

MEMORANDUM

September 14, 1961

TO: Philip A. Loomis, Jr., Director
Division of Trading and Exchanges

FROM: Boston Regional Office

RE: H. J. Res. 438 (Investigation of Securities Markets)

In accordance with the memorandum from the Chairman dated September 8, 1961, I am submitting to you certain ideas and recommendations as to the areas of inquiry which should be explored in the study authorized by Congress. Inasmuch as the memorandum was received on September 11 with instructions to submit to you within ten days these ideas, there has not been sufficient time to give this matter the careful attention and study it deserves. Therefore, from time to time, as new ideas and thoughts come to my attention, I will supplement this memorandum with additional suggestions.

I believe that this study gives the Commission and its staff a golden opportunity to use it as a springboard for the purpose of expanding the regulatory coverage to more phases of the securities business. At the present time, it is my opinion there is a certain amount of overlapping of regulations and too many gaps which are not filled. The exchanges regulate, to some extent their members, but too often we do not know to what extent this regulation is enforced, and often it is inadequate. The National Association of Securities Dealers, Inc. has certain rules and regulations which are enforced by committees which are too often staffed by individuals who are subservient to those they regulate. Most states do not have adequate securities laws and certainly they do not have the staffs to enforce even these meager and widely divergent laws. Therefore, they rely on the Commission to do the work for them. It is for these reasons that I believe this study affords a tremendous opportunity to obtain new legislation, a larger staff and larger budget so that the Commission shall be in a position to do that which they are now doing, plus that which the exchanges, the N.A.S.D. and other enforcing bodies are failing or are powerless to do. This is probably the time to request that all salesmen be registered annually with the Commission. I realize that many are now registered with the N.A.S.D. and I further realize that this is a tremendous task. However, it seems to me that if the N.A.S.D. can keep adequate records, there is no reason why the Commission with an expanded budget and staff could not do the same. If the Commission registers all salesmen of every registered broker-dealer, it would lift a financial burden from the industry because it would not be necessary for the N.A.S.D. to duplicate the registration.

The present method of taking action against a registered broker-dealer is both burdensome and cumbersome. This is particularly so when the infractions of the rules and regulations are committed by a small group of employees without the knowledge of the

registrant. It is necessary to take action against the registrant in order to penalize the individuals. If the salesmen were registered with the Commission, we would be permitted to take action against the individuals rather than the registrant when necessary, either by way of a suspension, dismissal from the business or a denial of employment in the business for any serious infractions of the rules.

This is also the time, it seems to me, when the Commission should consider whether it should delegate the authority to members of the staff to issue subpoenas similar to the Internal Revenue Service but, of course, with the necessary restrictions to insure that the issuance of such subpoenas is not abused.

With regard to the numbered paragraphs in the Chairman's memorandum, I have the following comments:

1. There is no doubt that a complete and thorough study should be made of the selling techniques including the supervision and training of salesmen. There are too many part-time salesmen who have been inadequately trained in selling both mutual funds and other types of securities. Salesmen in some instances receive two or three days of training, and are required to attend a sales meeting once a month for a few months and they are considered to be capable of qualifying as salesmen of securities. It takes much more than this "to make a salesman". In many instances, this applies not only to the mutual fund salesmen but also to salesmen employed by members of the exchanges.

Every registrant should be sent a questionnaire requesting that they state whether they employ only full-time salesmen or both full-time and part-time salesmen; what training, if any, is given; what supervision is exercised; whether the salesman has been employed after an examination; whether the salesman-applicant was given the questions and answers of the examination prior to taking it; whether he attended any courses prior to taking the examination. I am sure there are many other questions which the registrant could be asked as to the type of individual who is employed as a salesman and the adequacy of his training.

2. To discuss the distribution problems in the over-the-counter market and the "hot issue" problem, one could write a small book. One problem that we have come across which is very, very difficult to pin down is the problem where the underwriter of an issue orally guarantees to half a dozen or more other broker-dealers that he will protect these dealers from loss up to a certain number of shares if these broker-dealers will enter the sheets when the issue becomes effective. If a sufficient number of dealers enter the sheets with the guarantee of no loss, it is not difficult for them to bid the issue up, make a profit and assist the underwriter in the distribution of the offering. With this technique, the issue moves up quickly, the public comes into the market and the issue has become hot. We have tried to pinpoint on several occasions the "guarantee of no loss" but it is almost impossible to do so because those who are guaranteed will not admit it. Of course, there are other instances where gifts are given but these are less difficult

to find. Again there are many problems such as advertising, news articles planted in magazines and newspapers, all under the guise of legitimate reporting of news, both prior to the effective date and while the distribution is going on. A study should be made of all of these problems to determine what extent these have been detrimental to the investing public.

3. The Boston region does not have any serious problem with regard to issuers whose securities are listed on an exchange and traded in the over-the-counter market. It is my opinion that the Frear Bill which would require the reporting of material transactions; subject the issuers to the proxy rules; and subject them to reporting requirements similar to those who have to report under Section 16 of the 1934 Act and other provisions of the Securities Exchange Act should be pressed for passage by Congress.
4. The Boston Stock Exchange, the only exchange in this region, does not appear to have the problems which have been encountered in the investigation of the American Stock Exchange and which are probably also the problems of the New York Stock Exchange. Most of the securities traded on this exchange are geared to prices which are fixed by the trading on the New York Stock Exchange and are generally in odd lots. However, a study should be made to determine whether there are any problems.
5. There is no doubt that there are gaps in the scope of coverage of present market requirements and there is no doubt that these are not justifiable. Particularly in this region, there are factors or money lenders, if you will, who are operating without any regulation or restriction and are extending credit to anyone who wishes to borrow on securities. They will extend credit in some instances as much as 90% of the value of the securities and their interest rates are prohibitive, sometimes as much as 1 1/2% to 2% per month. Many well-to-do attorneys have turned to this field for their livelihood. There are some who advertise in the local newspapers. It is my belief that it is time for the Federal Reserve Board to supplement Regulation T and Regulation U with another regulation spelling out the terms and conditions under which anyone who is in the business of extending credit on securities shall be permitted to do so. These factors should be registered and it is suggested that they be registered with the Commission, their books and records subject to examination similar to the examination of broker-dealers.

Philip E. Kendrick
Regional Administrator