Crisis in the Securities Industry

A Chronology: 1967-1970

Prepared for the Subcommittee on Commerce and Finance, Committee on Interstate and Foreign Commerce, House of Representatives

New York Stock Exchange, Inc.

In late July 1971, Chairman John E. Moss of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives, invited officers of the New York Stock Exchange, other securities industry representatives and the Securities and Exchange Commission to participate as panelists at a public hearing scheduled by the Subcommittee for August 2, 1971.

In his invitation to the Exchange panelists, Representative Moss described the purpose of the hearings: to "consider the problems of broker-dealers and their causes during the 1968-1970 period and the role of the various self-regulatory organizations within the securities industry and of the Securities and Exchange Commission in working towards solutions to those problems."

The Exchange prepared for and filed with the Subcommittee on July 30, 1971 a summary chronology which traced the industry's paperwork problem from its beginnings in 1967 through the ensuing industry-wide financial crisis, including subsequent developments to the end of July 1971.

This booklet contains the full text of the chronology, preceded by the text of an introductory statement presented by the Exchange panelists at the Subcommittee hearing on August 2, 1971.

* * * * *

SUBCOMMITTEE ON COMMERCE AND FINANCE

John E. Moss (D-Cal.) Chairman

Williamson S. Stuckey, Jr. (D-Ga.)
Bob Eckhardt (D-Tex.)
Charles J. Carney (D-Ohio)

James T. Broyhill (R-N.Car.)
John H. Ware 3rd (R-Pa.)
John Y. McCollister (R-Neb.)

William H. Painter, Special Counsel

PANELISTS

Securities and Exchange Commission:

Hon. William J. Casey, Chairman
Hon. James J. Needham, Commissioner
Irving M. Pollack, Director, Division of Trading and Markets
Sheldon Rappaport, Associate Director, Division of Trading and Markets

New York Stock Exchange, Inc.:

Lee D. Arning, Senior Vice President, Operations
Donald L. Calvin, Vice President, Civic and Governmental Affairs
Robert M. Bishop, Vice President, Department of Member Firms

Industry Representatives:

Felix Rohatyn, General Partner, Lazard Freres & Co.
Harold A. Rousselot, Chairman of the Board, duPont Glore Forgan, Inc.
Patrick E. Scorese, Liquidator, Blair & Co., Inc.
George L. Shinn, Vice Chairman of the Board, Merrill Lynch, Pierce, Fenner & Smith, Inc.

National Association of Securities Dealers:

Lloyd J. Derrickson, Vice President and General Counsel
Edward R. Gilleran, Vice President, Regulation
Richard Peters, Associate Director, Enforcement

CONTENTS

Page

Statement of NYSE Panelists 1

Crisis in The Securities Industry
A Chronology — 1967-1970 7

Part I: The Paperwork Problem 8
Part II: The Financial Crisis 22
Part III: Recent Developments 31

Exhibit A: Intermediate-Range Program to Improve Securities Industry Operations 44

Exhibit B: 27 Steps Taken by Securities Industry in 1968 to Improve Operations 46

Exhibit C: The Operations Checklist 49

Exhibit D: Selected NYSE Statistics (April 1968 — June 1971) 50

Statement of the Panelists from the New York Stock Exchange, Inc. to the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, August 2, 1971*

We appreciate the opportunity to appear as panelists in these opening hearings in the Subcommittee's study of securities industry practices. As always, the Exchange is pleased to cooperate with the Subcommittee.

As we understand it, these hearings will deal with the background of the problems faced by broker/dealers during the 1967 to 1970 period. These four years comprised one of the most difficult periods in the history of the securities industry. It was characterized by a crushing burden of paperwork followed by a severe cost-income squeeze that brought financial disaster to many brokerage firms.

It was a period crowded with developments and crises. To help set the stage for the subsequent discussion, we would take a few minutes to present a brief overview of the events of the four past years.

The problem began in 1967 with a sudden and unexpected upsurge in securities trading early in the year. The continued record pace of trading began to take its toll, as the months passed, in the form of a growing backlog of paperwork and delayed securities deliveries.

The securities industry is unique in that it must process business as it is received, as the service it sells cannot be stockpiled. Therefore, the industry is subject to unpredictable changes in volume.

By early 1968, it was clear that the flood of business that had initially created the industry's paperwork problems were causing major difficulties – both operational and financial – for many securities firms, and a year of substantial difficulty ensued.

The following year was much the same, but by the end of 1969, the worst of the paperwork problems had been surmounted. However, a new crisis was beginning to emerge. By early 1970, the problem had changed dramatically, having shifted from one of overloaded capacity to one of insufficient business and shrinking profitability. Brokerage firms, which had made huge financial commitments for personnel, automation and other operations improvements, found their profit margins dwindling and then turning into losses. The sustained decline in both stock volume and prices in early 1970 eroded broker/dealer capital, brought heavy losses in trading inventory, and equally heavy

* The Exchange's statement was read by Mr. Arning.

operating losses. As a result, many broker/dealers were forced out of business.

In summary, the cycle of the four years – 1967 to 1970 – was one of an unprecedented and unexpected surge in activity, that necessitated substantial increases in operating and capital expenditures to increase capacity, followed by a substantial decline in activity and income.

Throughout this period, however, the New York Stock Exchange marketplace itself continued to function very effectively – almost impervious both to the furor taking place in hundreds of back and front offices throughout the securities industry, and to the sharp rise and then decline in stock prices and volume.

Mr. Haack, President of the Exchange, testified before this Subcommittee on February 26, 1969, on the background of the paperwork problem. His testimony also detailed the steps then taken by the securities industry to improve the operational situation.

The action taken by the securities industry at that time had its desired effect – the paperwork problem was largely under control by the end of 1969. While these efforts continued in 1970, the major Exchange effort was then directed to dealing with the financial problems created for member organizations as a result of the depression in the securities industry. As had been the case in the paperwork or operational crisis, the Exchange moved rapidly to deal with the financial crisis.

During this period the Exchange intervened directly in the affairs of nearly 200 member organizations – more than half the total number of firms dealing with the public. The most important result of this intervention was that the cash and securities of the customers of these firms were saved from loss that might well have been incurred.

During the two-year period – 1969 and 1970 – a total of 129 member organizations went out of business, merged or were otherwise acquired by other firms.

Most important, the Exchange, through its customer assistance program, has voluntarily committed $75 million to protect the customers of those firms which have encountered the most severe financial problems and were forced to liquidate.

An additional $15 million is specifically earmarked for possible use in connection with the duPont Glore Forgan indemnification agreement. Beyond this, up to $30 million may be made available to Merrill Lynch, Pierce, Fenner & Smith, Inc. under a separate indemnification agreement in connection with that member firm's acquisition of Goodbody & Co. Last week the Board of Governors sent a proposal to the Exchange membership asking approval to increase the ceiling on the Special Trust Fund by an additional $20 million. [On August 11, the membership approved this measure by a margin of nearly 6 to 1.]

Thus, the total cost of the Exchange's voluntary customer assistance program could exceed $130 million and, if all authorized funds were to be used, reach $140 million.

A table [page 5] showing the current status of the Exchange's customer assistance program is attached to this statement. Also attached are three charts [page 6] which demonstrate graphically the crucial developments of the past five years.

Chart I shows the average daily trading volume on the Exchange monthly for the last 5½ years and the level of total "fails" and fails over 30 days old from April, 1968 through June, 1971.

Chart II shows the number of sales and non-sales personnel and number of member firm branch offices from year-end 1965 to year-end 1970.

Chart III shows member firm capital and profits in member firms from 1965 through 1970.

During these crucial years, literally dozens of separate actions were taken by the Exchange and the securities industry. We have prepared for the Subcommittee a detailed chronology of the developments during this period, up to the present. This white paper is attached to our statement.

What have we, as a self-regulatory organization, learned from all this?

While it is not easy to generalize in the face of so many developments, it became apparent that:

1) the broker/dealer capital rules must be revised and strengthened;
2) the Exchange's Central Certificate Service, which eliminates the physical delivery of securities by immobilizing stock certificates within a central system, must be expanded; and,
3) Broker/dealer financial and operations reporting must be on a more frequent and more comprehensive basis to detect weaknesses at an early stage.

Substantial progress has been made in all three areas.

The Exchange adopted a new capital rule on July 15, after months of study and consultation with the Securities and Exchange Commission. The Central Certificate Service has been expanded to include New York Clearing House banks as participants as well as adding American Stock Exchange stocks. Currently, we are adding over-the-counter securities. Plans are underway to significantly broaden the scope and nature of the Central Certificate Service.

Reporting by NYSE member organizations has been expanded so that firms are reporting by way of a special questionnaire on their financial and operational status at least quarterly or more frequently, as required. This may be on a monthly, weekly, or even daily basis.

New Capital Rules

The changes in the capital rules aim at increasing the quality and permanence of the capital required of firms that deal with the public. While adjustments and fine-tuning may be required as the new rules are applied in the coming months, the Exchange is confident that the rules will provide a significant strengthening of the capital structure of a major part of the securities industry.

A *summary* of the new capital rules is included in the attached white paper.

Central Certificate Service

When Mr. Haack testified before the Subcommittee in February 1969, the Exchange's Central Certificate Service had not been fully activated. Basically, CCS is a computerized system for immobilizing stock certificates. Brokerage firms deposit certificates in their CCS accounts. Deliveries among these brokers are effected by computer debits and credits. The certificates remain in the CCS vault. More than 900 million shares are now on deposit, aggregating more than $30 billion.

Although use of CCS by participating brokers is voluntary, more than 75 per cent of eligible deliveries are being made each day between our member organizations by bookkeeping entry, rather than by physical delivery of a stock certificate.

CCS is expanding in other directions, as well. Ten of the eleven New York Clearing House banks now are direct CCS participants for computerized delivery to and receipt from participating brokers, in addition to the banks' participation in a collateral loan program through CCS.

Efforts are being made to broaden CCS further – to include other major investing institutions, such as mutual funds, pension funds and insurance companies, as depositors, and to enable out-of-state banks to take part. The Exchange and other organizations in the securities industry see CCS as the basic building block for a national comprehensive securities depository system.

Surveillance of Member Firms

The effectiveness of the Exchange's regulation of its member firms depends to a crucial extent on the information the Exchange is able to obtain from the firms and other sources for analysis of the operational and financial status of member firms.

Many such steps had been taken at the time of Mr. Haack's last appearance before the Subcommittee. Since then, the major emphasis

of the Exchange's monitoring program has been on the adequacy of member firm capital and the status of the firms' operations function.

The effectiveness of the Exchange's special surveillance program can be gauged by the fact that during 1970 some 170 firms came under such scrutiny and the great majority responded successfully to remedial steps under Exchange guidance – cutting their costs, infusing new capital or arranging mergers or consolidations with other firms. At year-end 1970, only seven firms remained subject to special financial surveillance.

This brief overview of the events of the past four years serves to illustrate the fact that the securities industry has come through a period of great stress.

The securities industry today is strengthened by the cooperative steps which have been taken by the Exchange, by its member firms, by other organizations in the financial community and by the SEC.

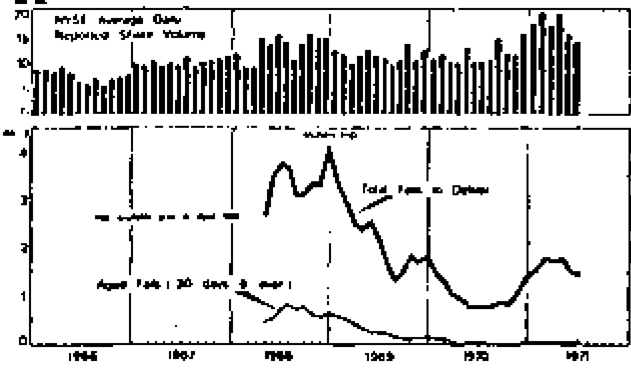
The Congress, and this Subcommittee, by passing the Securities Investor Protection Act has also added a new dimension to investor protection.

Further, we are confident that this Subcommittee's study of the securities industry, and the studies of the Senate Securities Subcommittee and Mr. William McChesney Martin, Jr., will prove helpful in effecting additional constructive changes to increase protection to investors served by the securities markets.

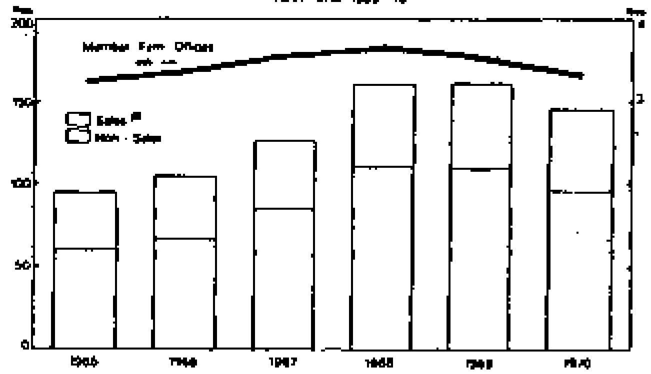
STATUS OF CUSTOMER ASSISTANCE PROGRAM
AS OF JULY 22, 1971

		Liquidations Fully Or Substantially Completed
Authorized Amount Available	$ 75,000,000*	
Funds Advanced and/or Committed, As Of July 22, 1971		
Amott Baker & Co., Inc.	1,861,000	X
Baerwald & DeBoer	900,000	X
Blair & Co., Inc.	14,900,000	
Dempsey-Tegeler & Co., Inc.	21,800,000	
First Devonshire Corporation	4,910,000	
Fusz Schmelzle & Co., Inc.	125,000	X
Gregory & Sons	5,340,000	X
Kleiner, Bell & Co., Inc.		X
McDonnell & Co., Inc.	8,425,000	
Meyerson & Co., Inc.	161,000	X
Orvis Bros. & Co.	4,200,000	
Packard & Co., Inc.	169,000	X
Robinson & Co., Inc.	1,550,000	
	$ 64,341,000	
H.S. Equities, Inc. (Formerly Hayden, Stone Inc.)	9,800,000	
Total Advanced or Committed	$ 74,141,000	
Balance Remaining Uncommitted	859,000	

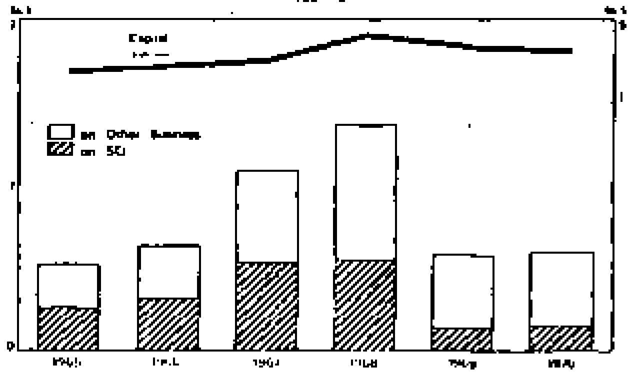
*(Increased to $95,000,000 effective August 11, 1971.)



NYSE VOLUME & FAILS TO DELIVER
Total Fails to Deliver
1966
1967
1968
1969
1970
1971



NYSE MEMBER FIRM OFFICES AND PERSONNEL
Member Firm Offices
Sales
Non - Sales
200
150
100
50
0
1965
1966
1967
1968
1969
1970



NYSE MEMBER FIRM PROFITS AND CAPITAL
1965 - 70
Capital
on Other Business
0
1967
1969
1970

CRISIS IN THE SECURITIES INDUSTRY

A CHRONOLOGY – 1967-1970

PART I: THE PAPERWORK PROBLEM

PART II: THE FINANCIAL CRISIS

PART III: RECENT DEVELOPMENTS

Prepared for the Subcommittee on Commerce and Finance Of the Committee on Interstate and Foreign Commerce, House of Representatives.

NEW YORK STOCK EXCHANGE, INC.

JULY 30, 1971

PART I: THE PAPERWORK PROBLEM

INTRODUCTION

From the standpoint of the investing public and the regulatory authorities – as well as of the New York Stock Exchange, its member organizations, and, indeed, the entire financial community – the operational difficulties which became known collectively as "The Paperwork Problem" comprised the core of the most serious crisis faced by the securities industry in 40 years.

Triggered initially by the sudden upsurge of share volume in all markets during the late summer of 1967, the paperwork problem persisted in one way or another through early 1970. Throughout that period, the New York Stock Exchange took the lead in organizing a massive coordinated assault on the operations tangle that stemmed in large measure from antiquated or otherwise unsatisfactory securities handling methods prevailing at many brokerage firms, banks, corporate transfer agents, and virtually every type of financial organization involved in the various phases of the securities issuance and transfer process. A complicating factor in some instances centered on hasty efforts to apply sophisticated computer technology to operations problems which had not been adequately analyzed in advance.

Another factor was the "management gap" attributable to the depressed state of the securities industry between the late 1920s and the mid-fifties. In some instances, older experienced management personnel simply had not groomed successors and found themselves overwhelmed by problems brought on by the volume surge. At other firms, younger management people did not at first appreciate the risks inherent in the avalanche of paperwork or in neglecting to maintain financial standards above the minimum requirements set by the Exchange.

While the problems were industry-wide, many individual organizations were, of course, able to maintain high standards of efficiency as a result of planning and development of stronger operational capacities and methods long before the onset of the paperwork

problem. Many NYSE member firms, for example, did foresee in the late 1950s and early sixties the need for improving back-office operations and had already installed and gained experience in using sophisticated automation equipment and techniques.

At the Exchange itself, development of a faster stock ticker and automated data-processing equipment – long before 1967 – set the stage for the Exchange to perform its own reporting functions efficiently throughout the high-volume period; and ticker performance was further strengthened by the implementation of special methods – deleting volume, deleting repeat prices, etc. – when volume pressures mounted. Development of the Exchange's Central Certificate Service was well-advanced by 1967, although CCS was not fully geared to play a major role in helping to process paperwork until 1970.

Unfortunately, even the most efficient firms were hampered to some extent by inefficiencies elsewhere which affected their own operations. For example, failures to receive and deliver securities in many cases stemmed not from deficiencies in a particular firm's own operations, but from problems at other firms, banks or transfer agents with which the firm could not help dealing on behalf of its customers. Significantly, the most persistent problems involved the processing of over-the-counter transactions – an area where the Exchange had no direct jurisdiction to effect improvements except through its assumption of a leadership role in coordinating the industry-wide assault on the paperwork situation.

By the start of 1969 – with the beginning of what was to become an 18-month decline in stock prices and volume – most aspects of the paperwork problem had begun to yield, albeit in varying degrees, to corrective measures. By early 1970, the cumulative effects of lower share volume and general industry-wide improvements in operating procedures succeeded in bringing the paperwork problem down to manageable proportions.

(In its aftermath, however, the lingering effects of the paperwork problem contributed heavily – along with the industry-wide profits squeeze which was progressively aggravated by the continuing price and volume decline – to the development of serious financial problems at many securities firms. Mergers and acquisitions, selloffs

of branch offices, and emergency infusions of capital helped most the troubled NYSE firms weather their individual crises. Howeve the seriousness of capital problems at a relative handful of firr precluded or resisted the most intensive efforts at solution. Th result was a small – but, to some observers, alarming – number rescue operations or liquidations in which the Exchange played dominant counseling or supervisory role.)

Inevitably, the resurgence of share volume in January and Februar 1971 – to levels exceeding those of 1967 and 1968 – generated good deal of concern on the part of the public, the regulator authorities and the industry itself regarding the industry's ability t handle it. To date, there appears to be no imminent danger of recurrence of the severe operational problems experienced during th earlier period. This is probably attributable to a combination o factors, including: a much greater proportion of large order contributing to heavy share volume; general industry-wide upgradin of back-office procedures and personnel; and efficient performance of a more comprehensive Central Certificate Service. Exchange member firms, in general, are more sensitive to the complex problems of massive records-keeping control and financial exposure than they were in 1967.

Nevertheless, the Exchange has taken a number of specific steps, described later in this paper, to help member firms guard against the possibility of recurrences.

BACKGROUND – 1967

Beginning in the early 1960s, share volume on the New York Stock Exchange – as measured by both daily average volume and total reported volume – increased at a reasonably steady and, for member firms, manageable rate. The rate of increase began accelerating sharply, however, in early 1967. Reported volume for the first quarter of 1967 was 615 million shares – 14% above the previous record total for any three-month period, and considerably more than the total reported volume for the full year 1957. New records were set during each of the succeeding quarters of 1967, and total reported volume for the year was 2.53 billion shares – a one-third increase over the preceding year.

By midsummer 1967, many securities firms were feeling the paperwork pressures generated by the prolonged high share volume, and the phrase, "paperwork problem," began adding itself to the language of Wall Street. To help ease some of these pressures, the NYSE Board of Governors curtailed trading by 90 minutes on nine consecutive business days, beginning August 8. A Special Committee of the Board developed a series of special procedures for member firms and the Exchange to follow in dealing with the growing volume of paperwork. Among the most significant of these were the establishment by Stock Clearing Corporation of an "early drop" facility to help provide a smoother flow of securities to the clearance operation; and the Board's authorization of nine "combined settlement dates" during the last five months of the year to create "free" days on which firms could concentrate on other aspects of their individual paperwork problems. In November, the Board voted to discontinue development of the Exchange's Central Computer Accounting programs and to channel the manpower, funds and energy thus freed into speeding final development of the Central Certificate Service.

A YEAR OF MAJOR STRESS – 1968

By early 1968, it was clear that the flood of business that initially had created the industry's "problems of prosperity" threatened to cause major difficulties – both operational and financial – for many securities firms. Heavy trading in both listed and unlisted securities in early January strained transfer and delivery facilities throughout the country. The Exchange's trading floor and reporting systems were able to handle the daily volume which averaged nearly 12 million shares for the month; but the number of "fails to deliver" securities among brokers showed a disturbing increase – with continued high volume levels allowing insufficient time for checking on delinquent items.

The Exchange sent a steady stream of letters and circulars to member firms, with specific suggestions for obtaining prompt customer delivery of stock certificates, maintenance of appropriate ratios between back-office and sales personnel in their recruiting and training plans, the all-important need for accuracy in records-keeping, procedures for safeguarding negotiable securities such as

government bonds, investigation of new operations personnel, ar margin safeguards.

New reporting requirements were adopted to help the Exchange ar member firms identify and deal with special problems. All memb firms carrying customers' accounts were required to file Speci Operations Questionnaires quarterly – or more frequently if require by the Exchange – with detailed information on the status of eac major area of records-keeping – including general ledger an customer account postings, dividends and stock record, and informa tion on such related matters as overtime, customer complaints, etc Many firms began placing voluntary restraints on business emanatin from problem areas such as over-the-counter transactions.

Where operations-troubled firms neglected to self-impose sucl restraints, the Exchange imposed specific restrictions either to limi expansion or reduce existing levels of business to more manageabl proportions. In practice, these restrictions began with limitations or opening new offices and hiring additional sales personnel. I necessary, restrictions were broadened to require discontinuance o advertising and sales promotion, firm trading, market-making and underwriting, and solicitation of over-the-counter business. In extreme situations, the Exchange placed quotas on the number of orders individual firms might accept; restricted firms from accepting any order which would cause a new customer asset to be delivered into a firm; and required firms to sell off branch offices. The Exchange's objective here was to identify and apply corrective measures to problems before they became so critical as to affect a firm's customers or other firms. In effect, the special restrictions were aimed at penalizing firms which had not properly managed their own growth, without unwarrantedly penalizing other elements of the industry. Limiting volume via restrictions, of course, freed employees of firms to devote more time to correcting errors and resolving outstanding open items.

The major securities industry organizations – the New York and American Exchanges and the National Association of Securities Dealers – established an Ad Hoc Committee on Office Operations (which included prominent operations executives of a representative group of member firms) to monitor the situation. Beginning January 22, trading in all securities markets was again limited to four hours a

day (10 a.m. to 2 p.m.). The Exchange directed member firms to keep offices staffed until at least 7 p.m. on weekdays; called for a full workday without the usual market on Lincoln's Birthday; and required member firms to staff their offices on Washington's Birthday. Beginning February 9, the settlement period was extended from four business days after a transaction to five.

(It should be noted that throughout the period associated with the paperwork problem, many firms continued to handle their own operations without undue difficulty – streamlining office procedures, strengthening personnel policies and adding new automation equipment and techniques. Many firms went to six-and seven-day office schedules; some added a second daily shift; others kept operating 24 hours a day when necessary. Some customers, while complaining of delays in receiving stock or of exotic billing mix-ups, may unintentionally have aggravated the problems at firms by making tardy deliveries to their brokers. The fact that, as the problems developed, the bulk of all *fails* to deliver involved over-the-counter rather than listed securities reflected credit on the Exchange's clearing facilities – but gave small consolation to over-burdened office staffs at member firms or to customers affected by back-office difficulties.)

Aided by the wide range of special measures adopted during the early days of 1968, member firms generally were able to make substantial inroads on the delivery problem, and the normal 5½-hour trading day was resumed beginning March 4.

In early April, representatives of the securities industry and the ten member banks of the New York Clearing House Association initiated a broad-scale cooperative effort to identify, research and resolve major problems of mutual concern. Five joint committees were established to study specific problems involving securities deliveries, transfers, collateral, credit and uniform securities identification. Other industry groups concentrated on looking into new developments in automation which might be applicable to securities processing; revisions of existing rules to set more stringent delivery requirements for brokerage firms; and a recruitment program aimed at attracting greater numbers of qualified clerical personnel into the industry.

To better document the scope of the paperwork problem an
backlog, the NYSE and the Amex, also in April, began requirin
member firms to report monthly *all* fails to deliver and fails t
receive listed and unlisted securities. However, with orders con
tinuing to pour in at unprecedented rates – NYSE reported volum
soared to 845 million shares for the second quarter, more than 25%
above the previous record for any quarter – the industry mobilize
for more drastic action. On the recommendation of the Ad Ho
Committee, the NYSE, Amex and NASD voted to close thei
markets one day a week beginning June 12.

The Exchange's Central Certificate Service began operations on Jun
21, when ownership of shares in four NYSE-listed issues wa
transferred between accounts of brokers by computerized book-
keeping entry. Additional issues were phased into the system –
according to an alphabetical schedule – throughout the remainder o
the year, and by year-end, a total of 535 listed issues (about 43% o
the total) were being delivered through CCS.

In mid-July, the Exchange began conducting periodic clearances of open fails in listed issues for member firms, pairing off aged fails submitted by the firms to eliminate intermediate deliveries and permit direct settlement of money differences.

A series of changes in NYSE rules were placed in effect in late summer and early fall to deal further with specific aspects of the continuing paperwork backlog. (The Amex instituted parallel changes at the same time.) Among the most important of the new requirements:

- **Mandatory Buy-Ins** – Beginning August 2, the Exchange required member firms to close contracts not fulfilled for a period of 50 calendar days after the settlement date. (Two subsequent additional changes provided for the execution of the buy-in order by the defaulting firm's broker instead of by a member of the Exchange staff; and reduced the age of open items subject to the buy-in rule from 50 calendar days to 30 days for stocks and 40 days for bonds. Since fails to deliver can be cleared up if a broker borrows stock, the Exchange also distributed a special directory of member firms available to lend stock to other firms wishing to avoid becoming subject to the buy-in requirements.

- Partial Deliveries – Beginning September 1, the Exchange prohibited member firms from accepting orders from customers who did not signify their willingness to accept and pay for deliveries on the basis of execution reports.

- Long Sales – Also beginning September 1, member firms were prohibited from making long sales for customers without specific assurance that the customers were prepared to make prompt delivery of the securities being sold.

- OTC Clearing – In a move aimed at the heart of the over-the-counter portion of the paperwork problem, the NYSE Board of Governors directed firms doing an over-the-counter business in the Metropolitan New York area to clear their over-the-counter transactions through the National OTC Clearing Corporation beginning no later than September 30.

- Fail Penalties – Beginning December 1, member firms were required to apply a graduated "haircut" – a charge against net worth in computing capital to meet Exchange requirements – ranging from 10% to 30% of the contract value of fails to deliver of 40 or more days' duration.

  (This requirement was aimed chiefly at aged fails in over-the-counter issues, since the Exchange's mandatory buy-in rule automatically took effect when a fail involving an NYSE-listed stock or bond reached the age of 30 or 40 days, respectively.)

Although 1968 had 12% fewer trading hours than 1967 – due to the elimination of 26 trading days and shortening of 28 others – reported share volume reached a new record of 2.93 billion shares, an increase of 400 million shares – or 16% – over the preceding record year. (Significantly, on 25 days during the year, reported volume exceeded the 16.4-million-share record which had stood since October 29, 1929.)

The considerable array of special rules and procedures aimed directly at alleviating the paperwork problem gradually began producing the desired effects – although continued high share volume through the

end of the year hindered even the most determined effort to whittle down the backlog. While total fails to deliver reached a year-end peak of $4.13 billion, aged fails at December 31 were down 22% from the mid-July peak of $837 million, and the industry ended the year with some hope that the operational road ahead would be smoother.

A YEAR OF IMPROVEMENT – 1969

Beginning January 2, the securities markets resumed five-day-a-week trading on a four-hour-a-day schedule. The cumulative effects of emergency measures, massive investments in both time and money for automation, and extraordinary efforts to increase both the numbers and quality of operations personnel – aided by some slackening of share volume – enabled most firms to keep abreast of current volume and make some headway toward clearing up the backlog.

CCS reached full activation for some 1200 eligible NYSE-listed issues in February. However, operational difficulties which persisted through August had the effect of limiting CCS' contribution to alleviating the paperwork problem through the remainder of the year.

Also in February, the NYSE and the Amex announced that the Rand Corporation had been retained to develop a long-range plan for improving the operations of the securities industry. At the same time, the two exchanges blocked out an intermediate-range program aimed at developing major changes in the way securities are processed and ownership transferred. Among the specifically identified NYSE programs were expansion of CCS, advanced design of automated clearing and central certificate systems, development of a complete Floor automation program and integration of such a program with CCS and the clearing operation. Other projects called for specific work to be carried out by the Amex alone and by the two exchanges cooperatively.*

In late February, President Robert W. Haack of the NYSE gave the Commerce and Finance Subcommittee of the House Interstate and

* Outline of Intermediate-Range Program is appended. [Exhibit A – Page 44]

Foreign Commerce Committee a summary report on the status of the paperwork situation.** Excerpts from his testimony follow:

> ". . . . .the paperwork problem is not only a New York Stock Exchange matter, but encompasses other national exchange markets, regional exchanges, and the over-the-counter market; it includes banks and it includes institutions. . . .
>
> "The causes and effects of this paperwork pile-up were severalfold. First, the process by which the industry physically handles, delivers, and then transfers ownership of securities is cumbersome, and when volume increased, it taxed the system beyond its capacity with existing personnel. This caused delays in customers receiving their securities, dividend credits, etc. Until different methods to evidence ownership and transfer are used, there will be delays in delivering securities to customers who desire a certificate in their name.
>
> "Concurrent with the paperwork pile-up, some member firms began to find their bookkeeping operations falling behind. This, of course, could have been the most serious aspect of the paperwork problem, had it not been controlled and corrected by the Exchange, because of the potential impact on the public. Prior to 1967, there had never been a serious records-keeping problem for the industry. Historically, the emphasis of the Exchange, the SEC and other industry regulatory organizations had been on enforcing rules to protect the customer from fraud in the sale of securities, from manipulation, and to provide financially sound organizations. Consequently, it was necessary for the Exchange to develop operational safeguards, in addtion to its historical self-regulatory policies. This has been accomplished and continues to be a priority among the Exchange's activities. . . .
>
> "Through examiner visits, analysis of financial and operational questionnaires and independent accountants' audits,

** A Summary of 27 Individual Measures was appended to Mr. Haack's testimony and is also appended herewith. (Exhibit B – Page 46)

the Exchange watches the financial and operational status of member firms. These sources have provided the principal information for placing member firms with operational problems under restrictions. These techniques, applied on a more frequent and comprehensive basis to restricted firms have also told us that the operational capacity of firms has improved dramatically. . . .

"In our opinion, the actions taken by individual firms and by the industry have managed to contain and reduce the paperwork backlog and over-all operational problems – except in the area involving aged fails in the over-the-counter market."

During the second quarter, although share volume remained at high levels – with the industry continuing on a four-hour-a-day basis – the general operational picture improved substantially. Total fails to deliver were down from the 1968 year-end peak of $4.13 billion to $2.55 billion at the end of May. Aged fails totaled $259 million at the end of May, less than one-third the $837 million peak registered in July 1968. In June, the Exchange conducted a special conference on the Surprise Audit by Independent Public Accountants – focusing on specific operational controls, audit planning and other aids toward combating the paperwork problem.

On the recommendation of the Ad Hoc Committee on Operations, trading on the NYSE and the other securities markets was extended to 10 a.m. – 2:30 p.m. beginning July 7, and to 10 a.m. – 3 p.m. beginning September 29. Fails figures at the end of August were the lowest since the Exchange began collecting fails data – $1.40 billion in total fails and $166 million in aged fails.

In August, the Board of Governors levied the highest fines in NYSE history – $100,000 against Charles Plohn & Co. and $50,000 against the firm's former managing partner – for violations of Exchange rules governing supervision of the firm's business in 1967 and 1968. (In September, the Board fined Hayden, Stone Incorporated $50,000 on each of three counts relating to violation of Exchange rules during 1968.)

In September, the NYSE and the Amex inaugurated a new program

designed to expedite the handling of customers' complaints – providing member firms with detailed guidance for establishing procedures aimed at giving management an overview of customer service activities, in order to pinpoint problem areas and speed corrective action.

Also in September, the Exchange began publishing "Perspectives on Operations," a newsletter designed to keep top management and operations personnel of member firms abreast of new developments in the various operations areas of the securities business.

By year-end, the industry – though hardly complacent – was justified in believing that the worst of the paperwork problem with which it had been grappling since mid-1967 was over. Volume for the year was a scant 80 million shares below the 1968 record – even though there were 100-odd fewer hours of trading during the year. (Average hourly trading volume in 1969, however, set a new record of 2.61 million shares, compared with 2.44 million shares in 1968.)

The principal barometer of the paperwork problem – fails to deliver – was well within manageable limits, and the industry had developed and assimilated dozens of new procedures and techniques for coping with sustained high share-volume levels. Total fails to deliver at year-end stood at $1.84 billion – down 55% from the preceding year-end peak; and over-30-day fails were down to $136 million, an 84% decline from the July 1968 high. A second statistical measure – the combined level of transactions on the NYSE and Amex – was running at an average of 59,300 a day at year-end, well below the 75,000 regarded as an early-warning level. The total level of fails, related to dollar volume of trading on the two exchanges – as reported weekly by a major segment of member firms – was equivalent to 1.8 days' combined dollar volume; this was well below the 2.5-day level which the exchanges regarded as cause for serious concern.

Steady improvement in the operational capacities of member firms had brought the total number of NYSE firms under operational restrictions down to 10 – from a total of 47 at the height of the 1968 crisis period. (In all, 105 firms were subject to some form of restriction at one time or another.)

The industry's emphasis had already begun to shift somewhat – from the necessity for dealing with urgent day-to-day problems which had given way to more or less routine monitoring of the operational status of firms as a means of detecting any danger signs for the future – to long-range programs aimed at minimizing the possibility that anything like the 1968-1969 problems could recur.

The Exchange President reported on a number of these programs in his annual message to the Exchange membership:

> "**The Importance of Unity** – We have close ties with other segments of the financial community – for example, with the American Stock Exchange, the NASD and other securities industry organizations, with the banking industry and with institutions. All of these organizations have a stake in seeing that the central marketplace operates as efficiently as possible – and we, in turn, want and need their support.
>
> "**A Nationwide Securities Depository** – . . .while many questions still must be resolved, we have our sights firmly set on the establishment of a truly nationwide depository system that will make the benefits of CCS available to everyone involved in the transfer and delivery of securities.
>
> "**Securities Industry Systems Study** – One of many concepts being evaluated is the so-called 'locked-in trade' whereby the trading floor would become an electronic bridge between brokerage firms and the clearance and delivery operations, triggering all the steps required to complete securities transactions.
>
> "**Long-Range Planning** – The need to engage in systematic, comprehensive long-range planning – and the importance of active support at the highest levels of management – (has been) stressed. . . .A series of planning bulletins has discussed basic planning techniques, projected NYSE volume, personnel needs and planning projects undertaken by various firms.
>
> "At the Exchange itself, a Long-Range Planning Com-

mittee of senior executives meets weekly to review the environment of the securities business and anticipate future developments.

"Integrated Automation Concept – The Board. . . approved a multi-phase proposal embracing changes and innovations in Exchange automation through the decade of the 1970s. The first two steps. . .call for an expanded-capacity Market Data System and computerized routing of odd-lot orders. These initial developments will serve as building blocks for the full program which would ultimately bring the concept of the locked-in trade into operation."

PART II: THE FINANCIAL CRISIS

A YEAR OF SHIFTING EMPHASIS – 1970

Almost imperceptibly, in early 1970, the securities industry's top-priority problem shifted from one of overloaded capacity to one of insufficient business. Having geared itself – at tremendous effort and expense – to handle expanded share volume, the industry suddenly found volume drying up and the value of securities inventories dropping sharply.

The first serious sign of the volume decline actually appeared in the third quarter of 1969, when daily average volume dipped to 10.3 million shares (from 11.6 million shares in the preceding quarter). Following a recovery to an average of 12.4 million shares a day in the customarily busy fourth quarter of 1969, the daily average fell below 11 million shares and remained there throughout the first six months of 1970. At first, the lower volume level was welcomed by some firms to which it offered an opportunity to make the final push in clearing up the remnants of the paperwork backlog. But as time went on, firms which had made huge financial commitments for automation and other back-office improvements – as well as for expansion to meet the earlier demands for customer service – found their profit margins dwindling and then turning into losses.

The industry's priorities began rearranging themselves to meet the new problem, with the Exchange again taking the lead – this time to deal with what was clearly developing into an industry-wide profits squeeze. The sustained decline in both stock volume and prices eroded member firms' capital and brought heavy losses in trading inventories, at a time when higher operating costs and general inflationary factors were adding another disturbing dimension to the industry's financial situation. The over-all result was that quite a few firms found their ability to comply with NYSE capital requirements impaired – and, in a few extreme cases, in serious jeopardy.

By April, two-thirds of NYSE member firms carrying public accounts were operating their commission business at a loss. To help alleviate the rapidly deteriorating situation, the Exchange, with SEC approval,

adopted an interim service charge on orders of 1,000 shares or less, pending establishment of a new minimum commission rate schedule. This charge – not less than $15.00 or 50% of the minimum commission applicable to the order, whichever is less – had the effect of improving the loss picture of the bulk of the firms; and, for many – especially those with a high percentage of small retail orders – it was crucial to survival in the face of the continuing profits squeeze. (On June 28, 1971, the Exchange presented an entirely new proposed minimum commission rate schedule to the SEC; and it is expected that the service charge will be discontinued with the adoption of a new schedule.)

Throughout 1970, a major Exchange effort was devoted to monitoring and trying to help firms correct deficiencies arising from substantial capital losses; working toward the development of a new minimum commission rate schedule; and providing financial assistance to customers of the relative handful of member firms forced into liquidation by their financial difficulties.

The cumulative events of the period from 1967 through 1970 led ultimately to the passage by Congress of the Securities Investor Protection Act of (December) 1970 and the creation of the Federally chartered Securities Investor Protection Corporation (SIPC).

Prior to SIPC's assumption of responsibility for the protection of its members' securities customers, more than 160 NYSE member organizations – and an undisclosed but presumably larger number of non-NYSE brokerage firms – went out of business. Most of the NYSE firms either merged with or were acquired by other NYSE firms – quite often through arrangements facilitated or initiated by the Exchange itself. Some 80 firms dissolved, retired from the securities business or self-liquidated, without undue public concern or inconvenience to customers. In most of the remaining situations, mergers or acquisitions were also arranged without serious inconvenience to customers.

While public attention focused on the affairs of 17 firms, many other equally or more dramatic situations remained outside the spotlight, as the Exchange worked intensively to assist troubled firms to weather their individual crises. Commenting on the role played by the Exchange, President Haack observed, in his annual message to the

Exchange membership (published in February 1971):

> "There are some people in our industry who believe that throughout the period of crisis – in the hectic days of the paperwork crunch and in the profits squeeze that followed – the Exchange itself functioned as a merciless taskmaster. And it is true that in the course of shepherding the industry through a major depression, stern measures were appropriate – and the Board of Governors, its Special Committees and, at their behest, the staff, did not hesitate to apply them when necessary.
>
> "The self-regulatory role exercised by the Exchange involved, first, the effort to clear up the massive operational difficulties experienced by scores of firms, and then, combating the capital problems spawned by the long price and volume decline. Through the successive crises, the Exchange intervened directly in the affairs of nearly 200 firms – more than half the total number doing business with the public. The most important result of this intervention was not that firms were occasionally miffed, but that the securities and cash of their customers were saved from losses that might well have been incurred in extended backruptcy proceedings – even when some of the firms themselves failed to survive."

The successful "rescue" operations carried out by the Exchange have never been widely publicized, but they are unquestionably a major element in the survival of the industry. The difficult decisions made by the Exchange during this period have been validated by the subsequent histories of the firms whose critical problems were not commonly known outside the Exchange and whose survival or orderly self-liquidation programs were, to a large extent, made possible by the absence of publicity.

The troubled firms experienced many of the same problems, although the details, of course, varied from firm to firm. At one time or another all of them were subject to some combination of more than 20 Exchange-imposed restrictions – ranging from bans on advertising and promotional activity to fixed limits on the amounts of business they were permitted to handle, and the requirement of

reducing expenses, personnel and branch office operations. The measures enforced by the Exchange were, of necessity, dictated by the specifics of each situation; some were hardlined, while others were flexible. But all were based on a thorough evaluation of reports and discussions with the firms' principals, and all were aimed at trying to return the firms to operational and financial viability.

The effectiveness of the Exchange's regulation of its member organizations depends to a crucial extent on the information the Exchange is able to obtain from the firms themselves, and from other sources of operational and financial information concerning the firms. The events of the crisis period underscored the importance of timely and accurate information and helped focus on specific areas in which improvements in information-gathering were desirable.

Many of the techniques developed and employed in monitoring member firm operations have already been described. As the paperwork problem gave way to an industry-wide financial crisis, the major emphasis of the Exchange's monitoring programs shifted to the adequacy of member firm capital.

Prior to the revision of the Exchange's capital rules in 1971, member firms carrying public accounts were required to have at least $1 of net capital for every $20 of aggregate indebtedness – i.e., a "net capital ratio" of 20:1. As evidence of capital problems at a number of firms began to mount, the Exchange, early in 1970, established an "early warning" system under which firms with capital ratios of 12:1 or greater became subject to special scrutiny by the Exchange, under the over-all surveillance of a Special Committee of the Board of Governors. Firms sustaining losses greater than 15% of their excess net capital in a given month also became subject to special monitoring, on the theory that continued losses of that magnitude could lead to capital violation within six months. These firms were required to submit detailed plans to the Exchange for cutting operating costs and adding new capital. They were also required to project probable operating results several months in advance and to submit weekly, and in some cases daily, reports on their financial condition.

Responsibility for maintaining surveillance of the financial condition of member organizations rests with five teams of coordinators in the

Exchange's Department of Member Firms. The system, initiated in 1969, was significantly reorganized and strengthened in 1970. Each of the five coordinator teams is responsible for continuing surveillance of a specific group of member firms. The coordinators receive the financial and operations questionnaires filed by their assigned firms and the reports of Exchange examiners, independent auditors, and the Exchange's regulatory divisions. The coordinators have developed a basic series of surveillance and guidance programs to uncover and alleviate financial or operations difficulties experienced at the firms under their jurisdiction. The various questionnaires used to collect information are currently being consolidated into a monthly report which will produce readily available, standardized information in depth, as well as standard information which will be placed in computers for comparison of comparable firms and trends over time by individual firms. The new system will give computerized assistance to the coordinator teams and promises to greatly increase their ability to identify emerging problems.

The effectiveness of this special surveillance program may be gauged from the fact that during 1970 alone, some 170 firms were subject to special scrutiny, and the great majority responded successfully to remedial steps under Exchange guidance – cutting costs, infusing new capital, or arranging mergers with other firms. At year-end 1970, only 7 firms remained subject to special financial surveillance.

Perhaps the most significant result of the program has been that customers of the 170 firms involved received their securities and funds held by the firms, and none of these firms has required any assistance from the Exchange's Special Trust Fund in the course of resolving those problems.

* * * * *

Of the 17 firms which attracted widespread public attention because of their severe financial difficulties, 10 went into liquidation under the supervision and control of Exchange-appointed liquidators (including one in 1968 and two in late 1969); 3 went into liquidation under their own direction but with financial assistance from the Exchange; 2 went into liquidation without need for Exchange financial assistance; and 2 averted liquidation through Exchange-

supported intervention by third parties with the assistance of conditionally pledged Exchange funds (one in 1971).***

The principal instrument of the Exchange's voluntary financial assistance to the customers of member firms in liquidation has been the Special Trust Fund originally established by the Exchange in 1964, following the liquidation of Ira Haupt & Co. The Special Trust Fund program reached its initial goal of $10 million, supplemented by $15 million in standby credit, in 1965. The Fund was augmented by an Exchange contribution of $5 million at the end of 1969, at which time the standby credit was reduced to $10 million. In June 1970, the program was expanded to $55 million to permit assistance to firms which had recently been placed in liquidation by the Exchange. (A summary of subsequent changes in Special Trust Fund authorizations and the current status of the liquidation and indemnification situations appears on pages 38-40.)

In the case of Goodbody & Co., the largest member organization to face the prospect of liquidation up to that time, a separate arrangement was developed outside the Special Trust Fund, under which another member firm, Merrill Lynch, Pierce, Fenner & Smith, Inc., agreed to acquire the troubled firm. As part of the program worked out with Merrill Lynch, the Exchange agreed to indemnify Merrill Lynch up to a maximum of $30 million in connection with specified possible losses and liabilities the firm might incur in connection with the acquisition. The Exchange would raise the necessary funds through assessments on its membership. It may be noted that the membership agreed to this course of action by a margin of better than six to one, and the acquisition was accomplished as of December 11.

*** **Liquidations By Exchange-Appointed Liquidators:**

Amott, Baker & Co., Inc. (1969); Baerwald & DeBoer; Blair & Co., Inc.; Dempsey-Tegeler & Co., Inc.; First Devonshire Corporation; Gregory & Sons (1969); McDonnell & Co., Inc.; Orvis Brothers & Co.; Pickard & Co., Inc. (1968); Robinson & Co., Inc.

Firm-Directed Liquidations With Exchange Financial Assistance:

Fusz-Schmelzle & Co., Inc.; H.S. Equities, Inc.; Meyerson & Co., Inc.

Liquidations Without Exchange Financial Assistance:

Kleiner, Bell & Co., Inc.; Charles Plohn & Co.

Indemnification Agreements Between Exchange and Third Parties:

duPont Glore Forgan, Inc. (1971); Goodbody & Co.

When Congress passed the Securities Investor Protection Act at the end of December, the Exchange announced the termination of its voluntary customer assistance program and planned phasing out of the Special Trust Fund. It was understood, however, that the Exchange would fulfill its prior commitments with respect to firms already in the customer assistance program. Under the SIPC legislation, the securities industry is committed to provide initial funding of at least $150 million.

* * * * *

While a major Exchange effort throughout 1970 was devoted to assisting scores of member organizations experiencing financial difficulties, other major programs continued to move forward, aimed at preparing the Exchange membership for the eventual return of favorable business conditions and new high levels of trading activity.

Stock Clearing Corporation's Central Certificate Service, for example, made important progress in expanding its services and refining its systems. More than 1.6 billion shares were delivered by computerized bookkeeping entry during the year – with the rate of eligible deliveries made on a voluntary basis increasing from 65% in January to over 75% by year-end. During the year, the total number of shares on deposit in the system increased to 553 million. Growing confidence in CCS – based on improved performance – was reflected in developments on three major innovations:

- An expanded pilot Collateral Loan program was operated during most of the year with the ten New York Clearing House Banks and some 50 NYSE Clearing Members as participants. More than $1.8 billion in collateral loans was initiated through the system in 1970.

- Eight Clearing House banks began participating in CCS as deliverers and receivers of stock via bookkeeping entry, substantially reducing the need for brokers to make deposits and withdrawals from the system.

- In November, CCS began accepting shares of an initial group of Amex-listed stocks for delivery among Clearing Members on a test basis. (In mid-April 1971, some 960 Amex issues

became eligible for delivery through CCS, bringing to 2,300 the total number of eligible issues deliverable through the system.)

In April, the full resources of Stock Clearing Corporation were brought into play in connection with clearance, settlement and delivery procedures involved in the listing of long-term warrants issued by American Telephone and Telegraph Co. as part of a complex $1.5 billion financing program. Specially devised procedures reduced the number of warrants requiring delivery from nearly 22 million to less than 6 million. The delivery of rights in connection with the issue was accomplished through CCS.

In another significant development, Stock Clearing Corporation, in May, converted from a Bond Comparison Service to a Bond Clearance Service for all NYSE-listed domestic corporate bonds. By year-end, some 91% of listed bonds were being cleared through the service – a degree of utilization that played a considerable part in reducing bond fails to deliver in early 1971. (Effective March 15, 1971, clearance of all listed domestic corporate bonds became mandatory.)

The Banking and Securities Industry Committee (BASIC) recommendation of a three-stage timetable for mandatory use of CUSIP standard identification numbers on all stock certificates and registered bonds was endorsed by the Exchange in 1970 – and implementation was begun. BASIC's study of possible development of a machine-readable stock certificate raised the provocative question of whether or not rapid development of an expanded central depository – which would include major over-the-counter issues as well as those listed on stock exchanges – might actually pre-empt the usefulness of an automated certificate. Subsequent BASIC studies have indicated the likelihood that this may occur.

The long stock price decline finally slowed in late May – the same month in which (on May 4, on the recommendation of the Ad Hoc Committee on Office Operations) the industry finally returned to a normal 5½-hour, 5-day trading week. By July, a modest upward price trend appeared to have developed. Volume, however, showed a more dramatic upward trend than prices – averaging 11.7 million shares a day on the NYSE during the third quarter, and more than 12.9 million during the final three months of the year. The vigorous

renewal of trading activity nudged total reported volume for the year just past the 1968 record – to 2.94 billion shares.

There was strong evidence that the industry – having come through both the paperwork blizzard of 1968 and early 1969, and the 18-month drought that followed – was ready and able to handle the new surge of activity. Total fails to deliver at year-end stood at $1.39 billion – just one-third the peak recorded at the end of December 1968, and 24% below year-end 1969. Aged fails were at the nearly insignificant level of $52.5 million. To be sure, the 1970 year-end figures were higher than the lows registered earlier in the year, and the industry was keeping a watchful eye out for possible unfavorable developments. In this context, it is significant that the NYSE did not find it necessary to place any member firm under operational restrictions through the end of the year.

To help minimize paperwork-related problems in the future, the Board of Governors, in November, established new minimum requirements for member firms' control of securities in their custody. New rules, effective January 1, 1971, require firms to make periodic counts of securities under their control; account for ledger balances with the securities held by clearing corporations or correspondents; and reflect all unresolved differences in a special "security count difference" account.

These rules were a part of a securities industry-wide program to reduce the problem of missing and stolen securities. During 1967-1970, the Exchange, in cooperation with member firms and other securities industry organizations, took a series of steps to reduce criminal activity in the securities industry. These included expanded background checks of employees; improved security procedures in member firms; support for the passage of fingerprinting legislation in New York State; and educational programs to broaden awareness of the problem and of appropriate action which might be taken by member firms. The effectiveness of these programs became evident as the number of instances of lost and stolen securities, according to Exchange surveys, declined from a high of 1,755 in 1968 to a low of 809 in 1970. At a hearing before the Senate Permanent Subcommittee on Investigations on June 23, 1971, the Exchange offered five suggestions for possible legislative action in connection with the problem of stolen securities.

PART III: RECENT DEVELOPMENTS

A NEW CHALLENGE – 1971

Having weathered nearly four years of continuous crisis, the securities industry entered 1971 with some hope that the worst of its problems were over – and that the long months of dealing with crisis situations on a day-to-day basis could give way to more intensive planning aimed at avoiding any recurrence of either the paperwork or financial problems which had plagued the industry since 1967. By mid-year, despite at least one crisis that was as difficult as any faced during the earlier period – the ultimately successful resolution of the capital problems of F.I. duPont, Glore Forgan & Co. – it appeared that the hope had not been unreasonable.

The new year began quietly – a condition that lasted exactly two business days. By the middle of the first week, activity began to quicken. The fourth, fifth and sixth weeks of the year set successive records for reported share volume – and reported volume for January was an unprecedented 348.6 million shares. Nevertheless, February's volume outstripped January's by a considerable margin – over 371 million shares traded, with a daily average of 19.5 million. March's volume – 390 million shares – set another record, although the daily average (in a month with more trading days than February) slipped to just under 17 million shares. Total reported volume for the quarter was 1.11 billion. (This was not merely a new record for a quarter; it exceeded volume for every full year prior to 1963 except 1929.) A new record for a single day's trading was set on February 2, when more than 22 million shares changed hands. That record fell on Feburary 8, when volume soared to 25.6 million shares which, in turn, was eclipsed the next day by volume of more than 28 million shares. Volume set another record of nearly 402 million shares in April – although the daily average of 19.1 million did not quite reach the March peak. (Daily average volume subsequently dipped to 15.3 million shares in May and further declined to 13.8 million in June.)

Inevitably, the new surge of volume elicited expressions of concern both within and outside the industry – including dire warnings of

predictions of a renewal of the 1968-1969 operations tangle. However, the available evidence indicates quite clearly that the industry was able to handle the new flood of business with reasonable efficiency.

Significantly, statistics on fails to deliver have shown far less of an increase than many observers anticipated. Total fails increased from $1.39 billion at the end of December 1970 to $1.80 billion at the end of February, and dropped to $1.46 billion by the end of June. (It should be noted that end-of-month fails figures generally reflect transaction levels during the early part of the month and the end of the preceding month – and that, even with this factor in consideration, the current totals, as indicated by weekly samples collected and published by the NYSE, remain well below the level the industry regards as cause for serious concern.)

In any event, the Exchange has continued to monitor the situation very closely. It has been noted that trading in 1971 has generally been in much larger units than in the past, with fewer transactions for larger volume levels requiring less paperwork. For example, the average sale printed on the ticker tape in June was 433 shares – compared with a maximum of 331 for any single month in 1968 and an average of 302 for that entire year. The 22 million shares traded on February 2, 1971 involved some 52,500 transactions; by contrast, 19.4 million shares traded on December 31, 1969 involved 76,865 transactions.

On February 10, the Exchange announced expansion of reporting and surveillance systems used to keep track of the operational situation at member firm offices. Among the specific indicators being watched:

- Combined total of trades and fails to deliver on the NYSE and Amex. The industry concluded in 1969 that combined volume amounting to 75,000 transactions per day can be processed without undue difficulty. The average has been running at about 55,000 transactions per day.

- Level of fails to deliver expressed in days of trading. The exchanges consider fails equivalent to 2½ days' combined dollar volume as a level where there is cause for concern. The

current dollar value of fails has been under 1½ days' combined volume. (0.9 days for the week ended July 16.)

- Number of fails to deliver outstanding more than 30 days. At the end of June, aged fails were at $66.5 million. This represented a substantial increase during the preceding five-month period, but it was still below the January 1970 level – and a small fraction of the levels recorded in 1968 and early 1969.

- Make-up of fails by marketplace. In the current period, over-the-counter and regional stock exchanges have been accounting for nearly 55% of all fails.

- Status of transfers from firms that clear by direct mail at the NYSE.

- Status of transfers from Central Certificate Service.

- Status of withdrawals of stock by CCS for COD delivery.

- Number of "questioned trades" on the Exchange trading floor.

- Number of securities contracts closed under the Exchange's mandatory buy-in rules.

- Rate of rejected deposits by CCS.

In recent months, the largest fails increases have been in NYSE-listed bonds – particularly with respect to over-30-day transactions. Bond volume has been at record levels – much of it involving small investors attracted by high interest rates, and therefore producing larger numbers of small bond trades and many more bond transactions. Two steps taken by the Exchange in March were aimed at alleviating this situation. On March 12, mandatory buy-ins of unsettled bond transactions were required after an elapsed period of 30 days – instead of after 40 days, as previously required. Effective March 15, participation in Stock Clearing Corporation's Bond Clearance Service was made mandatory for all transactions in listed corporate bonds between member firms – regardless of whether the transactions take place on or off the Exchange Floor. The Exchange,

at the same time, instructed members to resolve questioned bond trades promptly.

The data on fails to deliver are, of course, excellent barometers – indeed, they remain the best available barometers – but they are subject to a potentially disruptive time lag in that the data indicate a problem several weeks after the problem has begun to exist. The Exchange has been placing a new emphasis, therefore, on trade, transfer and delivery problems involving NYSE-only operations which can serve as an earlier warning guide and at least suggest the scope of a potential or developing industry-wide problem.

Thus, the Exchange, also in early February, alerted member firms about existing requirements to maintain current books and records; reminded chief executives of firms that they are responsible for their individual firms' compliance; and furnished a 20-point checklist to assist them in carrying out these responsibilities. Each firm was also requested to reply within one week to a special operations survey with data as of February 12. (A copy of the checklist – Exhibit C [page 49]– is appended.)

The special operations survey has enabled the Exchange to develop a more sensitive distant early warning index. Replies to about a dozen of the survey questions provide the Exchange with information from which can be totaled up various operations items which have not yet become capital charges for individual member firms but which show potential danger areas. The dollar total of the potential exposure items is then related to a firm's excess net capital.

Another new surveillance technique being applied by the Exchange involves sending Examiners into firms to look specifically at their handling of dividends. There appears to be a high degree of correlation between problems in the dividend area and problems elsewhere in a firm's operations.

Extending this program, the Exchange is looking at dividend data for the firms whose operations survey responses indicated no special operations problems – with the objective of rooting out potential problem areas which may not be detectable through other current procedures.

In May, the NYSE and Amex Boards of Governors adopted new rules, recommended by BASIC, aimed at sharply reducing the rejection by banks of COD securities deliveries from member brokerage firms. A BASIC survey had indicated that agent banks reject 16-25% of all COD deliveries, labeling them "Don't Know" (DK) because the banks lack information required for acceptance of delivery. The prime cause was found to be failure of the banks to receive instructions, either due to the customers' delay in issuing orders, or the brokers' delay in confirming details of the trade to customers. The new rules require that brokers provide COD customers with detailed transaction confirmations no later than the first business day after the trade; and that COD customers provide their agent banks with specific instructions no later than the third business day after the trade when ordering securities to be delivered – and not later than the fourth day after the trade when authorizing receipt and payment for securities. These rules are expected to reduce DKs by assuring that needed information and instructions are processed with sufficient speed to permit settlement on the fifth day following the trade. BASIC is conducting a comprehensive program to monitor and evaluate the effectiveness of the new rules, in order to identify brokers, banks or institutional customers failing to comply with them. Insufficient effectiveness may lead to consideration of a further requirement that COD customers provide agent banks with standing instructions so that COD transactions may be completed in the absence of specific timely instructions from the customers.

* * * * * *

The expansion of the Exchange's Central Certificate Service has perhaps been the single most important factor in helping brokerage firms meet growing operational demands. CCS currently has approximately 900 million shares – valued at some $30 billion – on deposit. In 1970, shares valued at more than $50 billion were delivered by means of computerized bookkeeping entries; in 1971, CCS deliveries are running at twice the 1970 pace, eliminating the need for much of the paperwork activity that clogged the industry's operations during 1968 and 1969. (During the first quarter of 1971 alone, $23.4 billion worth of stock was delivered through CCS, and more than 1.3 million items involving 747 million shares were delivered through the system.

Following the phasing into CCS of some 960 eligible American Stock Exchange issues in April, CCS began a pilot program for computerized delivery of the most widely held over-the-counter stocks. Although utilization of CCS by participating brokers continues to be voluntary, more than 75% of eligible deliveries are now being made by bookkeeping entry rather than by physical delivery of a stock certificate.

CCS is expanding in other directions, as well. Ten of the 11 New York Clearing House Banks—[an eleventh bank joined the New York Clearing House Association in 1971]—are now direct CCS participants for computerized delivery to and receipt from participating brokers. (This is in addition to the banks' participation in the collateral loan program through CCS, which enables brokers to pledge securities for bank loans via CCS bookkeeping entry rather than by physically delivering the shares to the lending bank.)

Although many hurdles lie ahead, many of them of a legal nature, efforts are underway to further broaden the range of CCS services — to include major investing institutions, such as mutual funds, pension funds and insurance companies as depositors, and to enable out-of-state banks also to participate. The Exchange and other securities industry organizations view CCS as the basic building block for a comprehensive national securities depository system, and a broad industry effort is pointed toward that goal.

* * * * *

Despite the apparent lack of indications of any large-scale recurrence of problems experienced in the 1968-1969 period, the Ad Hoc Committee on Securities Industry Operations, which had suspended activity in 1970, was reactivated on February 19, and decided to resume once-a-week meetings until further notice to provide a continuing regular review of the operations situation. The Committee noted that reinstatement of the NYSE's policy of restricting the business activity of operationally troubled member firms had resulted in one firm being placed under restriction in February. (The restrictions on this firm were removed in early May.) It will be recalled that at the peak of the 1968-1969 period, as many as 47 firms were under some form of restriction at one time; and over the full period of the earlier phase of the restriction program, a total of

105 firms were subject to operational restrictions at one time or another.

Outside observers have continued to watch the situation from their own vantage-points. One of the best-balanced assessments appeared in Newsweek Magazine in February:

> "Wall Street's capacity to handle growing volume has. . . been a major factor in containing the problem. For example, the Big Board's Central Certificate Service has eliminated much of the manual exchange of stock that occurs among brokers after a transaction, reducing it to a bookkeeping item. . .
>
> "In addition, Wall Street now has a better idea than it used to of where to look for signs of operational problems and it has refined tools for keeping tabs on these areas. . .
>
> "Finally, Exchange officials have shown a readiness to move in quickly when they spy trouble. Last week's Big Board decision to restrict one firm within weeks after volume surged contrasts with the long lag during the last market boom."

Of considerable significance was the conclusion expressed by the SEC following a meeting at the Commission on April 19, attended by representatives of the major industry organizations, that there were no widespread operational problems that would require general restrictions on stock trading. In agreeing that the industry could handle a significant additional increase in volume without undue difficulty in processing transactions, the Commission noted that "so far, only a handful of firms in the whole industry are under any kind of restriction because of operational difficulties."

Following an SEC-sponsored conference of industry leaders on paperwork problems and progress toward immobilization of the stock certificate, SEC Chairman William J. Casey was quoted in an interview with The Washington Post as saying that the industry is "well-launched on a system of depositories which should significantly minimize paperwork problems." Although Chairman Casey acknowledged a number of difficulties which must be overcome in

the establishment of a truly nationwide securities depository system, it seems significant that the Post's interview story was headlined: "Casey Sees End of Paperwork."****

* * * * * *

With the industry's operational situation generally well in hand, the Exchange continued to make substantial progress toward clearing up the remaining financial commitments assumed in connection with the customer assistance program.

To permit the Exchange to fulfill commitments made before the establishment of SIPC, two additional expansions of the Special Trust Fund were authorized by the Exchange membership. A third expansion was submitted to the membership for approval on July 29.

The first expansion, in January, increased the amount available through the Fund from $55 million to $75 million – to permit assistance to customers of two former Exchange member firms – First Devonshire Corporation and Robinson & Co., Inc. – which went into liquidation prior to the SIPC legislation, but which previously had not been included in the customer protection program.

The second expansion – to a ceiling of $90 million – was authorized in May in connection with possible indemnification of PHMFG Corporation, a private investor group headed by H. Ross Perot, undertaking recapitalization of F. I. duPont, Glore Forgan & Co. (now duPont Glore Forgan, Inc.) None of the $15 million allocated for this purpose has been required as yet. However, under the terms of the agreement, the Perot group must invest at least $40 million in the new corporation before any of the $15 million Special Trust Fund indemnity comes into play. (It should be noted, too, that any assessment of the NYSE membership to indemnify Merrill Lynch, Pierce, Fenner & Smith, Inc. for its acquisition of Goodbody & Co. must be completed before any assessment for duPont Glore Forgan, Inc. can begin.)

Finally, on July 29, the Board of Governors approved a further

**** [A table of pertinent NYSE statistics for the period April 1968 – June 1971 is appended (Exhibit D, Page 50)]

increase in the Special Trust Fund ceiling, subject to membership approval, to a maximum of $110 million (i.e., $95 million exclusive of the duPont indemnification authority) primarily to cover previously unforeseen exposure estimates arising as a consequence of involuntary bankruptcy proceedings instituted by three subordinated lenders of Blair & Co., Inc. Earlier in July, the Board set an assessment rate of 3/8 of 1% of net commissions to be paid by members and member organizations commencing with transactions on and after July 1, 1971, in connection with the Merrill Lynch-Goodbody indemnification. (The Special Trust Fund increase is expected to be voted on by the membership in mid-August. The Merrill Lynch-Goodbody assessment power was previously authorized by the membership at the time of its approval of the indemnification agreement in December 1970.)

As of July 22, 1971, a total of $74,141,000 had been advanced or committed by the Trustees of the Special Trust Fund in connection with the 13 Exchange-assisted liquidations; another $15 million was specifically earmarked for use, if necessary, for the duPont indemnification; and some $11.1 million beyond previously identified needs was estimated as necessary to complete the Blair liquidation. Beyond this, up to $30 million may be made available in the Merrill Lynch-Goodbody indemnification. Thus, the total cost of the Exchange's customer assistance program – assuming membership approval of the pending increase in the Special Trust Fund ceiling – could exceed $130 million and, if all authorized funds were to be used, reach $140 million. [The Special Trust Fund ceiling increase was approved by the membership on August 11.]

The size of the firms which have received or are now receiving assistance from the Special Trust Fund in connection with liquidation proceedings – based on the number of customer accounts involved – has ranged from very small (900 accounts) to quite large (75,000 accounts). And it may be noted that the number of customer accounts carried by Goodbody and duPont aggregated more than 500,000.

As of late July 1971, seven of the liquidations were either completed

or substantially completed, with three others approaching completion.*****

The problems encountered by the Exchange in arranging for the orderly delivery of customers' accounts from the 13 liquidating firms have varied considerably from firm to firm. The Exchange estimates that, to date, some 36,000 man-hours of Exchange personnel time have been expended in connection with the liquidations – exclusive of time spent in providing assistance to firms which have self-liquidated – while close to 1 million man-hours of the firms' own personnel's time have been consumed. The total number of customer accounts involved in the 13 liquidations is close to 200,000 – with securities and credit balances valued at more than $1 billion. No estimate has been made of the portion of that $1 billion which would have been lost to customers absent the Exchange's customer assistance program – or of the additional sums of customers' cash and securities indirectly safeguarded by Exchange-sponsored assistance to Goodbody, duPont and scores of other firms where liquidation did not become necessary.

* * * * *

Perhaps the most important lesson to emerge from the securities industry's long period of crisis was the crucial importance to securities firms – and especially to those dealing with the public – of improving the quality and permanence of capital. It is clear that only with the maintenance of a sound capital structure can a modern securities firm expect to be able to withstand a period of financial stress.

Recognizing this, the Exchange's Board of Governors, in July 1970, appointed a Special Capital Committee to study the Exchange's capital rules and recommend changes aimed at strengthening the capital structure of NYSE member firms. The committee, working

***** **Liquidations Completed or Substantially Completed:**
Arnott, Baker & Co., Inc.; Baerwald & DeBoer; Fusz-Schmelzle & Co., Inc.; Gregory & Sons; McDonnell & Co., Inc.; Meyerson & Co., Inc.; Pickard & Co., Inc.

Liquidations Approaching Completion:
Dempsey-Tegeler & Co., Inc.; H.S. Equities, Inc.; Orvis Brothers & Co.

Liquidations in Progress:
Blair & Co., Inc.; First Devonshire Corp.; Robinson & Co., Inc.

(No Financial Assistance Required):
Kleiner, Bell & Co., Inc.; Charles Plohn & Co.

closely with the Securities and Exchange Commission, painstakingly developed a complex package of capital rules changes that was unanimously approved by the Board in July 1971. A number of the rovisions adopted become effective August 1.

While adjustments and fine-tuning may be required as the new rules are applied in the months ahead, the Exchange is confident that the changes will provide a significant strengthening of the capital structure of a major part of the securities industry.

In summary, the new rules:

- Reduce the maximum net capital ratio from 20:1 to 15:1. This means that NYSE member organizations must maintain a minimum of $1 of net capital for every $15 of aggregate indebtedness.

- Double the minimum net capital – from $50,000 to $100,000 – which must be maintained by firms carrying public accounts. Initial net capital required of firms seeking permission to carry public accounts is raised from $60,000 to $200,000, or to 200% of the amount that must be maintained.

- Prescribe that all capital contributed to member firms must remain at the firms' disposal for at least one year. Six months' notice is required of a contributor's intention to withdraw, and extension of capital contribution is automatic under certain circumstances. (Prior to interim guidelines implemented in the Fall of 1970, capital withdrawal was possible, in some cases, on 90-day notice.)

- Require that all subordinated lending or contributing of securities for capital purposes be made through a standardized secured demand note and collateral agreement, and that all such collateral be fully paid securities. This is designed to reduce the direct increase or decrease in capital resulting from changing market values of securities.

- Require a 100% deduction from net capital for any short security differences more than 44 days old; and increase or

establish discounts from market value on certain types of securities held for capital purposes.

Although both SEC and NYSE rules had stipulated that the maximum allowable net capital ratio was 20:1, the Exchange had, as noted earlier, used a 15:1 ratio as a guideline for self-regulatory action. In addition, during the 1970 financial crisis, firms which exceeded a capital ratio of 12:1 were subjected to special surveillance procedures.

With the adoption of the new capital rules, firms which for 15 business days exceed a capital ratio of 10:1 will be barred from expanding their business by, for example, opening new branch offices. Firms reaching the 12:1 level will be required to notify the Exchange immediately. If the 12:1 level is exceeded for 15 consecutive business days, they will be required to reduce their business in order to achieve a 12:1 ratio or better.

Moreover, any firm must notify the Exchange when it receives a notice of a capital contributor's intention to withdraw capital when the withdrawal would increase the firm's capital ratio above 12:1. Such capital would then remain locked in the firm indefinitely. Capital contributions will also remain locked in if withdrawal would leave the firm with less than its minimum dollar capital required under the Exchange rules.

After a capital contribution has been locked in, the firm must within six months arrange for new capital or otherwise reduce its capital needs. This would be a period of close Exchange supervision, in which steps would be taken to reduce the firm's business and deliver out customer accounts – unless the firm succeeds in making capital improvements early in the period. If it is unable to achieve a 12:1 ratio at the end of six months without retaining the locked-in capital, the firm would be required by contractual obligation to commence orderly and complete liquidation of its remaining business.

The Exchange is convinced that these changes in capital requirements for member organizations will not only provide the firms with greater financial soundness and stability, but that it will enable them to merit a stronger measure of public confidence than ever before. One significant indication of renewed public confidence, in fact, may

be noted in the widespread public interest in acquiring shares of NYSE member firms which have, in 1971, begun to issue freely transferable equity securities under amendments to the Exchange Constitution, enacted in 1970, setting standards under which member corporations may "go public."

* * * * *

The securities industry has come through a period of extraordinary trial and – in some respects – error. There have been casualties among NYSE member organizations – and there have been many quiet rescues, and a few dramatic ones.

As a summary chronology, this paper has not attempted to deal with every significant event of the period. It does indicate, however, that the industry emerges from this period immeasurably wiser and stronger than it entered. The steps which have been taken and the lessons which have been learned – by the Exchange, by its member organizations and by other securities industry organizations – offer the promise that the industry should never again have to deal with a comparable succession of crises. If we have, indeed, achieved this, then the difficult years immediately past may ultimately be judged as a turning point in the history of a great industry dedicated to serving the investment needs of millions of American investors.

EXHIBIT A

INTERMEDIATE-RANGE PROGRAM TO IMPROVE SECURITIES INDUSTRY OPERATIONS: DIVISION OF RESPONSIBILITIES

	Industry Programs
NYSE	– Expansion of Central Certificate Service in order to reduce drastically the movement of securities. Inclusion of American Stock Exchange issues and over-the-counter stocks in system. Full participation of banks and institutions in system as depository members.
NYSE	– An advanced design of automated clearing and central certificate systems.
NYSE	– Integration of Floor automation and Market Data Systems with Clearing and CCS.
NYSE	– Develop solutions to the problem created by turndown of some broker-bank and bank-broker deliveries because of failure to receive necessary instructions. Estimates of turndowns for these reasons range up to 25% of such attempted deliveries.
AMEX with NASD	– Develop and install a nationwide regionally interconnected over-the-counter clearing system to provide trade identity at the outset, netdown of deliveries, fail clearance services, ability to participate in depository for bookkeeping delivery, etc.
AMEX	– Discuss with NASD establishing rules, policies and procedures in the over-the-counter markets directed toward fails control and fails reduction.
AMEX	– Promote installation and use by the securities industry of the CUSIP system of a uniform, automated number code for securities.
AMEX	– Study and develop as warranted an automated stock certificate to replace the style of certificate now in general use.
ASEF	– Continue development of manpower recruitment and training program for operations personnel, looking ahead 5 to 10 years.
NYSE and AMEX individually	– **Complete Exchange "Floor" Automation Plan and Install.** While the two Exchanges may develop separate systems, each will be designed to tie into member firm offices without requiring member firms to have separate sets of procedures or equipment to accomodate each Exchange system.

In the case of NYSE, individual projects include:

- Central order handling processing unit and system.
- Odd-lot automation.
- Round-lot switching to posts and to shared order delivery terminals and re-entry of executions via shared terminals.
- Specialists electronic books and accounting.
- Market Data System II (an advanced ticker and market surveillance system).

NYSE and AMEX	– Develop uniform management information system for member-brokers.
NYSE with AMEX cooperation	– Set performance standards for member firm operations and customer services.
NYSE with AMEX cooperation	– Help educate and inform member firms of latest developments in back-office procedures, systems and automation. Encourage firms to improve operations performance, including development and installation of new real-time automated systems.
NYSE with AMEX cooperation	– Strengthen existing rules and policies pertaining to member firm operations.

EXHIBIT B

LIST OF 27 STEPS TAKEN BY SECURITIES INDUSTRY IN 1968 TO IMPROVE OPERATIONS

[As appended to Testimony by NYSE President Robert W. Haack Before the Commerce and Finance Subcommittee of the House Interstate and Foreign Commerce Committee, February 26, 1969].

1. **Fail Clearance** – Periodic clearance of fails in listed issues to effect netdowns and eliminate intermediate deliveries in fail items and also to designate open items for buy-ins.

2. **Bond Comparison** – Computerized procedure to compare trades in listed bonds to ease settlement procedures for member firms handling bond executions.

3. **Stock Loan Directory** – A listing of member organizations and individual personnel at the firms who are available to arrange stock loans to make overdue deliveries.

4. **5th Day – Questioned Trade** – Extension to 5th day, the deadline for entry into clearance of questioned trade items from Floor.

5. **Uniform Window Closings and Reclamation Times** – Agreed, with bank cooperation, to establish uniform delivery time of 11:30 a.m. and uniform reclamation time of 2:00 p.m.

6. **Collateral Loan Facilities** – Developed, with bank cooperation, means to utilize bank collateral loan facilities commencing at 8:30 a.m. to contribute as much as possible, through substitution or otherwise, to early deliveries.

7. **Availability of Bank Vaults** – Developed, with bank cooperation, means for access to bank vaults by firms, up to 7:30 p.m. to facilitate an evening drop at Stock Clearing Corporation.

8. **Regular Safe Deposit Hours** – Developed, with bank cooperation, regular access to safe deposit vaults commencing at 8:30 a.m.

9. **Sealed Container Procedure for Over-Night Loans** – Developed, with the cooperation of the banks, means by which next-day deliveries can be packaged and sealed for bank acceptance as an over-night loan; such securities can then be immediately dropped the next morning for delivery without further handling.

10. **Clearing House Delivery** – Developed, with bank cooperation, procedure for broker-to-broker, bank-to-broker and broker-to-bank deliveries to pass through the Clearing Corporation and to avoid over-the-window items.

11. **AMEX Clearing Facilities for Transfer of Registered Bonds** – Endorsed use of AMEX transfer delivery facilities for all clearing members to effect distribution to agents of registered bond transfers.

12. **Evening Drop of Securities Deliveries at Stock Clearing Corporation** – Developed procedure to permit brokers and banks to drop "next day's deliveries" at Stock Clearing Corporation in the evening. This enables the receiving banks and brokers to begin processing these securities shortly after 8:00 a.m. on the morning of delivery day, thereby achieving a smooth and constant flow of security deliveries to receiving brokers and banks through Stock Clearing Corporation.

13. **Broker Window Ticket** – Developed, with bank cooperation, a broker-originated window ticket on transfers.

14. **Mandatory Buy-Ins** – Provision for mandatory buy-ins of contracts still open 50 days after settlement date, effective August 2, 1968. Starting December 1, 1968 the mandatory rule took effect for open contracts after 30 days [for stocks and after 40 days for bonds].

15. **Cautionary Letters** – Periodically, since August 1967, the Department of Member Firms and the chief examiner of the NYSE have issued letters of caution to firms relating to specific problems or conditions they were experiencing.

16. **Partial Delivery Rule** – Adopted rule to prohibit member organizations from accepting purchase orders from customers unless the customer or his receiving agent will accept partial deliveries. This rule became effective September 1, 1968.

17. **Sale of Long Securities** – In August 1968, adopted rule designed to assure that securities being sold "long" by member organizations can be delivered promptly. Included in this rule are several provisions designed to require member organizations to ascertain whether a customer was long the securities he was ordering sold; whether these securities could be made available for delivery by settlement date; or to determine the circumstances in the event the securities cannot be delivered by settlement date.

18. **Central Certificate Service Operation** – Almost all eligible issues are fully activated in the central certificate operation. The system is expected to be fully operational for all eligible NYSE issues in a matter of weeks. [NOTE: Stock Clearing Corporation points out that, in fact, CCS was not operating on an A-Z basis until August 1969 – and not playing a major role until 1970].

19. **Special Operations Questionnaire** – To keep informed of the day-to-day operational and records-keeping condition of member organizations, the New York Stock Exchange devised a special operations questionnaire early in 1968. Firms indicating a problem area are required to submit the questionnaire on a monthly comparative basis.

20. **Capital Penalties – Aged Fails** – Amended rule on capital requirements to impose a charge to net worth effective December 1, 1968, against fail-to-deliver items 40 days old and older in the computation of net capital. The charge amounts to 10% of the contract value of all securities in fails-to-deliver from 40 through 49 calendar days; 20% from 50 through 59 calendar days; and 30% for those securities 60 or more calendar days of age.

21. **Fail Reports** – Amended rule to require monthly reports from all member organizations clearing accounts or doing a principal business. The rule has enabled the fail problem to be measured and identified as to source and age in a manner not previously possible.

22. **Required NOTC Membership** – In an attempt to meet the fail problems in over-the-counter issues, effective September 20, 1968, member organizations doing an over-the-counter business in the New York City area were directed to join the National Over-The-Counter Clearing Corporation or make arrangements to have their O-T-C transactions cleared through a member of NOTC, unless they could furnish the Exchange with evidence of their inability to comply or that compliance would cause them undue hardship.

23. **Shortened Trading Hours** – In seeking a responsible method for reducing volume, shortened trading hours were first initiated in August 1967. Reinstituted in mid-January 1968, they extended 2 p.m. closings until March 4th. Commencing June 12, Wednesday closings were established and one-day-a-week closings were scheduled through mid-December. On January 2[1969] the five-day trading week was reinstituted in conjunction with shortened trading hours (10 a.m. – 2 p.m.).

24. **Bank-Industry Joint Project** – Created, in cooperation with the New York Clearing House Banks, a joint securities industry-bank project in which 56 representatives of the securities industry and the banking field serve on committees (credit, collateral, CUSIP, delivery and transfer) seeking solutions in mutual areas to simplify and speed the processing of security transactions.

25. **CUSIP** – The utilization of CUSIP identification has been endorsed by the New York and American Stock Exchanges and other securities industry and banking organizations. The publishing of a directory has been delegated to Standard & Poor's Corp., and is expected to be available in March.

26. **5-Day Settlement Period** – The settlement period was extended in February 1968 from four business days after a transaction to five, to give firms more time for settling trades.

27. **Restraints on Business** – Based on material developed for the Special Operations Questionnaire, many firms acted on the New York Stock Exchange's suggestion that voluntary restraints be applied to particular problem areas. In a number of instances, the Exchange imposed restraints where firms neglected to do so themselves. Those restraints ranged from a reduction of advertising and promotion to specific limits on the amount of business a firm might accept. The Exchange has made it clear, however, that firms should avoid unnecessarily imposing lower limits on the size of orders they will accept.

EXHIBIT C

THE OPERATIONS CHECKLIST

(Firms are advised to work for a downtrend in each item.)

Early Indicators

- What is the trade in-put error ratio?
- What is the trade cancellation ratio?
- What is the percentage of trades not processed on trade date?
- What is the ratio of uncompared trades to total trades?
- Are all "questioned trades" being resolved prior to settlement date?
- Are over-the-counter trade comparisons current?

Current Indicators

- What is the level of fails to deliver in terms of money and items?
- What is the level of fails to deliver in terms of money and items over 30 days old?
- What is the level of fails to receive in terms of money and items?
- What is the level of fails to receive in terms of money and items over 30 days old?
  Are buy-ins being executed?
- What is the value of customer unsecured debits?
- What is the value of customer unsecured short positions?
- What is the total receivable from both cash and stock dividends?
- What is the total receivable from both cash and stock dividends over 45 days old?
- What are the number of daily stock record breaks?
  Are all daily breaks being resolved?
- What use is being made of supense and/or difference accounts in order to balance the day's work?
  How frequently are they used?
  Are the items in these accounts promptly resolved?

Confirming Indicators

- What have been the results of security counts?
  Have the differences discovered during counts been resolved?
- What is the number of open items in transfer over 10 days?
- What percentage of the electronic data processing systems' capacity is being used?
  What percentage of operations employees are working overtime?
- How many customers' complaints are being received?
  Are all complaints being answered on a timely basis?

EXHIBIT D

SELECTED NYSE STATISTICS

APRIL 1968 - JUNE 1971

Month	Total Fails ($ Bils.)	30-Day + Fails ($ Mils.)	Total Trades (Thous.)	Daily Aver. Trades (Thous.)	Daily Aver. Volume (Mils.)	Aver. Shares Per Trade
1968						
Apr.	2.670	477.7	997	49.9	14.78	296
May	3.466	534.9	1,002	45.6	13.28	291
June	3.769	714.7	865	50.9	15.14	298
July	3.675	837.0	803	47.2	14.27	302
Aug.	3.095	723.7	629	34.9	10.78	309
Sept.	3.082	751.2	732	43.1	13.43	312
Oct.	3.358	586.2	823	45.7	15.11	331
Nov.	3.274	555.5	780	45.9	14.82	323
Dec.	4.127	649.7	817	45.4	14.87	327
1969						
Jan.	3.300	596.4	785	35.7	12.12	340
Feb.	2.969	528.6	613	34.1	11.68	343
Mar.	2.477	432.9	561	28.0	9.96	355
Apr.	2.319	351.7	642	30.6	11.29	369
May	2.551	259.1	698	33.3	12.22	367
June	2.183	271.0	626	30.0	11.20	376
July	1.668	253.2	625	29.8	10.87	365
Aug.	1.399	165.9	556	26.5	9.61	363
Sept.	1.468	123.1	587	27.9	10.44	374
Oct.	1.869	106.3	836	36.4	13.49	371
Nov.	1.691	134.9	619	32.6	11.25	345
Dec.	1.837	136.0	857	38.9	12.38	318
1970						
Jan.	1.457	136.8	594	28.3	10.53	372
Feb.	1.316	111.5	570	30.0	11.50	383
Mar.	1.060	70.0	564	26.9	10.14	377
Apr.	.968	55.5	591	26.9	10.15	378
May	.830	43.8	731	34.8	12.30	353
June	.790	36.7	635	28.9	10.29	356
July	.780	37.6	537	25.3	10.36	409
Aug.	.782	34.3	539	25.7	10.42	406
Sept.	.898	33.8	774	36.9	14.42	391
Oct.	.825	31.5	651	29.6	11.89	402
Nov.	1.087	38.6	562	28.1	11.52	410
Dec.	1.392	52.5	797	36.2	15.24	421
1971						
Jan.	1.559	51.2	835	41.7	17.43	418
Feb.	1.801	70.1	869	45.7	19.54	427
Mar.	1.738	52.7	942	40.9	16.96	414
Apr.	1.804	74.4	929	44.2	19.13	432
May	1.523	61.1	712	35.6	15.16	426
June	1.460	66.5	701	31.9	13.80	433

NYSE Archives

Jeremiah J. O'Donohue Papers

Box 19, Folder "JOD - Crisis in the Securities Industry, 1967-19[illegible], 197[illegible]"