November 16, 1962

Mr. Milton H. Cohen, Director
Special Study of Securities Markets
Securities and Exchange Commission
Washington 25, D. C.

Dear Mr. Cohen:

Following up on our discussion in your office last week, I would like to comment further on the fairness and desirability of permitting listed securities to be traded away from the primary market.

The success of the Exchange's auction market depends to a large degree upon the presence of enough buyers' and sellers' orders on the Floor so that the prices reflect the composite opinions of the greatest number of investors. However, we are informed that over the past few years our listed issues and shares are being traded in increasing numbers on the nation's regional exchanges and the over-the-counter market. We believe this erosion of the primary market is not in the public interest. It tends to undermine the purpose and usefulness of publicizing transactions in the primary market and may impair the liquidity which all investors rightly expect when investing in securities listed on this exchange.

The role of the regional exchanges in our opinion is to provide fair and orderly primary markets in issues of local companies which are neither sufficiently seasoned nor of adequate size to be of national interest. However, since 1934 the regional exchanges have been forced to look beyond local companies for trading opportunities -- largely because these companies prefer not to list, thereby avoiding the costs and burdens implicit in the Exchange Act's application to listed companies. The result has been to concentrate regional trading in national rather than local issues.

Numerous problems have emerged from this development of regional secondary markets in national issues. For example, regional exchanges are at times unable to service orders involving stocks listed on the New York Stock Exchange. These orders must eventually be executed on the New York Stock Exchange, possibly at a less favorable price then would have been available if the order had been sent directly to the primary market. This is particularly evident in certain cases where regional exchanges permit their members to execute such orders at prices reported on the New York Stock Exchange ticker tape three minutes after the order is originally received on their Floors. In addition, the job of maintaining a fair and orderly market by specialists in the primary market is made more difficult by regional exchange specialists offsetting their positions on our exchange.

Similar problems arise when transactions in listed securities are executed on the over-the-counter market. Here, too, there is no assurance of obtaining the best price available in the primary market at the time the order was executed. Indeed, the over-the-counter broker-dealer is not obligated to make a market even though he may put bids and offers in the "pink sheets." The over-the-counter broker-dealers making markets in listed securities are not subject to many of the restrictions placed upon our specialists in performing their dealer activities.

On the other hand, the over-the-counter market is better suited to perform in totally different but equally important areas. These include: secondary distributions; underwriting new issues of companies wishing to raise additional capital; and, making markets for the securities of thousands of companies which are small and relatively unknown and whose issues are insufficiently distributed to have attained that degree of public interest warranting continuous dealings on an organized exchange.

These diversions may bring about insufficient supply and demand on the primary market necessary to appropriately reflect the public's evaluation of the prices of these securities. This might result in the Exchange becoming merely a quotation board furnishing prices for the bulk of the transactions in listed securities being made off the Exchange Floor.

Consequently, we would urge a careful examination of alternative means for preventing this erosion of the primary market -- including revision of the Exchange Act to apply also to unlisted companies meeting certain distribution and asset standards and restrictions on trading listed securities off a registered exchange which is the primary market.

An appropriate extension of the jurisdiction of the 1934 Act to certain size unlisted companies would, we believe, encourage sufficient additional listing to more than offset the loss of business to the regional exchanges. The result would be the development of the regional exchanges as legitimate primary markets in local issues. And the elimination of over-the-counter markets in listed securities would permit the primary market to fulfill its vital role in a far more ideal and comprehensive manner.

Sincerely,

(signed) G. Keith Funston