

HOLD FOR RELEASE

4 P.M. THURSDAY,
SEPTEMBER 24, 1964

The New York Stock Exchange reported today that its Board of Governors has proposed modification and expansion of a number of its present rules governing several phases of the Specialist System.

In a letter to the Exchange's membership, Henry M. Watts, Jr., Chairman of the Board of Governors, and Keith Funston, Exchange President, said the revisions of existing Exchange rules, policies and procedures "do not represent or suggest any basic changes in the Specialist System" or its functions. This system, "as presently structured, is essential to the maintenance of a continuous two-way auction market for securities," they stressed.

The changes, approved by the Exchange's Board of Governors, deal principally with questions of procedure, they added. Among these procedures are included new provisions on liquidation of positions by specialists, certain modifications of rules dealing with "stopped" stock, practices governing "cleaning up" blocks of stock, and certain limitations on specialists servicing public accounts.

The modifications in the Exchange's rules, policies and procedures would take effect concurrently with adoption of a proposed new SEC rule which spells out more clearly certain requirements in respect to specialists' operations, the two Exchange officials said. The SEC rule "for the first time" embodies "the SEC's formal acknowledgement of the broker/dealer functions of the specialist," they reported. In addition, they said, the new rule "would have the effect of incorporating the Commission's endorsement of the Specialist System into the SEC rules."

The SEC has stated that the present rules of the Exchange, together with

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the modifications proposed by the Board, would fully satisfy all of the requirements of the proposed SEC rule.

Messrs. Watts and Funston said a Special Committee on Specialists, headed by Mr. Watts, began talks with the SEC staff last May which produced a useful "interchange of ideas." Other members of the committee are Walter N. Frank, Marcus & Co., Vice Chairman; James Campbell, Jr., Marks & Campbell; Richard deLa Chapelle, Lee Higginson Corp.; Norman S. Kohlmeier, Kohlmeier & Co., New Orleans; Robert J. Lewis, Estabrook & Co.; Carl N. Miller, Bache & Co.; John J. Phelan, Phelan & Co.; Milton R. Underwood, Underwood, Neuhaus & Co., Houston; and Alexander Yearley, IV, Robinson, Humphrey & Co., Atlanta.

As a result of these conferences, the two Exchange officials said, a number of recommendations originally made by the SEC's Special Study group were modified or substantially changed. "However," they continued, "where a Special Study recommendation appeared to offer the prospect of improving the Specialist System, the Board has not hesitated to endorse and take appropriate steps toward implementing it. The changes worked out between the Commission and the Exchange represent a constructive joint effort providing for implementation of those aspects of the Special Study recommendations which the Commission and the Exchange believe are in the public interest."

The two Exchange officials said that in adopting these modifications the Board was guided by three basic criteria:

1. "Would these measures serve the public interest?"
2. "Would they add to the overall quality of the Exchange market?"
3. "Would they help strengthen the Specialist System?"

To this end, the Board "concentrated on measures that can strengthen the Specialist System without disturbing the balance between regulation and flexibility which is so essential to the continued effectiveness of the system." These measures are consistent with the "Exchange's overall objective of bringing the performance of every specialist closer to the levels

maintained by the best specialists," the Exchange said.

Messrs. Watts and Funston said they thought it "significant" that the Special Study found that the Specialist System in its present form "appears to be an essential mechanism for maintaining continuous auction markets...and appears to be serving its purposes satisfactorily."

The letter said that modifications in the Exchange's rules, policies and procedures would be made in 12 areas reviewed by the Board. In four of these 12 instances "new procedures would be established," Messrs. Watts and Funston noted.

In other instances, the Board's action would involve an increase in Exchange requirements, codification of existing policies, reporting requirements, or proposals for future study.

The four new procedures would provide:

1. In establishing, increasing, liquidating and reducing positions in specialty stocks, existing rules would be modified to affirm current policy that a specialist's transactions should be consistent with his market-making function - taking into account the condition of the general market, the market in the particular stock and the adequacy of his position to the immediate and reasonably anticipated needs of the market.

Unless a specialist has the prior approval of a floor official, he should avoid liquidating all or substantially all of a position by selling stock at prices below the last different price - or by purchasing stock at prices above the last different price - unless such actions are reasonably necessary in relation to his overall position in the stocks in which he is registered. In addition, specialists should avoid failing to re-enter the market, where necessary, after effecting such transactions and should avoid failing to maintain a fair and orderly market during liquidation.

In addition, existing Exchange policy limiting a specialist's acquisition to 50 per cent of a substantial amount of stock offered at the last sale

price, and providing for his re-entry into the market, would be incorporated into the Exchange's rules.

2. A prohibition against a specialist "stopping" stock against the book or for his own account at a price at which he holds an order capable of execution, except under certain conditions. At the same time, the rule would affirm that a specialist may "stop" stock for his own account when there is no executable order on the book at the "stop" price.

"Stopping" stock is a market procedure used by a broker at his own discretion, and when circumstances permit, to assist him in getting the best possible price for his customer. The privilege of "stopping" stock is usually granted by the specialist in the stock.

The practice of "stopping" stock contributes to price continuity and orderliness in the market. The measure adopted would permit a specialist to continue to grant a stop in many situations where the overall effect is beneficial.

3. Establishment of a uniform practice requiring specialists when "cleaning up" a block of stock to execute agency orders on the book at the clean-up price - except for the amount of the block which can be executed at the current bid or offer. A similar concept of trading at one price would be established for situations in which a specialist intends to deal immediately with orders on the book which have limits at two or more different prices.

4. No specialist would be permitted to accept a buy or sell order for any stock in which he is registered directly from the issuing company, from its officers, directors or 10 per cent stockholders, from any pension or profit-sharing fund, or any institution such as a bank, trust company, insurance company or investment company.

Also, no order given to a specialist in stocks in which he is registered would indicate the account for which it is entered. In addition, the Exchange's rules would be modified to incorporate present policy that it is

contrary to good business practice for a specialist to "popularize" his specialty stocks.

The Exchange found no indication that specialists have given preferential treatment to their own public customers and said that present Exchange rules and procedures preclude them from doing so. The proposed revision is designed merely to provide additional safeguards against the remote possibility of preferential treatment being given in the future.

Other changes calling for modification of present Exchange rules would provide for:

1. An increase in capital requirements so that each specialist unit would have the ability to carry 12 units in each registered common stock. In addition, capital requirements would be changed for relief specialists.
2. Affirmation of current Exchange policy that, in normal situations, specialists' participation in openings and reopenings should not have the effect of upsetting the public balance of supply and demand.
3. Inclusion of the concept that "reasonable depth" is a factor to be considered in specialists' maintenance of fair and orderly markets.
4. Affirmation that specialists' transactions for the purpose of adjusting inventory in a stock are not to be made except as a part of a course of dealings reasonably necessary to assist in the maintenance of a fair and orderly market in that stock.
5. Continuation of the present practice of printing transactions involving "stopped" stock unless objected to by a member. After the close each day, each transaction not printed during the day would be printed on the tape and tabulated separately on the "sales sheets." These transactions would be included in the total volume reported for the day. When the "900 Ticker" becomes operative later this year, the feasibility of printing all "stopped" transactions with a special designation would be reviewed.
6. Notification to the Exchange by lenders of any intention to issue a

margin call to, or change or terminate an existing financial arrangement with, a specialist. In addition, the Exchange would notify the SEC of any case in which it appears to the Exchange that a specialist cannot continue in business because of his inability to make satisfactory financing arrangements or to meet a margin call promptly.

7. A requirement that, beginning with its next fiscal year, each specialist and specialist unit keep records showing its commission income and dealer profit and loss in each specialty stock, and that such data would be available for the confidential use of the Exchange, on request.

8. Affirmation of current policy that if the Exchange finds any substantial or continued failure by a specialist to engage in a proper course of dealings, his registration in any or all of his specialty stocks shall be subject to suspension or cancellation.

The Exchange also plans to publish a new circular to be distributed to all specialists calling attention to Exchange policy that specialists' quotations for their own account "bear a proper relation to preceding transactions and anticipated succeeding transactions."

With regard to the development of additional techniques for the surveillance of specialists, the Exchange will continue its studies to determine the feasibility of using computer equipment for this purpose. The Exchange's efforts in the computer field have long been directed toward the goal of automating Floor operations and surveillance to the greatest extent feasible. Perhaps the major problem which has to be solved is the development of techniques for inputting data without hampering or slowing down trading procedures.

(EDITORS: The text of the revised Exchange rules covering specialists is attached.)

NEW YORK STOCK EXCHANGE

March 16, 1965

Messrs. Silver, Poser and Birnbaum (later Fried) represented the SEC and the Exchange was represented by Messrs. Chapman and O'Reilly.

Silver said it was their general feeling that the new Floor Trading Rules had accomplished their purpose; but that the Exchange has not kept the SEC aware of administration, interpretation and enforcement of the Floor Trading Rules. They said they are very disturbed over the liberal administration of the rules instead of a tough enforcement policy.

Silver said they were shocked to note that members who were not registered traders had effected transactions on the Floor; and that these members had merely been sent a letter. He said it was ~~his~~ feeling that at least the matter of a rule violation of this nature should have been reviewed by the Advisory Committee. Silver said the Exchange was quick to act against violations of the Commission Law where members did not charge commissions and that, regardless of their feelings concerning the new Floor Trading Rules, we should strictly enforce them. He said that the Division was prepared to recommend that the Commission take action against members who traded on the Floor if they were not registered traders. I mentioned that the violations he referred to had not been willful; that I did not feel the cases warranted Advisory Committee consideration; and that all violations of Commission Law were not considered by the Advisory Committee. I gave illustrations regarding this latter point and also mentioned that even District Attorneys did not prosecute all matters brought before them. (SEC Short Selling Rule violations would be another example)

Silver said the Floor Trading Rules are complex. In this connection, he mentioned the area where members have been on the Floor during the day and leave the Floor to enter orders which are then considered off-Floor trading. He said that they had carefully stayed away from and "did not insist on" restrictions on off-Floor trading. However, they felt it was necessary for the Exchange to move in the area of tough administration with respect to such off-Floor trades initiated by non-registered traders. He suggested that we prepare interpretations which would set guide lines for members who entered off-Floor trading orders after they had been on the Floor. I reviewed steps we had taken to keep abreast of such trading including checking on the percentage of

total off-Floor trading by fifty Floor Traders, obtaining records of the same members with respect to their trading for a month in three active stocks during a volatile period, and obtaining more specific information regarding orders on one specific day. I also mentioned that we are presently interviewing these fifty members in order to ascertain how they are entering orders, the frequency of such orders, whether they enter buy and sell orders in the same stock on the same day, etc. I reviewed the highlights of what we had learned from the first twenty interviews and told them we would let them know the results of the remaining interviews.

There was a discussion regarding the type of Floor Trading Rule interpretations we would send them. Birnbaum asked for a copy of all inquiries that come over the "White Telephone." I said the information was available for him to examine in our office. Silver asked that they be informed any time a situation came to the Exchange's attention which could be argued whether it would be a violation or not; and any time a reasonable person might consider an action a violation, if it occurred.

The matter of a member acting as a broker and also trading in a stock was discussed. This led into the procedures we are following in checking for possible violations. In this connection, I mentioned that we had completed four of these inquiries; that we intended to check on Registered Traders at least once during the year; that we had found one member who had violated the Rule but our investigation was not complete on it.

Silver said there had been a long discussion at the SEC before they agreed to permit one partner of a firm to trade for own account and another partner of the same firm to handle brokerage orders. He said that they did not mean for the partner who is trading for own account to trade for firm account and they could not understand our permitting joint trading accounts where one broker handled brokerage orders and the other traded in the same stock. He felt we were reading the rule very technically. I mentioned that we had discussed this matter with them and they had agreed to it. I said that I was applying the example of the member firm to joint accounts. I said I saw no difference. He reiterated that he did not feel that a partner could trade for the firm account and another partner handle brokerage orders. Later he seemed to indicate he was referring to institutional orders.

Silver and Birnbaum both said they felt the words "effect a transaction" included handling an order. I told them I could not see such a meaning. To me, effecting a transaction meant to execute an order. Silver said words had many meanings, that I was interpreting the words liberally and not in the spirit of the SEC's understanding. Further, he said the purpose of the Rule was not to trade in stocks where firms had orders but to permit an individual partner to trade for his own account if he had not handled the order.

Poser referred to the "sloppiness" of reporting of times on the Registered Trader's Form 82 Reports. He also said he felt that in administering the "Three-Man Congregating Rule" that we should not restrict ourselves solely to cases where the members reported identical times on their reports. I said that we did not place such a limitation on our inquiries insofar as I knew. I asked whether Birnbaum, in looking over our files, had found any cases such as that. He did not answer.

Silver brought up the subject of the arbitrage exemption under the SEC Rule and asked what we were doing to see that transactions claimed as exemptions were really "bona fide" arbitrage. I said that we were checking the bona fide arbitrage transactions reported by Registered Traders to the best of my knowledge but that if we were not, I would let them know. I also mentioned that Member Firms and The Floor Department were working on a joint circular on the subject for issuance to the membership so that all members, including those who are not Registered Traders, would have knowledge of what they could and could not do. Silver said their Short Selling Rule would be involved and asked whether we intended to consult the SEC. I told him we had a file on SEC Rulings on the subject; that we had not arrived at the stage where we wanted to consult anyone; and that the circular was some weeks away from finished form because of the complexity of the subject and the different factors involved. ¶ In summarizing their feelings, Birnbaum said that we should probably require reports from Registered Traders on their off-Floor transactions; and from non-registered traders who were on the Floor during the day on their off-Floor trading. He inquired whether we had any information regarding the percentage of Registered Traders' transactions executed by specialists and \$2 Brokers. I answered in the negative but said the information was available on the Form 82 reports covering the two weeks when we were conducting the test on the Floor in connection with automating the surveillance of Floor Trading transactions.

Silver said they were primarily interested in preventing violations or misunderstanding by making interpretations ahead of time and educating the members by means of circulars.

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There was a discussion regarding the liaison between Member Firms and The Floor Department. (Mr. Chapman withdrew and Peter Fried joined the meeting). Poser mentioned that the Stock Watch Report had an asterisk on certain stocks indicating The Floor Department was also investigating but The Floor Department findings were not reflected in the Stock Watch Report; and that this leaves the SEC with an incomplete picture. I mentioned that the Floor Trading Division sent a summary of Floor Trading to Stock Watch in the event that the total of trading in any stock was 3,000 shares. Birnbaum was familiar with this but said they did not have the copy of the form we used and I promised to send him one. I said that Member Firms uses the same list of stocks as we do but have a different purpose; that we are primarily interested, insofar as specialists are concerned, in the markets maintained by the specialists including price continuity and depth; and that Member Firms had no interest in such subject. I mentioned that we were going to give Member Firms a summary of the specialist dealings in the stocks where we had the specialist dealings. I also described how we examine and make up the list of stocks on the Stock Watch List. (They asked and I agreed to advise Mr. Poser when the agreement regarding specialists was worked out with Member Firms.) I also mentioned that the Department of Member Firms and The Floor Department kept each other advised with respect to subjects of material interest. As an example, I mentioned the Cohn & Delaire case where it was a joint investigation; without reference by name, I mentioned the Ellis case where there was a joint investigation; I also referred to the fact that we advise Member Firms of any matter that involves the rules they administer and they do the same with respect to The Floor Department.

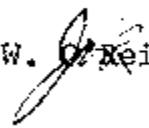
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I informed them that the Exchange had made a very diligent investigation of the eight cases they had turned over to us involving on-Floor trading and off-Floor trading. These were the cases which were to have been the subject of a public hearing on Floor Trading in the event we had not reached agreement with them. I said that in my judgment there were no cases which warranted presentation to the Advisory Committee; that there was one minor

violation of the Floor Trading Rules and there were three instances where I disagreed with the judgment of the specialists and, in each of these instances, the members would be advised. Further, I told him our files on these eight cases were available for their inspection and I inquired as to whether they wanted me to confirm what I told them in writing. Silver indicated that since the new rules corrected deficiencies which permitted such situations, that he felt this was a matter for the Exchange and not for the SEC.

I reviewed the standing of the "Definitions of Orders" and "Unusual Openings." I also took the opportunity of mentioning the question we had with respect to advertising on the tape after the close the specialist's desire to dispose of a block of a specialty stock at a fixed price. They indicated this would take a lot of discussion and thought. I told Silver that I would be in touch with him again with respect to the question. Silver, Poser and Birnbaum withdrew.

Peter Fried had raised a question concerning the specialist dealings in Dymo for the period September 22 - 30, 1964. I gave him a summary of the specialists' dealings and told him we had no reason to criticize the specialist's performance. He argued on the line that the specialists were buying stock when the price was rising on one day and on two days were selling stock on balance when the price was declining. I said we did not believe in the on-balance theory of looking at specialists' dealings but believed in the Tick Test and also in an examination of the specialists' dealings in connection with the transactions. On that basis I said we had no criticism of the specialists' performance.

J. W.  O'Reilly