appears that a long-term or investment potential might accrue, that type of security is placed in firm investment account rather than in the trading account.

Many of the securities traded by Loewi are not actively traded. Markets are made in these securities generally because of underwritings or a long-term affiliation/relation with management.

I discussed with principals of the firm the general area of the relationship between their retail department and their wholesale department. They stated that in a security in which they make markets and are in a generally long position, the normal and typical situation, the trading department will make the stock available to the salesmen for sale to a customer (solicited or unsolicited) on the inside offer side of the market. That is the salesmen will take the security at a cost which will equal that which the trader would receive from another dealer. The security would be "marked up" from that price to the customer. I was advised that on some occasions, even in securities in which the firm “makes markets" the salesmen will only be permitted to execute orders on an agency basis. This means that the salesmen will be limited to charging a stock exchange commission which usually is less than the principal markets. It is by this device that Loewi discourages salesman from recommending securities which it does not recommend. The salesmen tend not to sell those securities in which their commissions are limited to the NYSE schedule.

Loewi feels that it need not recommend every security in which it makes a market and it merely controls the recommendation of such securities by requiring that the security be purchased outside of the firm on an agency basis.

With respect to securities in which it does not make a market, Loewi executes the transactions on an agency basis and thereby avoids riskless transactions. Loewi stated that they put out over 100 reports in which they recommend certain OTC securities in various degrees. However, they do not make markets in all of these securities. They stated though that for the most part they probably would also make a market in any Wisconsin security in which they make a report.

In this memorandum, when I refer to "make a market" I mean appear in the sheets. It is true, of course, that Loewi makes markets in securities in which it does not appear in the sheets. That is to says it buys and sells certain securities and the financial community generally knows it will buy or sell in limited quantities. It has more or less a running inventory in such securities. Those securities, however, are inactively traded. Loewi stated, however, that with respect to their actively traded stocks, they continuously appear in the sheets since that is the best way to get advertisement. They stated that they receive telephone calls from many broker-dealers outside of Milwaukee to execute transactions or to check markets or both although they do not appear in the sheets, in which they may or may not have inventories. They say that this is because of their general reputation and because they are considered to be reliable.

In connection with the general subject of solicitation of retail customers and market-making activities, Loewi said that his firm considers itself a so-called sponsor in a number of Wisconsin securities and that it could make a trading market, that is a wholesale market, easily even though it did not solicit retail business. Loewi stated that their use of retail clients to dispose of stock is a useful function but certainly would not be indispensable to market-making activities which is in itself profitable and which they think could function by restricting their activity solely to wholesale traders. I cannot say that they were overjoyed with the discussion in this connection, but it did not seem to be an impossible proposal as we discussed it. They did not indicate that they would stop making markets in the event that such program were adopted. It must be emphasized that they were advised that I was just discussing generalities with them, that the separation was not being considered by the Commission and that I merely wished to evaluate the position of the firm in connection with certain over all basic problems.

Loewi stated that in May 1961 their aggregate inventory, which took into account both long and short positions, showed a long position of $366,000. In May of 1962 immediately before the market break the aggregate long position was $364,000. Their position within the foregoing 12 months' period increased substantially at one point because of a block purchase of $300,000 in one security which they disposed of prior to May 25,1962. Their long-term investment account generally was turned over somewhat in the period of January through May 1962 into some more conservative issues. There was some liquidation of speculative securities and emphasis on more buying of stocks which had a more solid long-term growth potential. The aggregate positions in the investment account however did not change.

They stated that the NYSE as well as the Midwest Exchange have been interested in always insuring the financial stability of their members. In this connection they said that on occasion the NYSE has valued one of their OTC securities at zero. The firm has a conservative accounting approach. They sharply cut their own evaluation on many of their OTC inventories in preparing NYSE statements. The Exchange often follows up the financial statements with questions on the volume and trading turnover, etc., so that they may properly re-evaluate the financial statement. They stated that for the recent NASD inquiry for the June 30th balance sheet, they will calculate the inventories at the current market price without the taking of a haircut. They did not appear to be concerned with the problem of the high inventories and concomittant lack of cash, as a problem in connection with the sponsorship of securities, since the over-all inventory investment is small in comparison to the company's other liquid assets. Therefore, even if they were required to calculate their inventories on a somewhat lower basis, it would have little effect on them since but a small portion of their capital or cash is used in the trading end of the business. Therefore, they would always have sufficient cash to 'sponsor' securities if the need arose Loewi stated that the availability of cash during times of market decline does not cause the firm to buy on balance or act as a stabilizer during times of stress. He stated that, generally speaking firms will wait out the decline rather than use their available cash for that purpose. He said that no firm will be a basket and it is unrealistic to expect one to do so in the present system.

In discussing the reasons for the dropping of 40 stocks in which they had made markets, they mentioned that they went back for the six months' trading prior to April 1962 and determined that they were losing money or not making money in certain securities, most of which were inactively traded. Therefore, they stopped making markets in those securities when the time came for the contraction described above. They liquidated their holdings and did not go back into the sheets.

Generally, the firm stated that the spreads in the market between the period May 1961 and December 1961 remained the same. But for the periods starting in January 1961 they felt that the wire houses such as Smith Barney's; Blyth, and Merrill Lynch were widening their spreads. They say that this was an impression on their part -- more of a feel -- and of course, just reflected their opinion as they saw the markets. They pointed out that with respect to their own firm, there was a very sizeable difference in their retail business. They stated, for example, in May of 1961 customers purchased as principal over six million dollars worth of securities and sold about three million. In May of 1961 customers bought on an agency basis about one million dollars in securities and sold approximately two million. In May of 1962, however, customers, bought as principal about 2.3 million and sold $760,000. As agent in May of 1962, they bought $870,000 and sold $1,500,000. This indicates that their retail business was falling off quite sharply over the previous year. It appears from the figures given that their business dropped from nine million dollars total on principal business to about three million and their agency business fell from about $3,300,000 to about $2,200,000. Since their agency business is for the most part in securities in which they do not make a market it appears that the greatest fall-off in principal business was in securities in which they made markets. They stated that their quotations did not change very much in May of 1962 compared to prior periods and they said that this might have been because of the fact that by that time the list had been refined to the point where they were making markets in securities in which they had definite interest and had done some research.

The company said that on May 28 they made firm markets in 100 shares only and that the markets were not subject markets for the first shares. After that, however, the market was small and they immediately dropped their bid. They stated that all of the teletypes or most of them went out with an indication that markets were small which indicated that the bid was never good for more than 100 shares and sometimes they lowered it as much as a quarter of a point or one point after the first transaction. They said that there was little doubt that the drops to a sizeable extent were in sympathy to the NYSE drop. They said, however, that customarily they did not drop their quotations until they at least had one transaction at a given price. However, they stated that after the market began to drop, even if they had not had a transaction in a security they probably would open up with a lower price than the prior day's last transaction. They said there was no doubt that they would not have done this on Friday, the trading day before the market break, since they usually make strong markets and don't back off rapidly. However, they stated that it is recognized that when a general decline hits the market, as evidenced by high volume selling on a stock exchanges that a firm making a market cannot tell how deep will be the decline. Therefore, even with no volume or little volume of selling pressure they must adjust their prices downward accordingly, although they try, they say, to make the market "orderly" in its decline. Therefore, although they might have little selling pressure volume, it was expectation of large volume which caused them to lose their quotations. We discussed in this connection the problem of liquidity. They said the lowering of the quotation may have presented persons from executing transactions. With respect to their inventories they stated that their inventory dropped 5% on May 28 and stayed about the same on May 29 and after the 31st. They said that there was no change in position therefore which was significant on the market days, and that generally it was in the same position as it was prior to the break. I pointed out to them that generally their inventories stay fairly constant around the $350,000 level. They pointed out that it was their intention to do the same in the market break. We discussed then in that connection whether or not they could be considered to have made a good market at times of sharp decline when they are doing exactly the same kind of inventory positioning as they were when the market was fairly stable. (They are doing the same kind of positioning as they were when the market was rising and when it was level.) I asked what standards they would use to evaluate their activity re positions since it apparently doesn't change depending on the general state of the market on particular days. They said that at least they were making some market which was more than most firms were doing. They said that no firm could be a bushel basket or a bucket even if they had the capital to do so. They said that both Merrill Lynch and Blyths with their enormous capital would be wiped out quickly if they attempted to hold the price in even a few securities in times of decline. They premise this conclusion on the assumption that if they decided to buy heavily during times of decline in the market or stabilize or retard the decline that they would thereby cause sizeable selling pressure. The dropping of the quote causes many prospective sellers to change their minds and retreat to a holding position. I think that this phenomena is critical in evaluating the OTC market since the lack of realistic liquidity may have prevented more serious realized losses from occurring by both broker-dealers and customers. It is the position of Mr. Loewi that it might be best to insure that firms have a strong cash position (through minimum capital requirements) and than not expect them to buy when the market goes down but rather hope that their cash position will permit them to buy when the temper of the market changes retail customers motivations, causing them to purchase on balance. I asked him whether or not bank loans would not meet this purpose which would be collateralized by inventory then on hand rather than having cash. He said that his firm didn't borrow for such purposes although he recognized that it was the practice of many firms to do so.

On the days of the market breaks I was told that Loewi's customers tried to sell but Loewi discouraged the customers from doing so. They stated that customers who tried to sell received very weak quotations good for only a hundred shares. They then changed their minds and didn't execute, withdrawing their order and canceling it.

Of significant moment was the fact that in many firms it was impossible to establish communication. Long distance wires were busy; there were significant delays in establishing contact with correspondents who only held subject markets for their principals. This also contributed to the general disorganization. Loewi's business (confirmations) in OTC securities for the 28 was the same as normal, for the 29th about twice normal and for the 31st three times normal. This includes principal and agency dealer and customer business.

Loewi stated that there was no short selling by either customers or broker-dealers that they knew of and, there was very little forfeiture bank loans. In this connection, Mr. Loewi advised that he had talked to bankers at length on this subject and that a representative of the largest bank in the United States told him that of 27,000 active accounts only two cases resulted in forced sale. Of course, he stated that he did not know how many of the 27,000 were called and how many voluntarily liquidated on the authority of the borrower or by the borrower. He said that there was no wholesale selling of pension funds, etc,. during the market break. Moreover he feels there may have been significant reductions in equity securities -- say from 75% to 25% by pension funds in the period from January through May.

Mr. Loewi stated that his public customers bought $103,000 on the 28th and sold $98,000. On the 29th they bought $219,000 and sold $197,000. On the 31st the customers bought $265,000 and sold $147,000 in OTC securities. His institutional clients bought nothing on the 28th, sold $12,000. They bought $28,000 on the 29th, sold $5,000. They bought nothing on the 31st and sold $32,000. He said that in his opinion there usually was more buying on balances compared to selling than there was on these three days though there was still an excess of buying over selling. I asked him whether or not the lack of more buying on balance was the result of lesser buying or more selling. He stated that the buying usually was greater than it was and the selling less but he was unable to comment as to whether the buying was much greater or the selling much less than on the subject days. (I think that we may need that kind of a comparison to make a meaningful analysis of the differences between this three-day period and prior periods. I thinks our OTC-5's will give us that information.) He said that when the market broke that subject markets were typical and that some of them, had subject markets for less than 100 shares. The customers couldn't get executions, the spreads of the New York houses were quite wide and undoubtedly there were dropping of quotations with very little volume.

I think we should consider that the selling pressure may not be measured by volume of consummated transaction. Consummated transactions really do not measure the extent of the public desire to sell which is the determining factor on the quote. This seems parallel to the situation with a specialist where the knowledge of the book (the anxiety or desire to buy or sell at given prices or at market) determines his market. Therefore, we might well consider the feasibility of some system which takes the book into consideration in evaluating the orderliness or adequacy of the actions of either the specialist or the sponsors if we are to develop rules in those directions. The book may be one of the few measures which probably correlates highly with the action of the market-maker.

A.G. Becker and Co.
Chicago., Illinois

This is the fourth interview. It was held at the offices of A.G. Becker &. Co., Chicago, Illinois with Messrs. Morrison, Fleet, Marr and Levin. They stated that the company makes three different types of trading markets. One of these is the Chicago market. This covers securities which Becker trades solely because of activity. They were not underwriters of such securities and are making the market generally because of high turnover. They make another series of markets in securities called the "joint account" securities. These securities are ones in which Becker acted as managing underwriter or feels some sense of obligation or responsibility to the company. The third group are the so-called Lewis Trading Account securities. These are primarily public utility securities.

The thrust of the discussion dealt with the Chicago markets and the joint account markets. A.G. Becker has no broker-dealer who appears in the sheets for it. However, they do appear in the sheets for another company, Shumate & Co. They lay markets for that company in Chicago (Midwest sheets) and give-up Shumate's name. They have an open wire to Shumate and Shumate quotes markets in Becker securities on Becker's instructions. In addition they have a correspondent relationship with Harbeson-Henderson in Los Angeles, a non-sheet correspondent, who is generally recognized as such in the community and who has an open wire to Becker. The transactions are executed on a give up basis.

Becker's traders are paid on a straight salary and a bonus and-are not paid on a basis related to gross profit.

They stated that, in prior years their trading department was merely a service department for salesman. However, five years ago the trading department because somewhat of a substantial profit producer. (In this connection it should be recognised that, when in referring to the trading profit of a firm which also has a retail departments, it is not meaningful to determine whether the profits of a principal transaction are ascribed to retail department vs. the trading department. Some firms treat the profit as a retail profit, others as a trading profits, while still others take all of the gains and just compute it against the firm profit and loss without attempting to segregate in any manner.)

Becker said that when they have a stock in inventory, they will sell the stock out of their inventory to customers on a mark up basis. The salesman makes 40% of the mark-up. The mark up is within the NASD 5% rule. On riskless transactions, the order is always executed on an agency basis if Becker does not make a market and does not have a long position in the securities. We discussed also the problem of sheet appearances, or non-sheet appearances in securities in which they hold position. I was told that in their public utilities section there are only 50 listings paid for in the NQB. However, over a short period of time, there are about 90 stocks in which markets are made. It is too expensive, they say, to list every security, particularly those which are less active. However, generally the street knows which ones are taken into position by the firm and it is not necessary to make a constant sheet repetition for each stock. However, with respect to industrials, for the most part, they put in each stock as often as possible and omit stocks only when the markets are very thin and they don't expect to get any calls.

Generally, their limits on trading positions are fixed in accordance with the schedules attached to this memorandum. That is, they do not go long or short in excess of $75,000 shares in their Chicago trading department nor longer in any one stock in excess of $25,000. In their joint trading their long or short is $39,000 and in any one stock $30,000. In utilities their long or short is $200,000 and in any one stock $30,000. These limits are fixed and positions are maintained within those general limits. In unusual circumstances if there is an acquisition which exceeds those limits, the position in all instances must be reduced within 5 days. Apparently the rules are quite rigid in this respect. The firm's theory is that it should not approach the limits and that cash must be kept available in order to stand up to the market in the event of a decline where they might be required to buy on balance. Representatives of the firm however, stated that this does not mean that the firm should stand up to the declining markets but merely means that they should not run away and should use the cash under appropriate circumstances to make an "orderly" market. There are no objective definitions as to how an "orderly" market is to be maintained in the OTC market nor are the standards for an orderly market spelled out to the trader. They said that the best they could do was just state the general rules "don't stand up, don't run, make it orderly."

Becker supplied us with a breakdown of inventory levels for the period May 1, 1961 through May 25, 1962. From a review of such figures it seems that Becker maintained its long inventory in the 12 month period April 30, 1961, through May 25, 1962. They did not increase their short position. Indeed, when the utilities department is also considered Becker, if anything, increased its total inventory position in the 12 month period. It seems fairly clear that they did not engage in any wholesale reduction of inventory. They said that the reason for this was because they have a very small position in relation to the capital of the firm. Therefore, since they make markets in 150 stocks, they can't cut back their positions significantly without seriously jeopardizing their ability to make a minimum market.

Becker stated that they have never had any problem or discussion with either the SEC, the Midwest Exchange, or the NYSE on their inventory valuation. The only interesting facet concerning their positions is a decrease in short position of from $170,000 to $71,000 in utilities stock over a 12 month period. Apparently, utilities are traded with very sizeable short positions in order to maintain a hedge against long positions. Becker covered their shorts before May because they felt that it was appropriate to do so in this period of fairly good volume. They did not do so in industrials nor did they substantially reduce their industrial long position. Becker increased its long position in sponsored securities in the period of January 1962 through May 1962. The only reason why there was not a net increase in position was because of a decrease in a position of the non-sponsored stocks.

Generally, they stated that the markets in the spring of 1961 were much broader than those in the spring of 1962. They said that they could afford to take chances and acquire more securities in the spring of 1961 on inter-dealer transaction by taking 200, 300 or 400 shares because of the knowledge that they would be able to reduce their long position in terms of their limit because of the increased buying power of the public in that period. However, in 1962, they could not afford to make as broad a market because they might be unable to liquidate a long position because of the lack of retail buying power.

Becker said that they could afford to make mistakes in the spring of 1961 in a particular individual security but could not afford to do so in the spring of 1962 prior to the market break. They stated that the markets were thinner in the spring of 1962 compared to the spring of 1961. They meant by that, they said, that there were faster changes in the quotations after the first 100 shares. They said that the differences in these markets were significant and were easily discernible to the trader. They repeated, however, that they could not and did not liquidate their long positions because to do so would make it almost impossible to make a decent market. (It must be remembered that they make markets in over 130 securities so any reduction would seriously interfere with other market-making functions.)

Becker described generally the differences between the taking of positions in sponsored securities vs. non-sponsored securities. In sponsored issues they say that there is usually a significant retail interest because they define that which is sponsored as a company in which it has had a recent underwriting. There is a sizeable block of people who have bought the stock and are familiar with its affairs. In addition, Becker has done research on firm and receives reports pursuant to the underwriting agreements. They say that in sponsored securities there are "outs" because of the retail interest and that they can therefore take somewhat longer positions in such stocks than they could in non-sponsored securities as a general matters. They can't take or afford to make mistakes in unsponsored securities as readily as in the sponsored stocks. However, they point out that there is no casual relationship between their inventories or their market making function and the existence of retail department. They stated that they do not feel that they have used their retail department to dispose of inventories and they do not believe that they take positions consciously because of the existence of the retail department. They said that in their opinion they have a responsibility to the issuer of a sponsored company whether or not they solicit retail customers. They stated that they are not certain how any type of restriction on solicitation of retail customers would affect their business. They don't know of any good that would come from it and are not sure of the detrimental aspects.

We also discussed in some length the volume of the retail business in various periods under study. They stated that there was much more retail business in May of 1961 than in 1962. They said that individuals by January of 1962 were not buying as much as they had been buying in previous periods but that by May of 1962 the trend had reversed itself and customers had begun to buy somewhat more than they had been buying in January but certainly not as much as in the previous year. They stated, however, that to their opinion there was significant cash buying with "new money" in May of 1961, but that in May of 1962, the increased buying over January was a reflection not so much of new capital investment in securities but rather was the result of switching out of one stock into another. They said, therefore, the selling probably also increased in May of 1962, as compared to May of 1961. They believed that the cash in May 1962 which had previously been put into stocks was slowly being moved into savings banks. They mentioned that they understood that the First National Bank of Chicago had increased savings accounts in May in excess of one million dollars per day. They said that they saw this happening but did not really change their method of operation.

Their records show that their public customers purchased approximately $6,000,000 in OTC securities as principal and $1,000,000 as agent in May of 1961; they sold $3,000,000 as principal and $2,300,000 as agent in May of 1961. In May 1962, prior to the 28th, they purchased $2,300,000 as principal and $870,000 as agent; they sold $766,500 as principal and $1,500,000 as agent. Stated another way, the business fell 50%, but the ratio of buying to selling remained about the same. However, principal sales in the latter period dropped as a percentage function of principal buying in May 1962 compared to May 1961.

The firm's investment account is not significantly changed during the period May 1961 - January 1962, except for slight shifts in special situations. It appears that Becker made the same number of markets approximately in May 1961, January 1962, and May 1962. The greatest change was in the kind of markets made rather than the number. They have also supplied us with & chart showing their buying and selling for each of the companies which they make markets in equity securities.

In the period January - June 1962, it appears that for the most part the firm generally neither increased nor decreased its positions significantly in 95% of the securities or, which it made markets. They explained that the reason for this was not only to limit their capital investment but also to try to trade, after reaching a certain level, from a generally steady position and not to accumulate or sell off significant amounts except in times of particular need.

Becker did not feel there was any short selling by brokerage houses in the street. Their customers cannot go short because settlement is required in seven days and they will buy them in if there is an attempt to short sell. Of course, they stated that fails to deliver by brokers increased substantially in 1961 but they think that that primarily was due to the tremendous volume of business and the delays caused by administrative difficulties. They could not, however, comment on the smaller New York wholesale trading houses re short sales during the market break because they did not have that many transactions with such firms.

They supplied us with a detailed breakdown of the volume of sales and purchases May 28, 29 and 31, 1962. This breakdown shows sales, and purchases by individuals and sales by institutions on a principal basis, on an agency basis by shares, dollar amounts and number of orders. A copy of such schedule is attached. In general, the chart shows that there was not a significant amount of public selling pressure. In fact it appears that in each of the three days studied, there was more buying power than selling pressure. This is particularly evident in their principal transactions, which, for the most part, are in securities in which they make markets lowering its quotations. They stated that their markets were thinner, were subject to change quite rapidly and in general were lower on little volume. They said that this was so whether the securities were sponsored or not. There were only two securities in which they made subject markets. A subject market according to Becker has the effect of suspension of trading on an exchange. They stated that on two securities they had to make subject markets because the markets were fluctuating so enormously that they were unable to even make a reasonable determination as to price. These securities fluctuated between $30 and $45 a share on one day and it was impossible for Becker to know at any point whether their market was or wasn't in line with other broker-dealers. This was accentuated because they couldn't communicate with other broker-dealers and determine what the market was. Generally, they said that the New York markets were similar to theirs and that firms did the best they could under the circumstances.

They commented to the effect that although Troster Singer appears in the sheets on 500 issues, it doesn't really make markets in any more than about 50 securities from inventory position. For the vast majority of others, it appears in the sheets and acts mostly as a middle man with practically no position. It acts as an "in between" broker who can execute for you because of the large wire system built up over the years. They said that many of the firms in the street who were so called large wholesale and trading houses did this and could not take positions in the vast majority of securities because of limited capital. They said that in such securities, of course, the wholesale trading house is worthless and cannot really form any kind of stabilizing function.

It is the philosophy of Becker not to buy up to its limit in the time of the sharp decline. This seems somewhat inconsistent with their previous comment whereby they explained that they wished to have cash available to meet emergencies. They reconciled it to some extent by saying that the cash would be used to buy securities later on balance after the market turned somewhat, but not to buy it during the severe drop. The turning of the market would be reflected by Becker's customers and others buying. Becker stated that they would save the money for another day when the retail customers really started showing an interest in the OTC securities again. This hypothesis or consent might be analyzed further since it appears in the interview which followed the Becker interview there was very significant public buying interest shortly after the sharp decline, but this retail buying interest (which was four times as much as in the previous month) did not cause the firm to begin to buy on balance and use its cash for that purpose.

Becker said that even in Chicago communication was poor between firms, that many firms were subject on all of their issues and some only on a few. The subject markets, of course, caused extreme delay in execution and was one of the contributing factors to the bad communication and the lack of transactions. Becker said that most all of the wire houses, such as Blyth were subject, which, in effect, made executions almost impossible.

They said that they were not making any markets in unsponsored securities by May 25. They stated that they just went about doing the same kind of things in the time of sharp decline (except as previously described) as in normal slow decline or normal slight rises. In this connection they stated, in response to a question, they considered themselves to be doing a good job from January through the 25th of May by keeping an even position in buying and selling small amounts of stocks from their position. They said that they believed that if the firm did the same kind of job through all kinds of markets including those, of sharp breaks that was perfectly consistent with what they considered to be their responsibilities. They said generally that their firm does not have enough money, nor does any specialist have enough to take all of the stock which probably would hit them if they stood up to a declining market. They stated that at the present time the market is thinner than it was about a month ago, that it had a slight rally after the sharp break but it is now going down again on little volume. They said that in their stocks the prices are slightly above the lows. They stated generally that the retail buying power is the critical determinant of OTC securities whether it be solicited or unsolicited. They said that the wholesale house and even their own merely follow the retail public demand and there were very few changes in money positions by the firm over the years. (This was somewhat belied by their own records, however, which show executive meetings authorizing substantial increase over the years in authorized long positions.) After further discussion of this matter, they said that there is no question that the long positions taken by the dealers have a significant effect on the market, but those long positions will be taken only if the dealer believes there will be sizeable retail buying power throughout the industry or in his own firm for those securities or for securities in general. They said that they believe that there was not much bank selling at times of the market break but that their firm shouldn't be interviewed re this particular area since most of the banks would sell to one of the wholesale houses on a liquidation rather than to a mixed house such as theirs.

[exhibit omitted]

PETERS, WRITER AND CHRISTENSEN, INC.
Denver Colorado (5th Interview)

The interview was held at the offices of Peters, Writer & Christensen in Denver, Colorado, on July 26, 1962. I was accompanied by a member of the Denver Regional Offices. Mr. Erikson, Peters, Writer & Christensen makes markets in about 70 securities, although its OTC-3 incorrectly states that it makes markets in only 20. The reason for the error was because the firm listed only those stocks in which they consider themselves to be sponsors.

The firm compensates their traders on a straight salary basis with a bonus based upon the overall business done by the firm. The reason for this is because they feel that in their trading operations most of the business is accounted for by retail customers as the result of solicited orders. These orders are executed through the trading departments. It was deemed inappropriate to give the profits of such transactions to the wholesale trader. They stated that the firm has a practice of marking up its offer on a principal basis to a customer for example, if it makes a market in a security. On occasion if, for example, the quotation is
7 to 7 1/2 the price to the salesman will be something slightly under 7% plus the NASD mark-up. The firm does not distinguish transactions in stocks in which they do not make a market or in which they do not have an inventory. In these securities they mark up on a principal basis as permitted by the NASD. They stated that the reason for this is to permit the firm to have a higher percentage of profit on each transaction. They stated that the retail department is far more significant than its trading department although they make markets. They stated that the trading department is profitable even in the inter-dealer business, but it is not very substantial because its markets are somewhat limited as in the capital to enjoy a sizable turnover with other dealers. It should be recognized, of course, that in most cases the security sold to a retail customer has been acquired from another dealer, and not from a retail customer.

The firm is set up in two separate corporations. One of the corporations is a member of the NYSE; the other is not. The agency business is done with the firm on the NYSE; the principal business is done with the firm which is not a member of the NYSE. The reason for the distinction is because the NYSE capital requirements are more stringent than the SEC's and the firm might have difficulty in meeting the NYSE capital requirements on its underwritings. Therefore, it established the policy of placing its principal business in the non-member firm, thereby avoiding the New York Exchange capital requirements. The firm stated that it puts all of its agency business into the NYSE, including its OTC business.

The firm's records show a $450,000 drop in inventory including municipal bonds between January 1961 and May 25, 1961 (from $1,271,000 to $813,000). They said that this drop was not because of a feeling of softening in the OTC market (although they stated that they knew this was occurring) but rather simply because the chief trader was going on vacation toward the end of May and the beginning of June. He, therefore, sold on balance for the two months prior to that point so that the firm would have a very low inventory. Actually, the firm indicated their inventory overall is quite high (in excess of one half million dollars in OTC industrial stocks) for a firm of its size. There has been significant pressure by certain members of the firm that the inventory should have been cut even further.

The chief trader stated there was no difference in the liquidation between the sponsored and unsponsored securities. He tried to keep his purchases to a minimum and did not distinguish in his liquidation between either of those two classes of securities, although he did liquidate completely a few unsponsored stocks.

The firm was advised by its correspondent firm in New York, Shields and Co., that according to Shields', the firm seemed to be much too high in its inventory for a firm of its size, and they were advised, or it was suggested that it might be prudent business practice to liquidate. However, aside from this comment, there was no official suggestion by either the New York Exchange, the Midwest Exchange or any other entity that their inventories were too large or that they might consider re-evaluation of some of their long-term positions.

The firm has a correspondent relationship with Scherk Richter. That relationship, however, does not involve Scherk going into the sheets for Peters. It merely is an open wire to St. Louis. There is a sharing of the cost of the wire. The purpose is to permit St. Louis firms to call Peters through the Scherk wire and vice versa, thereby avoiding long distance charges. The open wire costs $250 per month. The calls are for two purposes -- (1) it permits a St. Louis firm to determine through Scherk what quotations are being made by Peters, Christensen, and (2) it permits the caller to execute a transaction through Scherk will give up the name of Peters, Writers, Christensen.

The trader stated that if Scherk made markets in a given security, he would probably execute with them in filling a customer's order. The trader stated that he would always give Scherk the "first crack" at a transaction and would attempt to execute with them. He said that in times of activity, there is no time for checking markets and firms usually execute with their correspondent without checking other firms who also make markets in the subject security. He also said that the fact that he goes to Scherk so often to execute his customers' orders is one of the reasons why Scherk is willing to pay the $350 expense of its part of sharing the open wire to Peters, Writer.

The firm did not reduce it investment account inventories during the period May 1962 through May 1962. Any reductions which occurred were not the result of the general erosion of prices in those securities.

The trader lowered the firm's trading position by making small markets on the bid side, and then lowering quotations quickly. He said that he was able to liquidate fairly easily by following that pattern. The firm stated that although the firm makes markets in about 70 securities, Peters, Writer might only list 25 on any one day since that is the maximum they pay for with the NQB. They say that in some securities the firm appears every day, in others once every few days. Generally, the ones that don't print in the sheets are low or zero inventory or are quite inactive. As a general rule, however, if they do not appear fairly consistently, it is an inactive stock and is not significant to their business. They said, for instance, that in most local stocks it would be a waste of money to put their name in the sheets since it had no national interest and everyone locally knows of their interest.

Generally, within the year period between May 1961 and May 1962, the firm made about the same number of markets. However, they would not purchase in as large amounts (over 100 shares) in April or May or even in March 1962 as they would in the same period of the preceding year. They said that in March and April they might drop their quotations as much as a point or more in certain securities after having been hit with a hundred shares. They felt that many other firms were doing the same for some time prior to the market break and it was this feeling which made them tighten up the size of the markets that they made. Along with that, of course, was the fact that their spreads widened considerably in the spring of 1962, compared to the earlier period. The trader stated, however, that this might have been because he was going on his vacation and wished to liquidate any way and it is hard for him to separate exactly the motive for the wider spreads.

The position was expressed by the firm that the retail house makes a better market because they have the clientele to dispose of the inventory though solicitation. The firms say that they give no extra compensation for liquidating their inventory and that even the wholesale trading houses must indirectly must have solicited customers in order to take positions.

According to the chief trader he felt that there was very little short selling by the large retail houses in the spring of 1962. However, he felt that the smaller wholesale houses were selling short to some extent in the spring of 1962. He said that he felt that this activity was not more than normal, that historically smaller wholesale houses, particularly in New York do try to play against the market by going short and hoping for a speculative gain. He expressed the opinion that he did not want any margin in the OTC market because it would increase its speculative nature though he stated that he felt that the larger firms might disagree with him.

He has supplied us with considerable figures which relate his inventory position in non-exempt securities (non-municiples) from May 15 to June 15, 1962. These figures indicate quite clearly that the firm was buying on balance from the 15th of May through the 25th of May (from $649,000 to $718,000). When the market broke, the firm made all subject markets and they dropped their quotations on thin pressure; they widened their spreads immediately. (By June 15, they had reduced inventories to $536,000.) They said that the wider spreads were out of sympathy to the market drops in other securities; that the lowered quote did not reflect a particularly large volume of selling pressure of even attempted selling. They stated that they could not buy securities or act as a stabilizing function. They stated that they had no desire to do so, and that their only obligation was to keep an “orderly market." In this connection, the firm stated that it was not the policy of the firm to stabilize when the market is going up. The chief trader stated that it was a fiction to think that when the prices are going up in OTC securities and the firm has a long position they would thereby sell off their long position and make shares available to the open market. The trader stated that this was not necessary to be done and the firms would more or less keep a high bid rather than doing anything to retard the decline since the higher the price the more value was the inventory which they held in position.

As noted above, the firm sold on balance after May 25; they state that they reacted exactly like the public and no differently in times of a sharp break. They said that they could not be expected to do better and that the non-liquidity which occurred because of the sharp quotation change might have made for a better market. They said that they could not take the chance of holding their prices and being hit with large sell orders which might have occurred had they tried to hold price. They stated that on May 31st there was four times as much public buying on that one day in their firm as on any other day during that month. Indeed the selling pressure on May 31st was not significantly higher than the selling pressure on most of the other days in May. In fact, on May 1, 2, 4, 10, and 28 the public sold more on those on those days than they did on the 31st. Indeed the record shows that the selling pressure on the 28th was exceeded by four or five earlier days in May. I asked the trader whether his prices went up accordingly on the 31st. He said that they did not and there was little question but that the prices went down on little volume of selling pressure, but did not go up on high volume of buying power. I asked him whether this caused him to reach any conclusions concerning the operation of demand and supply. He stated that his firm might have been an exception with the heavy buying power but, at any rate, the firm had not reached the decision that it would be wise to buy on balance following the lead of their customers.

The firm stated that it was almost impossible to communicate with other firms the day the market broke, that the markets were subject, that teletypes were overlooked and so busy that one couldn’t even get into New York Hanseatie’s trading room to execute, let alone check markets. He said that with non-wholesale firms, such as Shields and Co., who are their NYSE correspondents, it was an absolute impossibility to get any kind of an OTC quotation, that the system of communication was totally inadequate and that a firm could not grasp what prices were in a given security, which firms were making markets of for how many shares. Under the circumstances, Peters was not about to make firm prices at decent spreads. He stated that in sponsored securities he felt that the firm had a requirement to make an orderly market. I asked him what this meant and he said to prevent wide drops or rises within one day or perhaps to prevent severe fluctuations within a short period. However, he said this only applies to times of slowly declining or slowly rising markets, but that his firm fails as does any other to maintain anything like an orderly OTC market in days of sharp decline of prices. The firm believes that under normal circumstances demand and supply does operate well in a system of excellent communication. For example, he said that if one broker-dealer in New York buys 100 shares, he lowers his quote 1/8. Every other broker-dealer because of the fast communication system knows that there was a buy executed. They also therefore immediately lower their quotations accordingly, thereby reflecting buying power showing the consummated transaction.

According to Peters the markets were very thin in June 1962, and there was very little retail buying. This severely restricted the willingness of the trading department to buy on balance. He said that if there was a sizable retail business that might change. However, the firm did not explain or could not explain the sizeable increased buying power which did not result in a firm decision to start buying on balance. The chief trader is the chairman of the NASD District Quotations Committee. He stated that the newspaper quotations are a waste of time and that they are totally inaccurate, that he puts in quotes at 9 a.m., and they do not appear in the newspapers until the morning edition the following day. He said that he is not required to check other markets, that he marks up approximately 4-5%, and that he is only expected to make a quotation something similar to that of his competitors. He stated, of course, that on many securities his firm is a leader and not a follower so that on those securities his firm really is the market and his quotation will determine what others will do in their securities. He said that it was of little value, he believed, to the firm or to the public except to give the public some general idea of the approximate price range which the security would be selling. He stated that some firms put inside quotations into the newspapers because their regional districts permit such activity. He said that his region does not do so but puts in the outside quote +5%.

[exhibit omitted]

Boettcher and Co.
Denver, Colorado
6th Interview

Boettcher & Co. is a member of the NYSE and is one of the largest and oldest firms in Denver. It makes about 25 or 30 markets in Denver, Colo. Basically the firm is not a high turnover wholesale trading house in these securities; rather, 80% of its sales from its trading account, go to its retail customers. Its trading department is merely a service for its retail department. The firm markets in about 36 securities in Chicago. These are mostly insurance stocks and gas stocks and the markets made in those cases are similar to the typical wholesale trading markets where the bulk of the buys and sells are done with other dealers. Of course, in this prior category (the Denver stocks) the purchases of the stock are made from other dealers. The disposition goes retail.

The company has a correspondent in Chicago who does certain clearance work for them. They do not lay markets for their correspondents nor vice versa. They are a Loeb, Rhoades NYSE correspondent which puts them on the Loeb, Rhoades wire system. This means that any other member of the wire system can communicate with them by dialing into the Loeb, Rhoades wire in their particular city.

The traders of the firm are paid on a salary basis plus a bonus. The bonus is computed on an overall basis and not on the profit in the trading.

If a market is, for example, 20 bid, 21 offer, the firm will offer it to the customer from its inventory at some price between 20 and 21 plus a mark up which will perhaps cause the price to be about 21 1/2. They stated that they usually do not mark up over the offer side but mark up somewhere between the inside bid and the offer. The firm stated that it treats riskless transactions on a principal basis but lowers the mark up to 3 %, and then only if the transaction is solicited or if the firm or the salesman has done research or put out a market letter re the security. Otherwise, if completely unsolicited (if the customer comes in off the street and asks for a particular security which is not in inventory and which the firm has not researched and in which the salesman has not expended any effort), then the transaction will be on an agency basis. Basically, however, whether it is principal or agency will be left up to the salesman and the client within the general limits of the firm policy. There is no definite policy re which are principal and which are agency except for the guidelines set forth above.

The firm stated that one of the reasons why the traders are not compensated on a commission basis is because that it was quite obvious that it was merely a service to the retail department and that it was the retail salesmen who were really generating the business. The reason that the company made markets was so that they would be able to purchase on the bid side and sell with the mark up over the offer, or close to it. If they were not in the sheets and if they did not make markets and take long positions, the firm would have to purchase the stock as someone else's offer and add either a commission or mark up. While the price paid to the customer would be the same (except for agency transactions), the firm would make less money since the firm would have a higher cost. The firm makes an effort to avoid taking long positions which can't be liquidated.

It has very specific limits on what positions it will take. The reasons for this is because if the positions have to be liquidated, they must be liquidated by initiating the call and hitting someone else's bid which generally is bad business and something to be avoided. The firm therefore is very circumspect in not taking much more stock than it can reasonably expect its customers to purchase from them.

Generally the firm does not pay extra compensation to their salesmen.
If they wish to dispose of stock held in inventory they merely keep a lower bid and a lower offer. I asked them how their Chicago office operated compared to their Denver office re retail customers. They said that the Chicago office had no retail customers and that the Denver office had practically all retail customers. They said that Chicago made better markets. However, they stated that the solicitation of the retail department did help in Denver because of the lower caliber of the stocks. That is to say that the Chicago office had higher caliber nationally known stocks and didn't have to rely on the retail department while the Denver stocks were of much lesser known quality and therefore required retail solicitation to keep up an active market. The firm said that if they had to choose between solicitation and making a market, they probably would solicit customers to buy the stock. It is quite clear that the market making function is only performed so that the firm can make a larger profit on its retail business. The firm also stated that when they are market makers, they can more readily know whether the quotation of a particular dealer is in line with the rest of the market. The firm, however, believes that its customers are getting proper executions in those securities in which they were not making markets.

Generally, the firm stated that it did not want to tie up its capital unless it could get a good return on their investment and that the good return was only assured if they could solicit customers.

The firm stated that there was a slight increase in the number of markets made in 1961. They said that the markets in the OTC market in 1962 were much thinner than in 1961. Generally the firm kept the same positions in 1962 compared to 1961. The difference was that the 1962 markets didn't have the activity of the 1961 markets so the quotations were more quickly changed after the first 100-share transaction. They said that the spread between the bid and the ask was about the same because the bids and the offers were down. The firm stated that it rarely does any short selling, that there was some short selling by the wholesale traders (which they believed to be a healthy competitive factor in the market). They stated that the firm rarely "buys in" a broker-dealer if he hasn't delivered but attempts to stay with him as long as possible. They did not notice any particular change in the amount of short sales in 1962 over prior periods. They stated, however, that they would not have definitive answers on this question since most of the short selling would be done by the small wholesale traders in New York City and they dealt with those firms only in insignificant amounts.

The figures they have supplied us which are attached as Exhibit 1 are self-explanatory as to the changes in their business. They include the stock purchased by retail customers in stocks in which the company made markets as well as those in which they did not make markets. Basically the figures show a slow decline in selling of retail customers in equity securities, and a parallel decline on buying, which was reversed in May 1962. In that month the buying power increased, substantially both in relation to selling and in comparison to prior periods. The firm believed that the large customers were buying stock and the small customers were selling stock.

They said that there were a number of cancellations on limited price orders by the buyers which helped accelerate the decline during the market break. They made a few markets which were subject and said that by and large they stood by their markets. The firm widened its spread considerably. Because of the problem of communication between Chicago and New York, they were afraid brokers were checking both their offices and bidding one against the other by buying from one and selling to another or getting quotations from one which were not the same as the other office.

Therefore they had to go subject on certain stocks to check their own wires. The principals of the firm say that when the NYSE stocks dropped they dropped their quotations out of sympathy to the general over-all market-drop. They said that they did not wish to sell their inventories at a loss and so merely bid themselves out of the market. They said that they watched the tape and that they saw no sizeable buying power from their retail customers.. They said that while the retail customer’s business was slightly over normal that there was certainly no significant selling pressure. They were concerned, however, with the lack of real buying power so they merely quoted themselves considerably lower on no-volume. There was, however, sizeable buying power on May 31, 1962. The company, however, didn't raise its quotations as much as the buying power would have generated at other times nor did they raise the quotations as much as they had lowered them when the market broke on previous days. The company said that it wanted to retain its cash and to make up for some of the losses which they absorbed on the 28th (price erosion). They said that they made this decision on the basis of what was good for the firm.

The firm policy at this time reserved cash until a more definite market turn appeared. They said, of course, that they had a responsibility to their clients but not to outside trading houses or professional houses, during the break. Therefore, when the market was dropping in the 28th, they felt that when they lowered their bid they were preventing the wholesale traders from “picking them off” and unloading their own, that is, the wholesale traders, inventories, on Boettcher. Since there was no substantial selling pressure from customers, they felt that customers weren't being hurt. The firm stated there were very significant difficulties in communications and that they were unable to get any quick quotations from other broker-dealers. Therefore, many customers were unable to execute orders immediately and retracted their orders because of the time delay. They said that the wholesale traders were reducing inventories considerably, that they were obviously sellers on balances and that, this was the reason why they (Boettcher) lowered their quotations. There was no doubt therefore that they quoted Troster Singer differently than their customers in stocks in which they made markets. They said that wholesale traders were given the worst markets. Therefore they assumed that the wholesale traders made their market accordingly. Generally they said that when they have an order in which there is a sizeable New York market that they will call their trading desk in New York and he, of course, immediately will go on the Loeb, Rhoades wire. They find, however, that Loeb, Rhoades prices aren't as good as they can get elsewhere and even though they have the Loeb, Rhoades wire they will call one of the other trading houses in New York. In this connection they said that if they did not have a New York office they would be at a considerable disadvantage because they would use the Loeb, Rhoades’ wire, which would be free. If they didn't like the quote they would have to make a series of long distance telephone calls to get a better one. They stated that at the present time there were obviously some good buys in the OTC market but they decided not to take a position in such securities although they might recommend those securities to their customers. They said that they hope that they will receive the sell orders on such securities and they will be able to purchase them at their bid rather than having to go out into the market and buying the stock at someone else’s bid. They said that they would wait until buying power is created in the retail department before they start investing their money again. With respect to banks, they said generally that the banks were not selling in the market break, that calls were made to individuals and that the individuals might have been selling in order to liquidate some loans. They had no specific information however on that subject.

Boettcher's records, which are attached to this memorandum, show that in May 1961, their customers (representing individuals and institutions combined) purchased and sold in excess of $7,000,000 worth of securities of which $3,000,000 were sales and approximately $4,200,000 were purchases. In January of 1962, their customers and institutional clients purchased and sold approximately $4,400,000 in securities of which approximately $1,900,000 were sales and $2,400,000 were purchases. In May of 1962, their records show that, there was approximately $1,710,000 in $1,710,000 in sales and $3,300,000 in purchases for a net total of about $5,000,000.

It should be emphasized that the public buying power in May of 1962 was greater than the public selling pressure for the month as reflected by the retail clients of the firm. This figure represents both principal and agency business. The above material only refers to transactions through Friday the 25th of May and does not include the days in which the market broke sharply. On the day of the market break itself, May 28, 1962, individuals sold $94,000 and purchased $167,000. On May 31 individuals sold $40,000 and purchased $202,000 in securities or five times as much as they had sold on that day. This buying power was not reflected pro rata in the firm's quotations.

[exhibit omitted]

7th Interview
Dean Witter & Co.
Los Angeles, California

Dean Witter & Co. is a member of the NYSE. They do not any open, wires with any other broker dealer. They do not have any correspondents re their OTC business. They have 43 branch offices and have wires into those offices. They state that they are not an active trading (wholesale) house but that their trading department is primarily a service to their retail customers. They make new markets in Chicago (6). The markets laid in New York in (illegible) NQBS are really California markets which are reported in New York as a service to dealer interest in California issues. The trading is done from California. They make about 50 markets in California of which approximately 80% are in issues underwritten by Dean Witter. Most of their underwritings have been in West Coast companies. Therefore, most of their markets are reported in the Pacific Coast sheets of the National Quotation Bureau Service.

The firm pays its traders on a salaried basis. They give such persons a bonus at the end of the year which is not necessarily based on the activity of the trading department. It is based on the firm’s overall business. In 1961 the traders received, along with all other persons who were with the firm for more than five years, a 3 months’ bonus.

The firm marks up 5% over the inside offer transactions out of its principal account to customers. In securities in which it does not make markets it executes on an agency basis unless the firm or salesman does some soliciting in which case the firm will allow a principal mark-up of about 3%. If the salesman or firm has done research, the salesmen will ask the firm to permit him to execute the transaction on a principal basis. A special list of "researched" securities is maintained of the firm. All securities on the list may be sold to customers on a principal basis. The managing partner, Mr. Taylor, explained that often the salesmen will attempt to have him include as one of the "listed" stocks, one in which he personally did significant research. Usually such requests are turned down.

The firm said that it does not put all of its markets in the sheets since it would be a waste of money to do so. It puts the most active securities in the sheets. However, the "street" usually knows of their interest or knows that they underwrote a specific security and often will call because they know of their prior relationship and because they know Dean Witter’s policy of making markets in issues which they underwrote. They stated that on occasion they go into the sheets when they have no position to attract buy or sell orders for an account of a client who wishes to buy or sell a large block on an agency basis.

The firm supplied us with extensive charts and tables showing various inventory positions some of which are attached to copies of this memorandum. Their record shows that the firm was $550,000 long and $110,000 short in May of 1961. On January 29, 1962 they were $376,000 long and $112,000 short. They said the liquidation occurred because of a decision to sell off at the end of the fiscal year (January 31, 1962). Usually January 31 is the low point in the year. Generally their inventories increased slightly through the week ending May 14, 1962. For the week ending May 21, 1962 inventories fell off somewhat but not because of any attempt to liquidate but rather because of softening of prices during that period.

The firm’s investment account did not change in the period May 1961 to May 1962 except for special purchases by the firm. Taylor said that generally there is no extra compensation for salesmen when the firm wishes to dispose of its inventories but that the disposition is usually done by lowering the bids and generally widening the quotations in a hope to dispose of their holdings. The interviewee was not one of the traders of the firm and appeared not to have all of the available facts concerning what happened in the OTC market in his firm with respect to size of positions or size of markets in the market break. It was his opinion, that neither the firm’s positions or size of markets changed between May 1961 and May 1962. He said that even though the retail business fell off, he thought sure that his firm was still making good markets. He said that his firm usually buys from other broker-dealers and sells to the public customers -- that they are not primarily a trading house. He stated that as far as the salesmen are concerned they made a greater profit if they could sell from inventory. (It made no difference whether or not they were in the pink sheets advertising the name. The pink sheets serve only as a vehicle which permits them to advertise the fact that they were willing to take securities on the bid side.) He stated that the reason they made markets and the reason that they go into the sheets was because they had to have some method of making money and compensating the firm for its research. They stated that if they did not do so, then they would have to execute transactions on a commission or agency basis which would severely limit their profit potential. Taylor said that the firm would always have to buy securities on the offer side of the market in agency transactions and that therefore their compensation would be limited to the inside offer plus commission rather than the bid plus mark-up. If they always had to ask for securities, they would always have less profits since they would always be purchasers at the inside offer. I advised that the firm could not answer question number 5 since it would involve too much time and work to determine the public buying and selling volume of OTC equity securities from May 1961 to January 1962 and May 1962. However, the firm did supply us with a complete breakdown of all of the transactions for May 28, 29, and 31 of all of their branches with clients and institutions in the most active securities in which the firm made a market. At the present time I have not been able to review such records but, they appear to be quite detailed and will supply us with a good picture of what the firm did in the active securities and what their clients did by way of selling pressure or buying power on those three days. From a cursory review it does not appear that the firm was subject to extensive selling pressure in any of the securities in which they made markets.

The firm also supplies us with a memorandum which spelled out exactly the relationship between principal and agency business of the firm. As far as I can determine the firm has completely inconsistent standards. On one hand they say that if a client initiates a buy orders the transaction must be on a brokerage commission basis. However, the memo says that on transactions in which the firm maintains an active market the mark-up cannot exceed 5%. I asked the interviewee how the transaction would be executed if the client initiated the order without any solicitation but the firm made a market. He said that it would have to be on an agency basis. He did not explain item C and he would not agree to any inconsistency.

[begin text of referenced memo]

May 22, 1962
MEMORANDUM TO: PARTNERS, ACCOUNT EXECUTIVES AND TRADING DEPARTMENTS

FROM: EATON TAYLOR

To further clarify our policies and ground rules on over-the-counter trading, we must make clear our position to clients as to whether we are acting as principal or broker. Both principal and agency transactions will be handled as follows:

a) The laws of agency cannot be violated. When a client initiates a buy order, he expect you to be his agent, and the transactions must be executed on a brokerage commission basis at the best price possible.

b) On so-called "riskless" principal transactions (sales to clients of stocks that we have underwritten or been active in retailing, but at moment not actively trading) the maximum mark-up shall not exceed 3%.

c) On transactions in issues in which the firm maintains an active market and carries inventory position, the mark-up cannot exceed 5%.

On (b) and (c) the trading departments will establish the profit credit on these issues. Please note the percentages shown are maximums and in many cases shall be lower.

These maximum mark-ups on both "riskless" and inventory transactions must include any profit or commission charged the customer for liquidation of other securities to provide funds to pay for the purchase. The N.A.S.D. rule covering this reads:

"In such instances, the mark-up shall be computed in the same way as if the customer had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased".

ET:aa

[end text of memo]

The firm stated that they were unable to comment on the extent of institutional buying since it was small. The firm said that its OTC profit for June 1961 taking into effect the evaluation of closing inventory was $302,000. For January 1962 it was $513,000. Profit in April 1962 was $361,000. In May of 1962 it was $227,000; in June of 1962 it was $245,000. They said that there was an erosion of prices in the last two months but that it was still profitable because 1) there was not a significant amount of buying by the firm and (2) they were able to widen their spreads and take advantage of the price differential. As a policy the firm maintains a substantial short position. Their clients may also maintain short positions in OTC securities. Dean Witter was not able to determine whether the wholesale traders were going short since this was a matter primarily known to the New York houses. They did not believe short selling to brokers to be significant.

They said that on the days of the market break that business was fairly light and that they were writing under 200 tickets a day which is about one-half of normal.

They said that the business on those three days was not much different than it was now and that in the falling market they did not aspect to do an overwhelming amount of OTC business. They said that there was not heavy selling pressure at all, that the buying power varied between certain stocks, and that in many cases the buying power might have been greater than the selling pressure although the quotations dropped. They said that the drops were out of sympathy to the drops on the big board and that they often widened their spreads so as not to be hit by other dealers who were unloading the inventories. They mentioned that through technical difficulties Blyth's wire to New York "blew a fuse" or had some technical difficulties which meant in effect that Blyth was making no markets at all for a period of three hours on May 28 in California. The firm did not make any subject markets. Taylor stated that it was almost impossible to execute agency orders for customers that telephone wires were busy, that the normal methods of communication broke down and that some customers revoked their sell orders. On the question of checking the market during the time of the significant market break, the interviewees stated that they usually wire the inquiry to their New York office who is supposed to do the checking. Two-thirds of quotations however, are requested by salesmen and not by customers. They, therefore, feel that they cannot ask their New York office to check the quotation because of the amount of time involved. Therefore the request for a quote will not be delivered unless it is marked OP (precedent) at which time the New York office will check the quotations of three markets. On the day of the market breaks, the New York office could not get into other houses to check and was lucky to get one quote from one broker, let alone a number of quotes from competing houses. They said that if they did not have an office in New York that it would have been impossible to even get one quotation. They stated that if a correspondent house is the only method of communication with New York, that the markets of that particular house will have to be relied on in a severe market break because the out-of-town broker-dealer does not have the time to check the market, let alone execute orders for someone else. They stated, of course, that many customers who put in market orders complained about the prices. They all stated that they put their market orders at one price and received executions at a touch lower price. Dean Witter on two occasions when the market was significantly lower at the time of execution than at the time of quotation made complaint and immediately received adjustments. They said that if they had made more complaints they undoubtedly would have received more money back for their customers.

The firm discussed at length the responsibility to its public customers and gave as an example its market activities in the common stock of Friden Corp., a company with already outstanding securities. It stated that when the market dropped prior to the effective date of the registration statement that Dean Witter kept buying heavily in the market to maintain the price. They said that they lost their own profit on the underwriting and they felt they owed the duty to the issuer to do so. However, it was to no avail and the activity probably won’t be repeated in the future. They stated that one of the ways that they might measure the degree to which a sponsor met his responsibility would be to determine whether the quotations were dropping without volume. They said that they held the price and kept the same bids and the same asks unless hit with selling pressure. I have not reviewed the records of the company to see if this were so. At the present time the firm is very wary of buying on balance and its markets are less broad and its quotations are lowered rapidly. The firm finds that the New York houses are backing away from sizable positions to some extent because they do not wish to be “stuck” with inventory. Markets therefore are lighter and business is about 50% off.

The firm stated that it makes an effort to avoid being hit by other dealers; if a dealer inquiry comes in to them for a dealer's account or for a customer they will tell the dealer who offers the stock to them that they will try to "work it off ." Witter does not care if a dealer is selling for their own account or if they are selling for the account of customers. So long as it isn't their own customer who wishes to execute, after 100 shares, the quotation changes. The firm stated that it has no obligation on its agency business to do anything except check the markets in these places. If it is a highly speculative security they do not feel that it is even their obligation to advise a customer that there are no public reports. They are strongly in favor of minimum capital and any system which would relate the minimum capital to the kind or amount of business that is done.

[exhibits besides memo quoted above omitted]

FIRST CALIFORNIA
San Francisco, California
(Eighth Interview)

During the past year the First California Corp. has made markets in 20 to 30 securities. Basically, these markets are made as a service to their retail customers and are not made for the purpose of profiting on inter-dealer transactions.

The company has Gregory & Co. as its main correspondent. Gregory will lay certain markets for First California in the New York area. Gregory will therefore receive inquiries from New York dealers and will give up in such the name of First California. Typically in such cases, the incoming caller speaks only to the person whom he calls and not to the long distance or foreign broker-dealer. He must therefore transact his business through the correspondent. This is the typical relationship and, of course, permits the correspondent to receive all information concerning transactions consummated or to be consummated with another broker-dealer. We were advised by Mr. Egan of First California that if a correspondent does not give up a name it raises a serious question as to whether he was trying to take the transaction away from the firm for whom it was intended.

Traders are paid on a straight salaried basis and receive no commission from their transactions. At the end of the year they will receive a bonus which will not be related to the profit ability of their transactions. The position of Mr. Egan is that to pay a trader on a commission basis will cost the client and firm money, and would ignore the fact that the traders are only a service to the retail organization. The firm, in most cases, purchases from other broker-dealers, (usually wholesale traders) and sells to their own.

The firm deals on a principal basis from its inventories re stocks in which it makes a market. The mark-up will vary with the customer. The mark-up will be at some percentage -- 3, 4 or perhaps 5% over the existing offer. On riskless transactions, that is, transactions where the customer on an unsolicited basis asks for a stock in which they, First California, were not making a market, the company will try to execute on an agency basis. Often salesman insist upon a principal transaction. If the salesman says that he has "worked on the transaction" or "worked on the customer", the transaction is executed on a principal basis. The purpose of making a market is so that the firm will be able to buy on the bid side and thereby have a higher profit by marking up over the offer. This is the reason for the market-making activities of First California and is the reason why the customer’s man will be anxious to solicit retail customers purchases since the margin of his profit will be between inside offer and the retail market. Usually it is between 40 and 50% of the differential. Usually there is no compensating mark down on sales. In May of 1961 the firm had an inventory of over $935,000. On February 28, it had an inventory of $1,400,000. On May 25 it had an inventory of $1,900,000. On May 31, it had an inventory of $1,880,000. It was quite obvious that the firm was buying on balance daring the spring of 1962 and such buying on balance caused the aggregate dollar amount of inventory to increase even though prices had softened in this period. They stated that the long position increased both in dollar amount and in number of shares in position. However, by July 25th, 1962, (two months after the break) the inventory was reduced to approximately $790,000. While it is true that some of this reduction could be accounted for by price weakening, the firm stated they were selling heavily on balance because they were too long in too many stocks with too much money invested. They made the decision to liquidate after the market break. The firm holds very few short positions (never in access of $30,000). The firm did not increase its short positions as a hedge against its growing long position.

The firm did not liquidate its investment accounts. In fact, they state quite accurately that they guessed wrong. The firm is not in favor of margin accounts and tries to discourage them as much as possible. It does not see any gain or benefit to have margin applied to OTC stock.

The firm states that if it had a over- long position that it would give its salesmen compensation or commission to liquidate that long position. They usually give some special additional credit over the normal 50% interest that the salesman would have in the mark-up. In such cases the firm loses some of its profits but the customer will pay the same. This practice is most frequently used if the firm has too long a position. It has been a typical practice of the firm to give salesmen extra compensation in the last few years to liquidate inventories if they are too high. They say that there is no question but that such activity stimulates the demand. They do not consider this a distribution within the meaning of 10(b)(6) and have not considered the applicability of that rule to the activity described herein.

The firm stated that the markets were much thinner in the spring of 1962 then in 1961. In 1961 the firm was able to acquire long positions and sell out the long positions immediately. In 1962 although the firm's long positions increased, they still did not believe the market from even their point of view was as strong as it was in 1961. It was quite difficult to retail out any of the long positions in 1962. Therefore, they acted accordingly and didn’t attempt to buy as much stock at a fixed price without lowering their bid. In 1962 they more often lowered the bid fairly quickly after the price had been hit for 100 shares. They said in summary, that in the spring of 1962 they took the stock in fairly large blocks but they lowered their markets downward as they were doing so which made the market thinner, as distinguished from 1961 where they took the block and did not lower the price of their quotations.

The firm stated that there was an extremely heavy loss in business in the first 3 or 4 months of 1962 in the volume of retail business done. They estimated that it fell off at least 40% over the prior year. They said that both buying and selling fell off and there was a general drying up of the OTC market. The firm stated that the customers were just holding the securities they purchased in 1961 and were not buying any more. They said that both agency and principal business fell off considerably starting in January 1962.

They said that short selling has been a factor in the OTC market by dealers only since 1960. Generally, the firm never permits short sales by its own customers. The firm stated that they were unable to determine whether the fail to delivers were a result of the break down in the administrative handling of securities or whether brokers were taking short positions as a hedge against market decline. They did not feel that there was heavy short selling on the days of the market decline in the area around San Francisco by the wholesale traders.

The firm stated that on the day of the market break there was very light selling from customers and very little business done by the registered representatives. However, there was a significant amount of calls made by customers asking that markets be checked in their securities. They found, however, for the most part few of these transactions were ever executed. This was particularly so in the OTC business. As an examples they said that over 9700 tickets were written on listed in OTC business in January 1961. In February there were 7600; in March, 7500; in April 6400; in May 7700. Twenty five percent of the May business was in the last three days. However, this was not significant. Most of the salesmen usually put on a great selling effort at the end of the month so as to raise their salaries in the coming paycheck. They said that many of the markets, even in the wholesale houses, were subject markets, that there was sizeable lowering of quotations and wide spreads. The firm stated that they cut their markets on no volume. Usually, however, they waited until at least they were hit with the first 100 shares before they lowered their quotations. There was a generally widening of the spreads particularly to other broker-dealers whom they were afraid were selling off their own securities to First California, in an attempt to liquidate long positions. They therefore quoted wider spreads to other broker-dealers they assumed to be sellers and lowered their bids constantly to them. They stated that they don't think there was much bank selling and they could not tell if there was a forfeiture or not because the banks do not indicate the nature of the seller or the reason for sale.

The firm stated that it probably would not make markets if they could not solicit retail customers since the only reason they are in the sheets making a market is to be of service to their retail customers. They said that if they could not solicit retail customers they would go out of the sheets completely. The firm expressed the opinion that Singer Bern was making excellent markets in New York on the day of the market break and probably much better than anyone else. They said that Blyth and Loeb Rhoades and firms of that type had an easier job of making markets in normal times since they had what was referred to as the "big wind" of retail buying power which enables them to buy on balance. However, when the market broke this fell apart completely and it was left to the wholesale trading house to do much of the buying particularly in the event that they wish, to retain business from other brokers.

The firm commented that the theory that a firm should check three markets is generally ignored and that it was a theory applicable only to trust departments of banks and not to any wholesale or even "retail" traders. They said, for example, that if you had an open, wire to Troster Singer or Singer Bean, it would be highly unlikely that you would use the open wire to check Singer Bean market and they pay for two more long distance phone calls to check two other markets. Most likely you will merely execute with Singer Bean and leave it at that. If you were to shop around the street would immediately know that you were checking bids.

That would get back to Singer Bean and the quotation would immediately become higher. In short, the firm said that the street would "'raise the quote" if you were known to be a checker of the market particularly against your open wire correspondent. The firm stated that it would have been impossible for them to have made anything but subject markets at the time of the market break. They stated that it was impossible to get through to a correspondent since many of the lines were busy and it was impossible to have a correspondent check markets for you. As a result of such time delays it was difficult to determine what your quote should be in your own trading activities. You had to make your markets subject so as not to be finessed by other broker-dealers whose markets couldn't be checked through your correspondent system. In short, the correspondent couldn't communicate with other broker-dealers fast enough and report back to you quickly enough.

The firm stated that it has some responsibility to act somewhat like a specialist in times of market decline. The firm, however, felt that when the market leveled off, it should liquidate its inventories. It did so slowly and the price of the subject securities declined but slightly. It said that now that it has cash, it will invest if the retail business will pick up and not before. When the salesmen feel that stocks are at a low enough point they will recommend and then the firm will buy. They said that very frankly that point will be reached when salesmen get "hungry" enough to have to push stocks in order to make a living again. They said that the market was very quiet at the present time and that there was no real noticeable buying power. They said that they sold off most of their inventory to dealers and to customers on salesmen as recommendations. They said that they were able to sell to dealers perhaps because many of the dealers were using the stock to cover short positions accumulated in May. They felt sure that the other retail houses were not creating buying power sufficiently great to permit wholesale traders to take substantial long positions at the present time.

J. S. Strauss & Co.
San Francisco, California
9th Interview -- August 21, 1962

J. S. Strauss & Co. is a member of the Midwest and Pacific Coast Stock Exchanges. It is not a member of the NYSE. J. S. Strauss & Co. is a dealer primarily in listed securities. It acts as principal in 95% of its transactions, as agent in 5%. In Mr. Strauss' opinion, his firm performs a valuable function by competing with the NYSE and the ASE. He stated that his firm's executions are almost always better for customers than would be Exchange executions. Strauss states that they have four main classes of clients--first, other broker-dealers; second, banks; third, mutual funds; and fourth, pension funds. Strauss & Co.

straddles the last Exchange price. For examples if the last price was $51, they would make a market at 50 3/4 to 51 1/8, or 51 1/4. They try to keep lower than half a point spread on stocks in the $50 range. They try to keep lower than a quarter of a point on stocks under $50.

In general they write more tickets with other dealers than they do with any other type of customer. However, by far the greatest volume of their business is with institutions and not with such dealers.

The markets they make are the same for odd-lots or round-lots. The spreads usually will not vary depending on whether it is a round-lot or an odd-lot. In their opinion the customer will save whether or not it is odd-lot or round lot. It is their aim to straddle the last transaction on the tape and to make sure that the amount over the last transaction compared to their bid or offer will be less than the NYSE commission.

It is not only their belief that not only would customers benefit if the security were sold at the tape price, but they contend, if a customer shows he is a buyer or a seller they will drive the price down or up as the case may be to the seller's or buyer's disadvantages particularly on a large block. If this happens the seller or buyer all the more will save by executing with Strauss, Stuart Miller, or Weedon & Co., etc.

When I was in the office the tape price of a NYSE security was 38 3/8. Straus bid 38 1/8 - 38 5/8 to an incoming caller (I believe the Chase Bank); the caller sold to Strauss 1,500 shares at 38 1/8. According to Strauss, the bank made a sizable profit, because even if the security were sold on the NYSE at 38 3/8, the commission would be more than 25 cents. It is the argument of Strauss that the seller made even more because the minute he showed that he was trying to sell 1,500 shares, the specialist would have lowered the price. Strauss is convinced that the institutional buyer or seller must communicate with the specialist first and know whether or not the specialist can buy or sell at or about the last quote. It is only after evaluating what the specialist can or will do that they decide to go to the OTC market and execute the transaction.

Strauss said he has difficulty in obtaining bank business because the banks, he understands and has been told, were approached by the Exchange and were advised its members would look unkindly to transactions in listed securities in OTC market. One particular bank stated that it had a fiduciary duty to its clients and refused to go along. After some discussions with the Exchange and the higher officials of the banks it was agreed that the bank would execute on the OTC market after it had tested the exchange members and specialists and determined if the price of the OTC market was better. Mr. Strauss feels that the whole problem of reciprocal business has hurt his firm and the industry and that if it were not for reciprocal business and the related pressures, the OTC market in listed securities would be a strong competition to the NYSE. He stated, of course, that if the minimum commission schedule were revised downward, he would have a much more difficult task as he would constantly have to lower and tighten his spreads to the point where it might not be profitable. He said that at the present time, however, the commissions are so significant that he can help buyer or seller merely by charging less for his service. He made it quite clear that he charges banks and institutional clients and other broker dealers the exact same price. This means, in effect, when the non-member broker-dealer buys from him the broker- dealer will have purchased stock at a price less then he could have bought it on the NYSE since he doesn’t have to pay a NYSE commission. However, the broker-dealer then may mark-up to his customers. The ultimate public investor therefore may be paying more than he would have to pay on the exchange or less depending upon the relationship with his broker-dealer. However, Strauss says that he has nothing to do with this. All he knows is that he sold it at a price less than it would be executed on the exchange and he has no responsibility toward the buying or selling broker-dealer's relationship to the customer.

Strauss said that depending on how good the customer was would control his willingness to give the customer a particularly good advantage .He tries to avoid having small individual public customers. He said that on El Paso Natural Gas he makes a market of 19 7/8 and 20 1/8 If the last transaction on the board is 20. He said that the perfect situation, of course, is where the New York Stock Exchange markets are steady on volume. In that kind of a case he can profit on every single transaction both for himself and for his clients. It is when the fluctuations of course, occur that he has difficulties and he must begin to evaluate the trends of the market. He said that on any decent size block, a specialist will be unable to execute the order at a decent price. He said that specialists are merely OTC traders and make their own bids and offers just like anyone else, that they do not have the capital to do the perfect job and that the minimum commission rate schedule permits him to do a better one for customers.

According to Strauss, if a large block appears on the NYSE it just doesn't get executed. He said that an OTC market is always best for a big block distribution. He said that if the big lock appears and it is set at a price limit, it merely overhangs the market and is not disposed of or, if it is at the market, the specialist keeps driving down the price on the seller. He said that this is the reason why you find that there is a necessity for secondary distributions off the board, which are, in effect, OTC transactions. He pointed out that the only reason that he cannot take those secondaries rather than haying them go the way of underwritings is simply because he cannot afford the capital investment without retail clients. He said, though, that in principal the secondary distribution is just about the same as what he does except that he must take risks and buy for his own account. He said that it is generally recognized that big blocks stay away from the exchange because of mediocre execution. He said that the OTC trader in listed securities takes enormous pressure off the industry because where there is significant selling pressure it never goes on the floor of the exchange but is siphoned off by the OTC traders.

He said, of course, that when he buys stocks and holds them in his inventory that he must depend upon activity and that the worst thing that could happen to him is a slowly declining inactive market (the situation in the last four or five months). He said because he has no retail department to dispose of the stock he is usually faced with a long-sell to term holding situation. He said that it is impossible to sell to Weedon since Weedon is probably in the same position as he is; he therefore must shop around and try to find an institution that is willing to buy. If he does he sells to the institution at a point below the current market on the Exchange, he takes his losses and forgets about it. The alternative, of course, would be to execute on the Exchange on a commission basis with a member. He says that he doesn't do this because to sell that kind of block the specialist would ruin him by just knocking down the price just as he would on any market order which came on to the floor.

He stated that the largest part of his business was bank business (for common trust funds, pension funds, etc,). He says that insurance companies are also good clients but not quite as substantial as banks or mutual funds.

Strauss expressed very strong opposition to stabilizing and said that it was a "disgraceful" type of manipulation. He stated that is was completely unfair to stabilize a price at $40 a share when in the absence of stabilizing the market would probably drop to 37. He said that a few weeks later, after stabilizing has ceased, the market then falls off to the 37 and the stabilizer explains, "That is just the condition of the market… the market conditions in general changes etc., etc," He said that it would be far better to force the underwriters to hold on to their stock and to have sticky issues rather than to allow stabilizing, an artificial price procedure. I asked him if this would not cause many issues to fall off in price based on 300 or 400 share transactions which dropped the price from 40 to 39 on a million dollar offering. He said that this is exactly what happens to him every day in the week where the price of a $50,000 inventory is lowered by one or two points merely because of the last 200 or 300 share transaction which takes place on the Exchange. He said that he is not allowed to stabilize and sees no reason why anyone else could.

Strauss described a typical situation in the street whereby an institution who wants to buy a large block will immediately clean up the OTC traders such as Weedon, Stuart Miller, and himself at prices lower than the price on the Exchange, saving thousands of dollars. Of course, the buyer might be only able to buy 10,000 shares out of a 40,000 share purchase authorization. The buyer then will go on the floor of the Exchange, put the order in, driving the price upward to a higher level on successive 1000 share blocks. By the end of the days the remaining 40,000 share block may have been acquired at high prices. However, these, high prices will be averaged with the lower prices obtained OTC in the earlier part of the day to determine overall cost. It will appear that the particular trader who acquired the block was able to guess the market right by acquiring stock at a very low point in the day. In addition, since the last tape print will be controlling the entire block will show substantial net asset value increase.

Strauss also described the situation where a fund is a buyer in the OTC market and in an attempt to keep the offers low will constantly have a pending offer on the exchange market which will force the specialist to lower his bid and keep the OTC quotation low at the same time. This is playing one market against the other, Strauss feels is part of the game and is the method by which markets are kept competitive.

Strauss described the situation where the institution has a 50,000 share buy order and buys 4,000 or 5,000 from Strauss. If it is on a good relationship with Strauss, it will tell Strauss that it has to buy another 45,000 shares and that Strauss should not go short in order to fill all or part of the balance since it will be necessary to go on the exchange and drive the price upwards which would damage Strauss if he goes short. It is expected, of course, in exchange for this information that Strauss, on the other hand, will not hit the market to increase his own long position and then sell to the institution at even higher prices.

Generally, in connection with the market break, Strauss was unable to divide up his OTC business on unlisted stocks from his listed business. He said in general that he did not liquidate by design though his figures which are attached to this memorandum show a definite drop in inventory. He said this was probably because of the "feel” of the traders involved and not because of any over-all firm policy. He does not pay his traders on a commission basis but pays them a straight salary plus a bonus which last year doubled their salary. His investment account is minimal and was not liquidated within the last year. Strauss was convinced that the strict wholesale dealers made much better markets than mixed ones because if they didn't do so they would never get any more business. He said that the wholesale trader must rely on the existence of continuous narrow prices or else the retail houses won't deal with them in the future. The retail house, however, has no one to account to but their own customers who are completely uninformed on the subject of what is expected of them. He said that the retail houses have no motivation to support any market therefore because it doesn't have to account to any professionals while wholesale traders must account to professionals. He said that the retail trader cannot really support the market because it doesn't have to account to professionals. He said that neither the wholesale trader nor the retail trader can support the market, because neither has the money to do so. He said that no firm can be expected to hold the price when the market is declining because volume which would not appear two points below the quoted price will appear in an attempt to "hit" the only dealer who is out of line. He therefore is in favor of lowering prices into some sort of a non-liquid market. He said that he had no doubts that the markets in 1962 were thinner than in 1961 because of the lower turnover of retail business which affected not only the retail houses but also the trading markets of the wholesale houses who indirectly must rely on retail business. The wholesale house however cannot rely on public buying power only, because their reputation will depend upon the extent to which they ignore the retail buying power and agree to take securities for their own account. He said that he does not recall the flow of institutional buying or selling on last year although it was clear that many institutions waited a considerable length of time after the NYSE drop and still are waiting to invest. There is only very slow selective buying.

He does not think there has been a sizable increase in institutional buying since the market break. He is unable to tell about the banks' sell off on collateral because he deals so much with banks that he cannot tell the reason for sales. He stated that when the market broke on the NYSE and the tape was late, he stood by and kept quoting continuous markets on every listed security in which he made markets even though he knew for certain that the tape was anywhere from 30 minutes to 1 hour late. He said that he could not stop making markets if a market was 85 on the last transaction with the tape 1/2 hour late he merely quoted 82 1/2 and gave it to the customer immediately at that price with no delay. The customer therefore knew it had an execution in a split second which was quite different from the situation on the exchange. He pointed out, I think an interesting phenomena. He said that many of the large institutions have communication problems within their own organizations. For example, a situation arises where a fund broker has an authorization to buy stock up to, for example, $42 a share. When the market falls quickly there is not sufficient time for the fund managers to re-evaluate the situation and advise their trader exactly what to do with respect to canceling the order or putting in limited orders or market orders. As a result, many funds stand on the sidelines merely because it is impossible to get a proper vote or authority in time to evaluate the situation, know what is happening to the market, and then notify the trader to execute.

With respect to his OTC business, he said, of course that he widened his spreads, dropped his bids, that he did buy some stocks on balance, that he made some subject markets and that he did drop many securities on no volume out of sympathy to exchange prices. He said that there was no real selling pressure but that he lowered his bid because of the fact that he anticipated that there would be heavy selling pressure.

DEMESEY-TEGELER & CO.
Los Angeles, California
10th Interview

Dempsey-Tegeler & Co. is a firm located in St. Louis and in Los Angeles. It makes markets in 120 to 150 securities in Los Angeles. These trading markets are autonomous from the St. Louis markets. Dempsey-Tegeler has an open wire to its, office in New York City. It also has an open wire to Gregory & Sons in New York City, A. M. Kidder in New York City and Wertheimer. It also has wires to three other cities. Gregory lays certain markets in the pink sheets for Dempsey-Tegeler. The reason for this is because many firms don't know Dempsey-Tegeler since it is primarily a St. Louis-Los Angeles house. The firms in New York do know Gregory; therefore if Gregory's name is in the sheets they will call Gregory and Gregory will give up Dempsey-Tegeler's name on the transaction. Dempsey feels that if it did not have Gregory, the New York firms would just call another New York dealer and they would lose business. The give up is compensated based on the number of shares that Gregory gives up to Dempsey-Tegeler. The incoming caller to Gregory saves a long distance telephone call.

The firm stated that the policy of laying markets in the sheets for another began about five years ago. The firm said that the practice of "opportuning" has, of course, increased with the growth of the correspondent system. Opportuning is where the correspondent who is either merely an open wire correspondent or a sheet-appearing correspondent may take the incoming call and instead of giving up the principal firm, may execute it themselves. According to the interviewed partner (Heckt), he is of the opinion that there is nothing wrong or unethical about it. He said that often if the market was 20-21 and he received an inquiry in a security whose market was someone else's, he often would never relay it but would execute the transaction for his firm at 20 and try to sell it at 21. He said that he no longer trades for Dempsey-Tegeler so that practice has been discontinued. He said, of course, that he probably wouldn't "opportune" with Gregory since it is & fee paying arrangement based on the number of give ups. However, on a straight open wire transaction where the correspondent is not laying markets and does not appear in the sheets, he thinks there is nothing improper about it. This is inconsistent with some of the statements made by traders and is one of the reasons why they have pulled correspondent wires.

The firm stated that the reason why it has open wires to Kidders, Werthemier and Gregory is because its own New York trader cannot get the best markets as can Wertheimers, Gregory and K adder. For example, normally their trader cannot get good markets from Lehman, however, Wertheimer can get excellent markets from Lehman because of their relation ship with the Lehmans traders. Similarly, Kidder knows the insurance stocks in Boston and will be able to test those markets much more effectively than can Dempsey-Tegeler's office in New York. Therefore, Dempsey has open wires with firms who can get the best price from other dealers.

The firm pays traders on a commission basis (a fixed percentage of the gross profit minus certain charges for overhead and expenses). The traders are independent contractors. The profits or losses are computed by computing the beginning and ending inventories. There is a mark down of inventories at the end of every month before arriving at the compensation. If the trader loses money, he must make it up before he starts gaining a profit again. In this connection, it should be noted that the firm always retains some of the trader's compensation in the event that he has losses and doesn't make it up.

The firm, as an example of the way that it treats its retail department, gave the following example. In a market of 10-10 1/2 they will mark up 5% over the offering price to the customer on a principal basis. The salesman, on riskless transactions where the firm has no inventory, will permit execution on a principal basis. The salesman, on riskless transactions where the firm has no inventory, will permit execution on a principal basis, if the salesman “does any work on the deal." The salesman will receive only agency commission if he does none. The salesman decides whether he has "done work" or not. According to Mr. Hecht, a salesman must do something because customers never buy. Customers only have to sell stock. They must sell, he argues to meet loans; they must sell to buy furniture or automobiles and all selling is forced selling. Buying, according to Mr. Hecht, must be created. Therefore, by definition the salesman must have done something. Therefore, 99% of the transactions in the OTC market executed by his firm are as principal even though the firm may have no position.

The firm also commented on the problem of flash, secondary distributions when the firm hears of a secondary the same day that it is to be sold to the public. The firm said that the secondaries were a great boon for a salesman, in that it provided a motivation to sell securities, since it gave him a much higher rate of compensation. He said that as a practical matter the salesman knows little about the company; he is theoretically supposed to check Standard and Poor if something is reported so he can discuss it intelligently with the customer. Most often the salesman gets on the telephone, calls the customers, and tells the customer that he has just come across a wonderful opportunity to sell the stock to him without any commission at the last price on the exchange. There is no disclosure of the fact that the firm itself paid substantially less than that price and the salesman is making a substantial commission in excess of his usual rate. He said that the salesman knows little, if anything, about the stock and does very little checking but that the motivation to sell is sufficient for him to start using the telephone because of the very high rate of compensation.

The firm's inventory position on May 31, 1961 showed $161,000 long positions, $49,000 short. In January of 1962, it was $308,000 long and $118,000 short. On May 25th it was $302,000 long and $1,000 short. The firm stated that it did not reduce its inventories, that it liked the market and saw no reason to liquidate. The firm did not believe the market was about to collapse sharply even though it had been falling off slowly. It should be emphasized that when the market falls off slowly, the firm may not necessarily be losing money on its trading activities if it keeps a fairly level inventory balance. If inventories are kept at a steady level and if there is any substantial turnover during the month, the monthly spreads multiplied by the number of transactions will exceed the amount of loss caused by the erosion of inventory prices. According to the firm, the danger is that if you start to accumulate inventory during the month the amount of money lost through price erosion will not be overcome by profits made during the month on the turnover. The firm said that it was making the same number of markets in May 1961, January 1962, and May 1962. However, the markets in May 1962 were much thinner than in May of 1961. Although the positions might have increased somewhat the firm's ability to spin off substantial parts of its inventory were severely curtailed so that the buying was with much greater discretion than previously. The firm said that if it sponsored securities it would be a buyer on balance. That was one of the reasons why it had bought on balance when the markets started to fall off slowly in the spring of the year and the prior months. The firm stated that it must do this to be in business and that such activity completely changes its trading function. The firm says that when it becomes a buyer on balance in times of stress it does so as part of what they call an entire redistribution process. They feel that the securities in which they make markets, many of which are sponsored, are moving from weak hands into strong hands, they are merely the middleman. They, therefore, will take the securities on balance from the weak hands as evidenced by the selling pressure and put it into strong hands by use of their active retail department. They will, therefore, be buying from dealers and selling to their customers and perhaps other dealers. They said that the selling pressure is probably coming from retail customers but not their own and that they had the responsibility to create the buying power from their own customers so as to make a redistribution when the markets are declining as in the spring of 1962. However, they couldn’t dispose of all their inventories they were accumulating, and they were buyers on balance in securities which could not be quickly sold out of inventory. Therefore, it increased over the previous year.

The firm also made an interesting commentary on the OTC market. In the OTC market, if a customer puts in an order to buy stock at the market and the market changes quickly between the time of the decision by the customer and the execution, the firm is severely criticized. Yet on the Exchange on the same kind of market order, the customer accepts the fact that the price may change between the time of the last transaction which he sees on the tape and the time he gets his execution. According to Dempsey-Tegeler the customer honestly feels that something about the Exchange excuses market shifts in the interim between the placing of the order and the transaction, while OTC market customers feel that any shift was probably because of the inadequate activity by the trader or trading house in executing for him. The firm said that it was their practice to give their retail salesmen an extra commission or an extra part of the gross spread for selling off inventories. In other words, they would sell stock to the salesman at a somewhat better price than they usually would and allow the salesman thereby to get a higher mark up for his efforts. In addition, the commissions for salesmen range between 40% and 60% depending on, among other things, the salesmen's activities with the firm and the state of the inventory.

With respect to odd-lot business on an exchange, the firm gets a 70-30 break on the NYSE and 80-20 on the Pacific Coast. Therefore, they execute on the dually listed securities on the NYSE since the difference isn't very great. They say that the mutual funds are doing an increasing amount of business on the local exchanges and in a very complicated, round about system cause reciprocals or rebates to be given in a manner which might not be appropriate. The firm would not discuss the matter and merely said that the reason for the executions on the regional exchanges is to permit roundabout reciprocals. I did not pursue the matter further.

The firm is opposed to margin in OTC securities.

The firm supplied useful information on its general business in the period of May 1961 to January 1962. In May 1961, they did $28,000,000 in retail business (principal and agency buying and selling). In January of 1962, they did $23,000,000. In May 1962, before the market break, they had only $13,000,000 in retail transactions, a 50% drop from the prior period.

The firm did not believe there was a great deal of short selling by customers of their retail department, their trading department, or by the small trading houses during the market break. On May 28, 29, and 31, customers bought 93,000 shares for $904,000. They sold 57,000 shares for $472,000. It was quite obvious again, as in many other firms, that there was more buying power than selling pressure.

On the day of the market break the firm gave firm quotations for only 100 shares, widened its spreads, made subject markets constantly, if it I wasn't the sponsor of the security and even on those stocks where they were the sponsor they changed their markets on each inquiry particularly if there was an intervening transaction. They were dropping quotes on no selling pressure and often dropped their bids based on the NYSE tape. They did a great deal of business (approximately three times as much as they had in prior days). In preparing for interview the firm noted that their customers were buyers not sellers. They tried to determine why they lowered their quotes on buying power. They assumed that other dealers were putting stock to them. I asked them whether or not the wire houses were putting stock to them (which would indicate that the wire house customers were selling) and they agreed that that was unlikely since there would be no reason why wire house customers were selling while their own customers were buying. Again the problem came back to whether the wholesale traders were selling on balance or whether wire house customers were calling for quotations and the flow of requests for quotations plus the tape caused the Dempsey-Tegeler firm and many others to lower their prices and create a semi-non-liquid situation. During the day of the market break Dempsey-Tegeler salesmen tried to sell as much stock as they could to create retail buying power. As previously noted, the effort was worthwhile. The firm's theory is that bad news means that all markets will drop and that it is unreasonable to expect lack of selling in a given security to control the quotes of that security. Dempsey said that it did a much better job in making markets than Troster-Singer. They said that when markets are declining they can be a buyer on balance, take their inventories, spin it off to their customers, thereby acting like a specialist or a sponsor which the non-retail house cannot do. They therefore provide, they say, a more useful function. They say that Troster provides no function at all. He merely has wires, knows the buyers and sellers are going to come in and plays one against the other and thus makes his inside profit. He takes no responsibility for buying on balance in the event of slow decline. He therefore has no need to make a bigger market, a wider market or any other kind of market to help the price of the security in time of generally bad news to protect the price. The firm admitted, however, that their comments went mostly to sponsored securities and that Troster probably did a satisfactory job in actively traded nationally-known securities.

On the close of business on the 29th, the firm had $269,000 long and 42,000 short. On the 31st it had 123,000 long and 103,000 short. The firm, of course, was selling on balance. The firm said that there was great buying power and therefore they sold on balance and they did not affirmatively try to liquidate. In this connection, it must be emphasized that the firm's quotations, however, did not substantially come back in comparison to the decline on the 28th. In one of the sponsored securities, the price went to $21 a share down to $14. The firm thought themselves to be the primary market-maker. The firm bought 3,000 shares and sold 2,600 shares which would indicate that there was about 400 shares more selling pressure in the open market and their quote dropped seven points.

The firm is opposed to Regulation A and best-efforts deals. It wants minimum capital and it wants something that will insure better delivery as well as a system whereby it would know what stock is investment stock and what stock isn't, what is free to be sold and what is not.

As an interlude here' we might mention what happened when the hot issues came to the market in California. In order to avoid a free rider, if a customer went to a broker to execute a sell order on the market on a hot issue shortly after it came out, the executing broker would be advised by the managing underwriter that if the order were executed with it on an OTC basis that it would insist on a regular deliver; that is, a delivery within four days and they intended to so stamp the confirmation. However, the underwriter had the certificate under its control at the time. The customer couldn't get the stock to sell. This, of course, severely limited the floating supply.

Currier & Carlsen & Co.
Los Angeles, California
11th Interview

The interviewee was Currier & Carlsen & CO., Los Angeles, a member the of the Pacific Coast Stock Exchange. Mr. T. Carlsen the principal of the firm was interviewed.

Currier has a direct wire to Troster-Singer. Troster appears in the pink sheets for Currier. When a New York broker-dealer has an order for such a security, he will call Troster. Sometimes he will know that Troster is making the market for Currier; sometimes he will not. At any rate, Troster will check the Currier & Carlsen quotation if it has not been left with them before and will "give up" Currier & Carlsen's name. Troster will also give up Currier & Carlsen's name to broker-dealers in securities in which Troster does not appear in the sheets. Currier & Carlsen does not appear in the sheets for any other firm. They will, of course, transmit orders and get quotes on securities in which Troster makes a market as a service to Troster when they are called by a Los Angeles firm. This latter situation is the typical correspondent system where the correspondent sometimes appears in the sheets and sometimes is merely a conduit for information, and/or execution. The open wire system allow any broker in any city to call another broker who might have a wire to New York and obtain quotes without making their own long distance call. The firm described the correspondent system further by saying that the Green & Co. wire goes into Mitchum, Jones and Templeton; the Singer-Bean wire into Evans, MacCormack; the Hanseatic wire into Pledger & Co.; Troster into themselves; and Strauss & Co. into Stern, Frank, Meyer & Fox. Therefore, it is very easy for them to check all of the big New York markets by merely calling these broker-dealers.

Currier basically is a trading house. It does very little retail business. All of its traders are paid on a commission basis because of the firm's opinion that it keeps costs and expenses down. The firm stated that the wholesale trading department runs the retail department and runs the firm and not vice versa. Less than 5% of its business is with retail customers. The inventory position of the firm in its over-the-counter securities were as follows:

[table omitted]

The firm stated that in the winter and spring of 1962 before the market break there was a distinct feeling that the market would go down; therefore, the trader decided to trade from a short position and the firm's shorts substantially increased. It must be emphasized that the firm's short positions were not short positions caused by the firm going out and hitting the bid side of the street. Although the short position of Currier & CarIsen increased substantially, it must be emphasized that the short positions were lengthened by merely making the worst bid in the sheets and the best offer. There was no attempt to deliberately short the market. That is, there was no attempt to hit the streets' bid and sell heavily; rather the short position was reached by slightly shifting quotations so that you became a seller on balance on incoming calls. In effect, therefore, the spreads were the same but the entire quotation was somewhat off the normal sheet quotation. It is clear from the firm's records that it was a seller on balance. This means either that the firm was an affirmative seller on balance, contributing to the decline, or was filling buying power on these days. If the latter, it was inappropriate to lower quotations. The firm held longer positions in sponsored stocks because it tends to be a buyer on balance in critical periods. In certain sponsored stocks, the firm makes a distinct effort to prevent the stocks from running away when there is substantial demand which arises out of a press release or an earnings report or a market letter. In those cases, the firm will sell heavily on balance and even go short to keep the stocks at reasonable levels. (This activity of Currier & Carlsen was strongly disrupted by a prior interviewee who stated that when the market arises the traders never or rarely ever attempts to slow down the rise by selling against it. More likely they will merely make the same competitive markets as anyone else and hope that their inventory valuation will be increased greatly.) Currier & Carlsen said that this practice merely reflected a difference of opinion an approach but they did not feel it to be the best practice; therefore, they often went short and cut their short-term potential in sponsored stocks on strong demand. Currier & Carlsen feels that if it does not go short on certain stocks in high demand that the security will "go through the roof." They state that in order to stabilize they will act the opposite of market. Currier stated that they feel that the taking of short positions acted as a significant stabilizing function from January through May 1962. They felt that by going short, although they were not acting as a stabilizing factor at that time since they were sellers on balances in a declining market, they were able to create an artificial floor or bid and if there was a sharp break in the market they would have to cover their short by buying on balance when the market turned around after a sharp break. I asked Currier whether or not the taking of short positions in a declining market meant that they were sellers on balance and therefore they contributed to the decline. They said that might be so temporarily but someday they would have to buy. I asked them whether or not it were true that at the time of a sharp break when the market was going still lower that there would then be no motivation to start to cover their short, and the shorts would not be covered until there was an indication that the market had turned around. They stated that they would, not cover their shorts until there was some increase buying power generated by other sources.

The firm stated it drops securities which are not actively traded. Recently in a certain security the firm went 20 days without making a single trade and therefore dropped the stock. The firm states that its retail department is not an important function in its markets but is quite important in thinly traded local securities. They said that they are sponsors in such stocks because of certain underwritings which they managed and in which their few customers participated. He gave as a definition of what they consider to be sponsorship, a feeling in a certain security that they were trying to make the market "orderly”, that they were buying on balance when necessary and that they would attempt to make a broad market. Sometimes they were on the Board of Directors. Within the last few weeks a firm decided to drop the Currier & Carlsen representative from the Board of Directors. Currier immediately advised the trader that if he wished to stop trading the stock that he should feel no responsibility for it -- “the hell with it." The firm will not buy on balance. Its markets will be no broader than any other security and the trading will be done purely from a profit and loss point of view and no other.

The firm said that in 1962 it was quoting slightly differently compared to the period in 1961. In 1962 they were constantly lowering their quotations if they saw that another dealer was hitting their bid. However, if the dealer stated to them that he, the dealer, was acting as agent for a customer then they would hold the bid to the other dealers so that the customer could get a good price. They do not like other dealers putting stock to them and will duck such selling pressure by lowering quotations immediately.

With respect to the operations of the firm’s retail department on May 28th, 29th and 31st, the firm supplied the following data: On May 28th its customers bought $12,000 and sold $41,000; on May 29th they bought $70,000 and sold $36,000. On May 31st they bought $35,000 and sold $26,000. They said generally that their customers were buyers on balance on both on an agency and principal basis. The firm said that it stated to cover the short positions on the 29th, but increased it shorts on the 31st. On the 28th and 29th their spreads became very wide (approximately double normal) and although they made no subject markets after the first 100 shares, they usually lowered their quotations significantly. In many securities they lowered quotations without selling pressure in a particular stock out of sympathy to what was happening on the big board. The firm said that on agency transactions it was almost impossible to obtain a quotation from New York, that very few people knew the market, that unless you could execute immediately on the telephone at the market that other transactions would occur before yours, thereby causing a price change; that communications had broken down, that it was impossible to check markets and that generally markets made outside of the New York were subject because the correspondent firms were not permitted to make firm markets (they had to check each transaction back to the New York principal firm before they could give any information to a California firm). This caused considerable delay. The firm dropped its bids all down the line in all of its securities and in the firm’s words "all heroes are buried in the cemetery." The firm said that they will not buy solely because someone else wants to sell. The firm said that customers put requests for quotes and then withdrew the order to sell and didn’t pursue the matter. The firm stated that they think that the time delays in quotations were a significant factor in causing a lack of liquidity. The firm did not raise its quotations when the market turned (though there was buying power) to the same extent as it lowered it when there was little selling pressure. In the firm's opinion if they had held their quotation, even when there was no selling pressure they would have been hit with selling pressure. It must be emphasized that according to the firm if they had held their bids, customers would have looked around and seen every stock on the exchange dropping and the OTC stock dropping except the one stock in which they decided to hold the market. They would have been hit with such a flood of sell orders that (1) they would have become insolvent and (2) they couldn't have held the price anyway. The firm stated that wide spreads were typical in New York, no communication, thin markets, dropping of quotations all throughout the 28th and 29th of May. They pointed out that the NYSE tape makes decisions not only for the trader in the firm but also for the average public customer who often will make inquiries and receive quotations which appear to reflect selling desires. This causes, perhaps, lowered quotations although the pressure is never consummated because the pressure itself causes lack of communication, lowering of bids which often causes customers to change their minds; therefore no sales but lower quotes.

The firm said that its responsibility was to make a market only if it were profitable for the firm. They thought that the responsibility was being fulfilled if they were making that market since by definition they would therefore be a competitive factor which benefits the public. At present time there is very little retail business and very little trading business. The firm used to write 200 tickets a day, now only writes about 50 tickets per day. Two days ago the firm had only eight tickets -- that is, only eight transactions. The firm is of the opinion that the public hearings scared people away from all OTC securities. The firm closed its OTC underwriting department.

EVANS MacCORMACK & CO.
Los Angeles, Calif.
12th Interview

Evans MacCormack (EM) is a mixed wholesale trading and retail firm. It makes markets in approximately 50 securities. It has approximately 45 to 50 registered representatives. Ninety percent of its transactions in securities in which it makes over-the-counter markets are solely inter-dealer transactions. That is, they buy from dealers and sell to dealers. As a rule they do not sell their over-the-counter traded stocks to retail customers since they feel they the caliber of their traded securities does not justify solicitation of public customers in those stocks.

The firm has an open wire to the firm of Singer Bean. The firm, however, states that it will not necessarily execute with Singer Bean but will execute transactions for customers with another competing New York dealer if the competing dealer makes a better market.

The firm generally marks up transactions over the inside offer in securities in which it has a position. On riskless transactions they are executed on a principal basis and agency -- depending upon the salesman's wishes. They feel that if the transaction is executed on a principal basis they have some sort of an obligation to watch over the security, which they do not have if it is executed on an agency basis.

The firm said that both Singer Bean and Gorey & Company lay markets for them in the sheets and give up EM’s name; in turn EM lays 45 to 50 markets for Singer Bean.

I was advised that traders are compensated on a basis of gross profit made, usually 50%. The trader must make up losses. This does not seem to be a particular problem since according to Mr. MacCormack his top traders have never had a loss in any month during the last five years. The firm writes everything down to market at the end of the month. The firm generally stays in the sheets regularly in the stocks in which it makes an inter-dealer market. If it is making a market and does not go in the sheets it is usually because the stock is inactively traded, and/or because the street knows of their interest. The firm said that it can check New York markets easily by calling one of the New York correspondents in Los Angeles or San Francisco. Singer Bean pays the cost of the wire and there is a one or two-cent fee for the give up and vice versa.

The firm made a decision early in the year to go short; therefore it adjusted its quotations so that it became a seller on balance. It did not go short by hitting street bids. They therefore made a market from a short position. They did so by dropping their bids and widening their spreads, and in being slow to cover the short position. The firm has no investment account.

The firm said that it sometimes will buy on the open market in advance of a recommendation or a market report. It does this by going out and initiating a call and awaiting someone else's bid. They then will mark up from their average cost not from the highest offer on the street at the time of the public recommendation. The firm said, however, that it will never offer to the public at a price below the inside current offering of the street. They said that the reason that they cannot issue the market report first and then execute agency orders is because there would be too much speed required by customers for execution and speed would mean that there was concentrated buying power by EM and the price would rise drastically and quickly. The firm said that if they were able, however, to buy over a longer period of time by going into the sheets or by placing orders over a longer period of time, they would accumulate the stocks at lower prices. In addition, the salesmen of the firm want to have a fixed price to offer to the customers and do not want customers paying various prices depending on the time of day of the execution.

The firm does not give any extra compensation to their salesmen because they rarely sell stocks or solicit customers to buy stocks in those issues in which they make continuous markets because of their generally speculative nature.

The firm said that the turnover in 1961 was much faster than in 1962 and that they could dispose of inventory quickly in 1961 merely by appearing in the sheets and answering incoming calls from other dealers. However, in 1962 this was not the case and the positions began to increase fairly rapidly. They therefore widened their spreads in an attempt to make themselves less prone to be buyers on balance. The firm does little institutional business and very little short selling. The firm stated that the market broke even it became a seller on balance. Specifically, on the day of the market break, May 28, the firm's customers bought $29,000 in over-the-counter securities as principal and $25,000 OTC securities as agent. The firm’s customers sold $2,000 in principal transactions and $25,000 on agency transactions. On May 29, the firm's customers purchased $50,304 as principal and $46,222 as agent. Customers sold $2,000 as principal and $50,000 as agent. This would indicate that customers selling was placed on the street; buying was executed by selling from inventory, or executing riskless transactions (cannot determine which because the names of the securities are not broken down). On May 31, public customers purchased on principal $45,000 and on agency basis $8,000. Customers sold on principal basis $2,000 and sold as agent $9,000. Therefore there was significant buying power over sailing pressure.

In addition, the reports show that dealers bought from EM $41,000 in securities and dealers sold to EM a total of $71,000 in OTC securities on the 28th. This means again that dealers were probably either selling off their own inventories or putting customers sales in the street to other houses rather than absorbing it.

The firm made similar comments re the market break to those of the prior interview which need not be repeated.

The firm stated that when they are the sponsor of a stock they feel an obligation to make some kind of market and that they would buy securities and try to hold prices in a declining market. The firm stated that they would stabilize and buy on balance and would control the price to the best of their abilities by that activity. They would stabilize to make the market orderly and if they were not sponsors they would just watch it go down. They said that they stabilize particularly when there is no reason for the drop in price except for the sympathetic drop on the NYSE or generally bearish news not effecting their stock. EM greatest complaint about markets was the enormous spreads in the OTC markets where securities were selling at spreads where the offer was 25% to 50% over the bid. They said that they would never deal with retail customers in such stocks because of the very significant spreads. The firm stated that most transactions occur on the bid and ask price and there is little negotiation in between in most transactions.

The firm said that they are almost completely segregated and that they believe that this is the proper way to do business. That is, they do not solicit retail customers in the stocks in which they make a trading market. The firm states that the reason for this is because of the very sizeable spreads. The firm has supplied us detailed breakdowns of their transactions on May 28th, 29th, and 31st, some summary of which was reported above.

[exhibit omitted]

STAATS & CO.
Los Angeles, California
13th Interview

Staats & Co. is a member of the N.Y.S.E. It makes markets in approximately 34 common stocks. It has 115 registered representatives. It has a separate trading department and sells to its customers from that trading department on a principal basis. In the usual case it marks up over the inside offer. The trading department sells the stock in effect to the salesman who marks it up. On riskless transactions, that is, stocks in which the firm does not make a market, the transactions will be on a principal basis if, and only if, the stocks are on a special eligibility list. Staats has an eligible list of 300 securities on which it has done research which it considers eligible for principal transactions. In those cases it permits the salesmen to mark up riskless transactions on a principal basis. On all other stocks the salesmen will be limited to an agency commission. Staats does this because they feel that their liability is greater to the public on principal transactions so that they try to discourage transactions in speculative securities by not allowing the salesmen to make as much commission or profit on non-eligible securities.

The trader is compensated on a straight salary basis. The firm says this tends to prevent gambling; in addition, he cannot take advantage of the retail customer or of the salesman. He works solely for the house and for the benefit of the retail clients. He has therefore no motivation to make individual profits for himself. Most of Staat's offices are in California. They have two in Arizona. Staats has an open wire to Goldman Sachs of New York. Goldman Sachs lays markets for Staats in the eastern sheets and Staats lays markets for Goldman in the Sheets in the far west. Staats also has an open wire to Eppler-Guerin of Dallas, Texas. Goldman Sachs receives 4 cents per share on any give-up stock on the open wire. This compensation includes not only stocks in which Goldman Sachs appears in the sheets but any other stock in which Goldman Sachs has firm markets for Staats. By this I mean that Staats gives Goldman Sachs firm markets at the beginning of each day and changes those markets from time to time, even though Goldman does not appear in the sheets. The firm stated that retail selling amounts to a relatively small percentage of its over-all business in the OTC stocks; that is, of all the transactions in stocks in which a market is made by Staats only 15% are made to retail customers, the rest are inter-dealer buys and sells. The firm stated that one of the reasons that it went into the trading business was because it felt that many new issues were being lost to California investors because there was no secondary after-market in such issues and only New York houses would perform that function; therefore many of the California firms were going to New York underwriters. Staats therefore decided to make after-markets as an adjunct to its underwriting. They said that they must, on occasions if the market is weak, buy on balance and spin off the inventory to customers. They say that they are willing to buy on balance even if they don't like the security and even if they would not ordinarily do so in their typical operation.

The firm said that in April 1961 it was $625,000 long and $107,000 short. In December 1961 it was $580,000 long and $183,000 short. In April of 1962 it was $462,000 long and $20,000 short. The firm stated that although its inventory was reduced somewhat in the year between April 1961 and April 1962, it made a mistake in reducing its short position. The firm's lower long position primarily came about because they were slight sellers on balance by shifting their quotation. They said that because of the lack of new underwriting there was generally less turnover and they were willing to take smaller positions. The firm said that it has a policy of not going short; rather it but tries generally to trade from a flat position. Often it will be required to go short to fill a customer's order but it will attempt to wait and delay covering that short until someone wishes to sell the stock to them rather than going into the market to cover. Therefore short positions might appear on their books which are really not an indication of a lack of confidence in the market.

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The retail business was falling off badly and they could not expect to have the retail customers help them reduce inventories. As an example they pointed out that in May of 1961, their customers bought and sold 9 million dollars in securities in the OTC markets both as principal and as agent. In January of 1962, the customers bought 6,700,000 and in May of 1962, 4,800,000. The firm seated that it did not believe that there were any short sales in the OTC market to any sizeable extent either by retail customers or by their own or other traders. However, they heard rumors that many of the dealers in the large metropolitan areas had gone short but they could not tell that. They said there, was no question but that the spring of 1962 it was much easier to buy stock than sell it since there were few ready buyers. Short positions were fairly easy to cover during this period. On May 28th, the firm's customers bought $159,000 in securities and sold $418,000 in securities in the OTC market. This would indicate a sizeable amount of selling pressure. The firm states that on the buy side, of the $159,000, $115,000 were principal transactions with the firm and $43,000 were agency transactions. This means that the firm's customers were buying from Staats' inventory or were buying securities on riskless transactions. On the sell side, however, the firm had $371,000 sold on an agency basis and 47,000 on a principal basis. In effect, this means that when a customer wished to sell stock the firm did not usually take a position, but rather put the stock on the street. On the sell side, the firm looked around and acted as broker and tried to place the stock for the customer. As a result, there were more principal transactions in the buy side than there were in the sell side. (It is not clear, of course, from these figures, whether the principal transactions meant that the firm was a buyer on balance since it may have been executing riskless principal transactions.) On the 29th of May, however, the public purchasing power increased. There were $229,000 bought and $154,000 sold. On the 31st, there were 217,000 bought and $141,000 sold. The firm's positions on these days were as follows. On the evening of the 25th of May, that is the day before the market break, the firm was $428,000 long and $41,000 short. After the first day of the break, on the 28th, they were 511,000 long and 16,000 short. This means that the firm bought fairly substantially on balance, and reduced their short position. On the next day, the 29th, however, the firm sold their long position down to $427,000 long and increased their shorts to 60,000, a somewhat depressing effect since the quotations were generally lower. On the 31st they continued selling off their firm positions until they sold off to 315,000 long and they increased their shorts to 80,000 by selling 20,000 more short on balance. It should be mentioned here that there might be included in these figures some erosion in prices in addition to selling on balance. The firm stated that their customers were definite buyers on balance, that there was more buying power than selling pressure from retail customers. They said, however, that their quotations dropped out of sympathy to the markets on the listed exchanges; in addition, they believed they were getting someone else's agency business (selling pressure); they therefore started to sell on balance. They raised the quotation somewhat on the 31st but did not raise them enough to make up the drop in the previous day. The firm stated that it could not afford to hold the bids.

The firm stated that at the present time that the OTC market was at a very low ebb, that the markets were somewhat at a standstill with regard to volume.

The firm stated that in New York practically all of the markets were subject and that when their own firm was hit with 100 shares they lowered their quotations. They said if you could get into a New York house directly, you might get a firm market for 100 shares. However, they would have to consider the markets to be subject because they don't go into New York directly but usually called the correspondent and nothing was left firm in the correspondent houses. They said, therefore, to assure an execution one would have to give a market order because the correspondents only had subject markets. The firm stated that in their opinion it was their responsibility to maintain orderly markets and to maintain firm markets for 100 shares in times of crisis.

The firm described sponsorship and what they considered to be their responsibility in a transaction where they bought 14,000 shares on balance after an underwriting. The firm then sold to the broker-dealers who were participants in the distribution the 14,000 shares on the bid side rather than on the offer. It therefore gave considerable incentive to the dealers who had customers who wished to buy the stock. By selling to the dealer on their bid side, even though it was being put to them, the dealers were able to mark up the securities over the inside offer and solicit customers on a very profitable basis. It therefore shifted the inventory from Staat’s hands to that of the hands of customers of other firms.

The firm stated that in connection with new issues that it will not open an order or take a customer who wishes to sell a new issue. If he is an old customer the firm will often require that he deliver the stock before sale because the buyer will demand regular delivery of Staats. The purpose is to prevent Staats from executing an order for a customer who does not have the stock. (The managing underwriter still holds it.)

With respect to newspaper quotations, Staats said that the typical quote of 19 to 19 1/2 on an inside quote would probably read 19 to 20 1/2 in the newspapers. The firm stated that if a customer wished to buy the stock, he, of course, would pay the 20 1/2 and if he wished to sell, it would be 19, less the commission. The firm said that it's their policy only to mark down if the transaction is one in which the stock was not bought from the firm. Apparently salesmen make much of the fact that if you buy through them as dealers they will be glad to execute your sell transactions with nothing but a commission charge.

The firm is opposed to philosophy of dual listing on two exchanges and is opposed to anything which would cut into the N.Y.S.E. flow of facts concerning transactions in the company's securities. The firm felt that the OTC market failed to really make good markets in listed securities and that they should be prohibited.

BARTH & CO.
Los Angeles, Calif.
14th Interview

Barth is a member of the NYSE. It makes 65 markets in Los Angeles and 45 in San Francisco. It has an open wire to Portland, Oregon, and to San Francisco. It has offices in those cities. It also has a New York office which is a service office in which it has an open wire. The purpose of the New York office wire is to permit Barth to call New York directly without extra cost and allow the New York office to check the New York markets. It has correspondents in Phoenix, Arizona; Sacramento, California; Dallas, Texas; and St. Louis, Missouri. In St. Louis its correspondent is Scherck-Richter. Scherck does not appear in the sheets for Barth; however, Barth does appear in the sheets for Scherck. In addition, there is a joint accounts with Scherck-Richter (SR) in certain securities. This means that Scherck and Barth share profits and losses in specified securities and they both make markets in those securities.

Barth states that in Dallas, Texas, it will leave firm markets with their correspondent, First Southwest, so that First Southwest need not call them if they receive inquiries on particular stocks, though First Southwest does not go into sheets for their them. They say that dealers in the Dallas area know that Barth has a wire to First Southwest and because of this a dealer in Dallas will call Southwest for markets which they know to be Barth's. Of course, First Southwest makes no markets in those securities. Barth said that if a firm, market is not being made by an open wire correspondent that they might consider going in between the inquirer and the principal. They said that they would do this because they, too, are interested in executing transactions and so long as they are merely an open wire correspondent as distinguished from a firm market maker correspondent they feel that it is appropriate for them to do so. In this connection, it should be noted that other firms I spoke to considered this to be an improper activity and to be one of the reasons why wires were pulled from certain firms.

With respect to the firm's transactions in stocks in which it makes markets, they are on a principal basis usually with a markup over the inside offer of between 3% and 5% depending on the price of the security, etc. The initial decision of how much to mark up depends on salesman and review of the partner in charge of that salesman's activities. On riskless transactions the salesman will decide whether it is to be principal or agency (depending on solicitation); the salesman will decide if he has solicited the business and if he has worked on the deal. If he has and he wants a principal transaction, it will be marked up. It will be executed on an agency basis it the salesman has done nothing by way of research, solicitation, etc. The salesman, however, makes the initial decision whether he has done anything.

The traders are paid on a salary plus a bonus based on the profit of the trading department. The trader's compensation therefore will be related to the amount of profits that he makes.

The firm makes sheet appearances in practically everything in which it makes markets except for some very fast trades and quick deals, that is, the so-called opportuning. This is the situation where the firm will come in between the inquirer and its wire correspondent. The firm said that when it does so, it usually has established a general policy whereby the correspondent knows from time to time that it will do so. If the correspondent objects, the firm states they won’t do it.

The firm stated that it buys stock both from dealers and from their own customers. About 80% of its buys are from dealers and the remainder from public customers. The sales, of course, are in a much higher percentage to public customers. The firm stated it trades some stock merely because of retail interest and not because they wish to trade that particular security on the basis of inter-dealer buying and selling. The firm stated that in a number of securities where there was a sizeable retail interest, it found that their customers were getting very poor executions. For example, if the market was 10 to 11, they would have to go out and buy stock at 11 and then mark up to enable them to get a profit. Therefore, Barth went into the sheets when the market was still 10 to 11 and were able to buy stock at 10 and offer it to the salesmen at 10 1/2; the customer would get the stock at 10 1/2 plus the markup, rather than 11 plus markup. They said that they would usually not mark it up less than the inside offer. According to the firm, they stated that when the other dealers saw that they were able to compete in this way, it caused a better, narrower spread to exist in the OTC market, since other retail customers would not go to their brokers knowing that they would have to pay that much more than they would if they were customers of Barth & Co.

I asked the firm whether this was consistent with their theory that they mark up over the current inside offer (not in between) and they said that that was the usual case and the situation here described was not too typical.

In connection with the relationship to the trading departments, to the retail departments, they gave the following example.

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Barth & Co. supplied a significant amount of records which are incorporated by reference to their memorandum. Some of the main points are as follows. At the end of May 1961, Barth's San Francisco office had a long position of $507,000 and a short position of $69,000 for a total long of $439,000. At the end of the year, December 31, 1961, they had a long position of $629,000 and a short position of $70,000 for a net long of $560,000 in their OTC inventories, thereby increasing their inventories during this period. At the end of January 1961 they had a long position of $397,000 and a short of over $100,000 for a net long position of $297,000, a net drop of over $300,000 in their long position in the month of January 1962. At the end of April 1962 they had increased their long position to $432,000 and reduced their short to $38,000 for a net long of $394,000. By May 31st (trading date) they had a long of $392,000 and a short of $8,000 for a net long of $384,000. This May figure is before the market break. They have also supplied us with figures for their Los Angeles trading department (which makes markets in different securities as noted earlier in this memorandum). In their Los Angeles department, in May of 1961 they had a long of $241,000 and a short of $345,000 for a total short position of $103,000. By January 31, 1962, they had a long position of $481,000 and a short of $150,000 for a net long of $330,000. By the end of April 1962 they had a long position of $433,000 and a short of $120,000 for a net long of $313,000. For the end of May 1962 before the market break they had a long position of $390,000 and a short of $40,000 for a net long of $350,000. The firm stated that in May of 1961 they were making the best offer in the sheets and the worst bids. The reason for that was an attempt to go short because they felt that in the summer of 1961 that the market was going to fall off sharply and they wished to trade from a short position.

The firm described the way that it computes its profit and loss is as follows. Every month the firm takes either a profit or a loss from its trading activities and it marks down to market according to the market price of the inventory at the end of the month. The trader, therefore, and the firm start out new every month. They compute the profits made during the month by subtracting their total cost of shares bought from the total funds received from shares sold. This will give the company its spread profits. They then compute the inventory at the end of the month and if the dollar amount of the inventory at the end of the month has a market value lower than the inventory at the beginning of the month this account is subtracted from the trading profits and is also subtracted from the trader's profits. If there is appreciation in inventory it is not marked up. The trader therefore must be sure that he doesn't buy on balance in a declining market because that kind of erosion will cut seriously into his turnover profit during the month. The firm stated that it tried to lighten up its inventory in the spring of 1962 but it was unable to do so significantly and the positions were not liquidating fast enough because there was no retail buying power. In May of 1961 the firm would average about 500 transactions a day in OTC securities both with customers and with other dealers. At the present time they are waiting only about 80 tickets per day. It is a very slow market and the firm feels that the market is quite thin. By the end of May before the market break, the firm was able to cut down its inventories somewhat. However, they were unable to cut down fast enough by selling on balance.