THE FLOOR DEPARTMENT
Memorandum

November 12, 1963

Operation S.E.C.

Today the following persons met with me in my office:

Walter N. Frank	-	Vice Chairman of the Board
J. W. O'Reilly	-	Associate Director of The Floor Department
David Silver	-	Special Counsel to the Director of Division of Trading and Markets
Gary Strum	-	Attorney - Division of Trading and Markets

It was made clear at the outset that nothing said by Mr. Frank, Mr. O'Reilly or myself should be construed as an expression of the Exchange's position in any matter, since such positions will be determined only by the Board of Governors. Mr. Silver made it equally clear that any remarks made by him or Mr. Strum would not necessarily reflect the official views of the Commission.

The purpose of the meeting was to obtain clarification from the S.E.C. staff members concerning the recommendation in the Study Group Report with respect to the participation of specialists in openings [Chapter VI - Section D 5(a)].

I started the discussion by pointing out that the recommendation involved a rigid restriction on the participation of the specialist in opening transactions, and a proposal that opening prices be permitted to move from the previous close in the direction dictated by public supply and demand; but that, on the other hand, the Study Group Report also recognized the need for the specialists' participation to provide price continuity. In view of this we asked for clarification.

Silver gave a hypothetical case of a specialist who has 5,000 to sell at the market and 1,000 to buy at the market. Silver said it is the purpose of the recommendation that the specialist, under such circumstances, could not buy more than 4,000 shares, regardless of market conditions or what the specialist may feel the needs of the market will be.

He said the philosophy of the Report demonstrates a basic acceptance by the Study Group of the dealer function, but that at openings, where there is a concentration of buying or selling, the price should be in the direction of the pressure of public orders; and that the specialist should not participate for his own account in such a way as to move the price against the public balance.

We then discussed the importance of specialists being permitted to anticipate the needs of the market. It was pointed out that such a rigid restriction could damage the price continuity at the opening and following the opening sale. Mr. Frank gave a hypothetical case of a stock which closed at 39 3/4. The following morning the specialist has 5,000 to buy at 40 and 2,000 to sell at 39 3/4. He also has 2,000 to buy at the market and 1,000 to sell at the market. The best offer on the book is at 41 and the specialist has no position. The lack of offers and the possibility of subsequent demand causes the specialist to feel that an inventory would be desirable in order to supply stock and maintain price continuity on the way up. Yet, under the proposal he could not acquire stock; and if the stock were to open at 40, the specialist would have to sell "short" 4,000 shares. The point demonstrated by this example seemed to give Silver some pause.

Silver then stated that he hoped the Exchange did not regard any of the recommendations (I believe he referred only to those concerning the specialist) as being "hard and fast." He stated that he would not like to see us approach the various recommendations with the thought of coming up with just a rigid "yes" or "no" answer. He expressed the hope that the Exchange would suggest possible modifications or qualifications which could accomplish the basic purpose. He also said that although the word "rule" had been used in many places, it is possible that if the Exchange and S.E.C. could agree on the basic philosophies, some matters might be resolved by expressing them to the specialists as "statements of policy."

In addition to the discussion concerning openings, Silver made reference to practically all of the major recommendations concerning the specialists. The highlights of his remarks in these areas were as follows:

> That their Recommendation [Chapter VI - D(2)] that part of the Saperstein Interpretation be embodied in in a commission rule under Section 11(b) was prompted principally by the lack of a legal basis upon which they could move in the Re & Re case; that the rule they contemplate would be written in broad terms to cover such situations as the Re case; that they envisioned the present so-called "Saperstein Interpretation" as a commission rule with an affirmative obligation to deal; that in their minds it would be much like the short selling rule, which is a rule of the S.E.C. and actually enforced by the Exchange; and that they do not have in mind using the rule as a means of putting themselves into business to conduct day-to-day regulation of specialists' performance.
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> That it is his feeling that the recommendation to increase specialists' capital requirements is one which probably should not meet with opposition; that he is hopeful the Exchange will be able

to present its position on this subject fairly soon. (I told him his feelings would be stated to the Committee on Specialists, but that there are many other matters that are under consideration and we are not in a position to give any indications of timing.)

That they had given thought to the segregation of the broker-dealer function but felt that strengthening the controls and surveillance over the specialist would be a much better course to pursue.

That they felt very strongly about the printing of stopped stock and all transactions on the tape.

That the recommended prohibition against stopping stock with a customer's order would not apply to a broker. (This statement came as a result of a question from Mr. Frank. When asked to explain the difference in attitude toward the broker, Silver stated that the specialist has a duty to maintain the market which the broker does not have, and that the specialist may be using the customer's order as a substitute for risking his own capital to maintain the market; whereas the broker would not have such a motive since he does not have a responsibility to maintain the market.)

Toward the end of the discussion, Silver asked whether we could give him any idea of the timing with respect to the presentation of the Exchange's position concerning the various recommendations concerning the specialist. We told him it was not possible for us to do so. However, I explained to him that meetings are being held regularly not only by the Committee on Specialists but also by other Committees to whom the various recommendations on other subjects had been assigned; that I did not believe the Exchange was contemplating delaying discussion with the Commission until all the recommendations in the area of the specialist had been resolved by the Board, but that I envisioned the possibility of discussing the recommendations in groups of subjects which seem related to each other. In this connection, he made the comment that the adoption of one or more recommendations where there is agreement on the part of the Exchange would lead to a better "atmosphere" in the subsequent discussion of other recommendations. At this point he again mentioned the hope of reaching agreement in the near future on the proposed increase in specialist capital requirements.

W. K. Vanderbeck

Copies: Walter N. Frank
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