

Office Memorandum • SECURITIES AND EXCHANGE COMMISSION

DATE: September 20, 1961

TO: Thomas B. Hart, Regional Administrator

FROM: J. Edwin Corbett, Chief, Branch of Investigations

SUBJECT: Investigation of Securities Markets

I have reviewed the memorandum from Chairman Cary dated September 8, 1961 together with the attached statement of Mr. Cary before the Subcommittee on Commerce and Finance dated June 27, 1961. You requested comments concerning methods to be employed in this investigation. I have discussed the memorandum with members of the staff who have come forward with a few ideas. As the contemplated investigation is to be extremely comprehensive in scope, I believe more thought and study should be given to this matter than we have been able to give in the limited time allotted for our comments. In addition to the comments herein stated, it is probable that further discussion among members of the staff will result in additional ideas or suggestions which could be incorporated in a subsequent memorandum.

Periodically reports are received from stock exchanges of disciplinary action against members. Study of the violations which resulted in such action by exchanges might furnish a clue to various areas of misconduct on the part of members, the rules which are most frequently violated, and the need for possible revision of such rules.

It seems to be the consensus of members of the staff that a major portion of the investigation of exchanges could well be devoted to the study of the operations of specialists who would appear to have greater opportunity for manipulating prices and practicing abuses of rules and regulations than almost any other member.

Comment is requested concerning selling techniques including supervision and training of salesmen. It is of course highly desirable that salesmen be properly supervised and trained, particularly in view of the great influx of salesmen who are entering the securities field without any previous knowledge of the business. It might be stated that proper supervision and training of salesmen would require that the trainers have a thorough knowledge of the business and know as much or more than those being trained. A large number of broker-dealer firms which are owned by persons having no securities experience are making their appearance on the financial scene. Registered representatives of member firms and salesmen employed by non-member firms are required to pass examinations before being registered and therefore must have at least some slight knowledge of the business in order to pass such examinations. However,

there is no such requirement for owners of firms who are looked to to supervise and train their employees. It might be desirable to give some thought to this matter.

Many complaints are received from holders of securities traded in the over-the-counter market involving their inability to obtain financial information concerning issuers of such securities. It might be well if this question could be given some study and a determination made as to whether such issuers should be subject to all or some of the reporting requirements imposed upon issuers of listed securities.

It would seem to me that conditions existing in the over-the-counter markets would be the subject of the major part of this investigation. So little is known about this market that it is difficult to make any categorical pronouncements. There is no record of the volume of trading nor prices at which transactions are executed. It is my candid opinion that abuses which may exist in securities markets would be far greater in the over-the-counter market than those which may exist on any exchange. The National Daily Quotation Sheets must be relied upon as the best indication of market prices. The size of the market and the interest of dealers in individual issues is often indicated by the number of names appearing in the sheets and the number of shares being bid for or offered. While I believe an effort is made by the quotation bureau to keep the quotations legitimate, I think it is a well known fact, and we have broker-dealer reports to substantiate it, that many quotations are inserted by dealers who have no particular interest themselves and who are merely acting for other dealers. This has a tendency to create the appearance of activity where in fact very little activity exists. A current investigation being conducted by this office will show that following its purchase of 200 shares of stock from an issuer at \$100 per share the purchasing dealer in Chicago caused a dealer in California to go into the eastern sheets with a bid of \$300 per share for this same stock and while this bid was appearing in the eastern sheets the Chicago dealer sold stock of that issuer at \$300 per share. The same report will show where this same Chicago dealer working in concert with three Texas dealers determined among themselves each day the market price to be inserted in the sheets and all four dealers appeared in the sheets with quotations at the agreed prices. There may be instances when it would be desirable for one dealer to cause another dealer to insert quotations in the sheets on his behalf but by and large it is a practice which is employed for some ulterior motive and is fraught with danger. This undesirable situation should be explored.

I believe it would be desirable to analyze the distribution of new issues in the over-the-counter market. It has been rumored that one of the reasons so many new issues are "hot" is that deals have been made by underwriters with purchasers whereby purchasers will be allotted stock on the condition that they will enter a market order to purchase additional shares immediately upon final distribution of the issue. The marketing of one such issue recently which came out at a price of 10 and advanced to 17 the next day was analyzed by this office. That analysis disclosed that with the exception of one 50-share lot no purchaser who received stock in the initial offering had purchased stock the following day at the higher price. There has been recently a form of "new issue hysteria" sweeping the country. Buyers have been clamoring to buy any new issue regardless of name, nature of business, or price. This was clearly demonstrated recently

in our survey of the Minnesota intrastate new offerings. Nevertheless, a study of the situation might be illuminating.