May 6, 1963

G.K.F.

Here are memos from Department of Member Firms and Department of Stock List giving their comments on SEC Study Group recommendations. Rud will be sending directly to you memos from his Departments.

We will go ahead to work on coordinating the comments on SEC Study Group Recommendations where there is an overlap of two or more departments.

Unless you have other plans, I will also take charge in this area.

E. C. G.

ECG-L
Attachments

NEW YORK STOCK EXCHANGE

MEMORANDUM

May 1, 1963

TO: Mr. Ruddick C. Lawrence

FROM: Daniel H. Woodward, Jr.

SUBJECT: S.E.C. Recommendations, Criticisms and Exchange Comments Re:
Chap. III. B - Selling Practices and
Chap. III. C - Research and Investment Advice

A. PREDICTIONS

SEC Recommendation III. C pg. 95

"That it be unlawful to distribute a market letter ...which...makes exaggerated or unsupported predictions of prices or earnings."

Comments

Exaggeration hasn't been permitted under our general standards of truthfulness and good taste.

Other existing Exchange standards also deal with this recommendation:

"Forecasts of future performance of a security, or of the market generally, should be clearly labeled as opinion."

The Exchange believes that this problem can best be handled through standards rather than by adopting a new statute. Proposed new NYSE standards amplify existing standards as follows:

"Projections and predictions should be clearly labeled, along with identification of the sources or bases of the estimates. Exaggerated predictions of corporate earnings or stock prices, or other factors that would directly affect the value of securities have no place in the publications of New York Stock Exchange member organizations."

B. PROMOTION OF RESEARCH FACILITIES

1. SEC Criticism III. C pg. 102

"The Exchange actively encourages its members to

advertise the quality of their research services, but makes no effort to determine whether the research facilities of any firm are commensurate with its claims."

Comments

The contention that the Exchange encourages its member firms to advertise the "quality" of their research facilities is simply not true. Moreover, under standards of truthfulness, the Exchange has held member firms responsible for the accuracy of claims they make regarding their services and facilities.

2. SEC Recommendation III. C (1)

"The New York Stock Exchange, instead of indiscriminately encouraging its members to advertise their research and advisory facilities, should adopt standards governing the representations its members may make in this regard." III. C pg. 95
"That it be unlawful to distribute a market letter...which... implies that the broker-dealer has an adequate research staff when such is not the case."

Comments

To say that the Exchange "indiscriminately encourages" its members to advertise their research facilities is a distortion of the facts. We checked Exchange ads and tie-ins over the past 8 years and current literature. Research was mentioned in only two instances out of several hundred tie-in suggestions. In Exchange ads and literature, research was mentioned in a general way, for example:

"Member firms, all together, spend millions of dollars for research to provide information for investors."

The report quoted from the testimony that the phrase "Information and advice based on research" appeared in one part of an Exchange display program. This seems to be a basis for the above criticism. Our phrase does not make any reference to research department facilities or the quality of research. Furthermore, this display program was never produced or used by member firms.

A program has been instituted which checks on the ability of a firm to live up to claims made in advertising and promotional material.

The Exchange also feels that this problem can most effectively be handled through standards rather than law.

Although this situation would be covered by Exchange standards of truthfulness, proposed new NYSE standards further spell out our requirements:

"A market letter, research report or similar publication should not carry a research department by-line, or by implication give the impression of originating within a research department unless the member organization, in fact, maintains a qualified research department." (NOTE: The same general recommendation regarding representations of research services was applied to portfolio analysis and estate planning which are also dealt with in proposed NYSE standards.)

C. ENTRANCE QUALIFICATIONS FOR ANALYSTS

SEC Criticism III. C pg. 4

"The Study has...discussed the total lack of established standards or criteria for qualification as an analyst".

Comments

We are intentionally excluding consideration of any standards for testing or setting entrance qualifications for research personnel until we know whether any industry-wide group might be able to undertake the assignment.

D. DISTRIBUTION OF RESEARCH FINDINGS

SEC Criticism III. C pg. 90

"The ethical propriety of making recommendations available in advance to favored classes of clients is a matter of some difference of opinion, particularly in the brokerage community."

Comments

Proposed new NYSE standards state:

"If a market letter or research report is intended for general release to customers, it should not be distributed in advance to selected customers but should be released to all customers at the same time."

E. DISCLOSURE

SEC Recommendation III. C (2)

"Require disclosure in written advice of existing positions, intended dispositions, and market-making activities, rather than general "hedge" clauses as to possible present conflicting positions or transactions."

Comments

The Exchange has, in the past, placed the responsibility on the member firm whether or not to disclose information regarding positions or special relationships.

Proposed new NYSE standards would make mandatory disclosure of positions, special relationships and any market-making activity:

"When recommending the purchase or sale of a specific security in market letters, sales literature and research reports, member organizations must disclose the following information:

(a) "The aggregate positions, long and short, of the member organization, its partners or officers and the person who made the recommendation, when the positions are substantial in terms of the type of security being recommended and the number of shares outstanding. Positions should include any type of options, but need not include holdings for arbitrage or for normal market-making purposes. For NYSE listed stocks, positions may be shown in ranges of 10,000 shares. For example: "Our firm and its partners own between 30,000 and 40,000 shares of XYZ Corporation."

(b) "Directorates, held by any partner or employee, or any special relationship (such as being a consultant for a fee) with the company recommended."

(c) "That the firm makes a market in the issue being recommended, if such is the case."

The recommendation for disclosure of "intentions" is impractical. Intentions might change, and firms may not know what their intentions will be in the future. The Exchange is opposed to this proposal.

2. SEC Recommendation III. C (2)

"Require disclosures in printed material of sources of information, research techniques used and/or other bases of recommendation, rather than general disclaimers as to sources and reliability of data in market letters."

Comments

Proposed new NYSE standards read:

"The bases of any written recommendation (even though not labeled as a recommendation) should be clearly indicated or offered.

"Recommendations based primarily on technical rather than fundamental analysis should be labeled as technical analysis, unless this fact is clear from the language of the report itself. The identification of technical analysis should include a brief description of the techniques involved."

In regard to "hedge clauses" or disclaimers, the Exchange has not felt that they relieve the member firm of responsibility. We do not permit disclaimers which state:

"The opinions expressed are those of the writer and do not necessarily represent those of the firm or its partners."

Similarly, we have prohibited such obviously inconsistent statements as:

"The above is not to be considered as a recommendation or solicitation," when a clear recommendation was made.

New standards covering disclaimers which are somewhat broader than our previous policy have been prepared. They state:

"Member organizations should avoid using hedge clauses and other qualifying statements which imply that the information contained in the accompanying report was obtained from reliable sources unless these statements can be substantiated. Hedge clauses, moreover, should not be contradictory or inconsistent with statements elsewhere in the report."

F. IDENTIFICATION OF WRITER AND DATING OF REPORTS

1. SEC Recommendation III. C (2)

"Require indication of the name of the person responsible for the preparation of market letters, and dating of such material."

III. C (2)
"Require disclaimers in connection with salesmen's written or oral recommendations not emanating from a firm's research department or otherwise sponsored by the firm."

Comments

The Exchange has for years required dating of research material. However, proposed new NYSE standards make this requirement explicit:

"All market letters, research reports and similar publications must be dated."

In regard to the recommendation that the writer be identified, we propose that:

"When a market letter or research report did not originate, or was not primarily written by the firm's research department, the name and principal position of the writer should be prominently noted."

Since, in a number of firms, a report may be the production of a number of people in the research department, we feel that as long as the report was prepared within the research department, a research by-line would meet our standards.

The new standards also state:

"In distributing research reports or similar publications prepared by correspondents or advisory organizations, a member firm should identify prominently the name of the originating organization. In lieu of such identification, the distributing firm assumes full responsibility of the report, in keeping with Exchange rules and standards."

The Exchange does not feel that it is practical to require disclaimers in connection with oral recommendations. Proper conduct in personal selling is a matter of supervision by member firms plus the Exchange's spot-checking program and educational activities in this area.

G. FOLLOW UP ON SECURITIES PREVIOUSLY RECOMMENDED

SEC Criticism III. C pg. 35

"...most firms interviewed indicated that no organized effort is made to follow up on stocks favorably recommended."

Comments

We feel that this criticism is too broad. It would force our firms into the obligation of continuous follow-up of all recommendations.

We propose a more specific new standard as follows:

"Member organizations should make a reasonable effort to publish any changes in previous recommendations."

H. DISTRIBUTION OF MATERIAL PREPARED BY PUBLIC RELATIONS FIRMS

SEC Criticism III. C pg.117

"...circulation by broker-dealers under their own names of material prepared by public relations counsel of the company whose stock is recommended, or by advertising firms or others, represents an abdication of responsibility."

Comments

The Exchange feels that there is nothing inherently wrong in a member firm using material prepared by a company's public relations counsel as long as it is properly identified. We would oppose banning member firms from using such material, and propose a new NYSE standard which reads:

"Releases prepared and published by an issuer or its public relations counsel should be clearly identified as such."

I. REFERENCE TO OFFICIALLY FILED DISCLOSURES BY ISSUERS

1. SEC Recommendation III. C (2)

"In printed investment advice which purports to analyze issuers, there should be required references to most recently filed official disclosures by issuers, and representations that such filed information has been examined, with specific identification of issuers for which no officially filed information is available. III. C (4)

2. "...reckless dissemination of written investment advice by broker dealers, whether or not for a separate fee, or by registered investment advisers, should be expressly prohibited by statute or by rules of the commission and the self-regulatory agencies and should be made expressly subject to civil liability in favor of customers reasonably relying thereon to their detriment."

Comments

These recommendations could present serious complications for our member firms. They could hamper preparation of material since reports filed with the SEC are not readily accessible.

Naturally, "reckless dissemination" of written investment advice by member firms would be a violation of existing Exchange rules and standards.

However, the statement that failure to comply with the procedure outlined should be made the basis for legal liability is an extreme proposal. The Exchange would oppose such strict requirements for reference to officially filed disclosures and to make non-compliance subject to civil liability.

On the other hand, we think our firms should be encouraged to make use of officially filed information when feasible. A new proposed NYSE standard has been prepared to this effect:

"In preparing statements regarding the financial condition of a company, member firms should make a reasonable effort to take into account the latest published information, including official disclosures by issuers as required by Federal securities laws."

J. TRADING AGAINST RECOMMENDATIONS

SEC Criticism III. C pg. 87

"Evidence of scalping was found by the Special Study Group, both among registered investment advisers and brokers."

Comments

Exchange circular #170 on trading against recommendations says in part:

"(Member firm personnel) should refrain from any action in contemplation of the report, such as making a transaction for their own account, or for accounts in which they have an interest or discretion, or passing on advance information concerning the report to persons outside their firm."

A program to check member firm positions in stocks recommended in market letters has been in effect for a year. Suspicious cases are investigated and acted upon jointly with the Department of Member Firms.

K. INTERNAL COMMUNICATIONS III. C pg. 58

SEC Criticism

"...the very volume and brevity of the internal communications conveying recommendations, and the speed with which inquiries are answered, indicate the limitations on the depth of the underlying research..."

Comments

The brevity of internal communications does not necessarily indicate lack of depth of underlying research. Moreover, Exchange rules generally cover the proper use of information conveyed for the purpose of investment recommendations.

However, in order to strengthen and spell out our standards regarding the presentation and use of such information, we propose, after a study of a number of firms with extensive wire connections, the following:

"Internal wires, memoranda and other communications which refer to securities, industries or the market in general and which are seen by or distributed to

the public are to be considered market letters. This material should also be approved by a partner and retained by the firm for three years subject to review by the Exchange.

"Wires which are posted on bulletin boards or reproduced in large quantities for distribution to registered representatives are likely to be seen by, or given to, the public. Member organizations should see that this material conforms to rules and standards established for market letters and sales literature, or exercise close enough supervision to be sure that this material is used only for internal purposes."

"Communications marked "For Internal Use" or "Confidential" are exempt from market letter review if their distribution is actually internal. However, internal communications are still subject to all other applicable Exchange rules and standards, such as the rule against spreading a rumor."

L. SUITABILITY OF RECOMMENDATIONS

SEC Recommendation III. B pg. 186

"Statements of policies should cover...practices deemed incompatible with standards of suitability, such as indiscriminate recommending of selling of specific securities to other than known customers."

Comments

If this proposal were to be applied to market letters and research reports, it would probably eliminate all recommendations in such material. It could seriously cut down on the flow of investment information to the public.

For years the Exchange in its advertising and other educational activities has pointed out the importance to the investor of relating his securities purchases to his own individual objectives and circumstances.

As an additional measure we propose to extend the principle we have been following to new NYSE standards for member firms which would state:

"All recommendations should clearly point out the risk and the investment objectives for which the particular recommendation is made. Readers should be reminded that a specific recommendation should be considered in the light of their own investment objectives."

M. MARKET LETTER - SALES LITERATURE REVIEW

1. SEC Recommendation III. C (3)

"The market letter surveillance program of the New York Stock Exchange should be strengthened and redirected toward achieving greater responsibility and restraint in the use and contents of such letters."

2. SEC Criticism III. C pg. 102

"The Exchange's market letter and sales literature review falls considerably short of vigorous and aggressive self-regulation. Its administration raises serious problems which are discussed in further detail in Chapter XII, B."

Comments

These criticisms are unjustified. The Exchange pioneered market letter review in 1956 and the program has evolved and expanded from that time. In 1956, market letters were reviewed on the average of once every three years. In 1959, review was stepped up to once every two years. By late 1962, the rate of review was increased to at least once every six months. We estimate that some 15,000 pages of market letters will be reviewed this year.

When lapses from Exchange standards are detected, the Exchange acts promptly to notify and--if necessary--discipline the offender. When a problem arises with a particular firm, special surveillance of that firm's sales literature may be continued on an indefinite basis.

In addition to the review program, the Exchange is carrying on an active educational program in this area which includes monthly conferences for member firm people who prepare and approve market letters and a series of educational circulars which reinforce and explain existing rules and standards.

We are not sure what the SEC is driving at in the statement that the administration of our review program raises serious problems. There have been no problems in the administration of the program.

It is common practice at the Exchange for service departments also to perform a regulatory function. We believe that people who work in communications are best qualified to evaluate and regulate member firm communications.

3. SEC Criticism III. C pg. 118

"While the NYSE has established "guideposts" for the preparation of sales material, a number of firms appear to pay little attention to them..."

Comments

This sweeping charge is unsupportable. Member firm advertising has to meet Exchange standards since rule 471 requires that all advertising, other than routine announcements, be submitted for prior approval. Our files indicate that except for rare instances this rule is being complied with.

Similarly, rule 472 requiring that market letters and sales literature be approved by a partner of the firm and kept on file for a period of three years, is being met by member firms. Our educational activities and spot checking program act as a deterrent to violations of our standards. The record shows that over the years only a few member firms have been involved in serious infractions of Exchange standards. In these cases appropriate action has been taken.

N. BAIT ADVERTISING

SEC Criticism III. B pg. 7

"...much broker-dealer advertising is, at least in its broadest sense, "come-on" or "bait" advertising, in that the advertiser offers to supply something "free" or "without obligation."

Comments

This statement carries an implied criticism that the Exchange has been lax by permitting "bait" advertising.

The Exchange does not, under existing standards, permit any misrepresentations in member firm ads.

In our opinion the practice of offering research reports or other literature in ads is a legitimate method of acquainting the public with a member firm's services.

It is our impression that in other industries, "bait" advertising generally refers to a deceptive practice in which readers are mislead by design. It is grossly inaccurate to apply this term to the member firm practice of offering samples of their research work or literature.

10-181—1563

NEW YORK STOCK EXCHANGE

MEMORANDUM

May 3, 1963

TO: Mr. Ruddick C. Lawrence

FROM: George Bookman GB

SUBJECT: Public Relations problems in first chapters of the SEC Report

Milton Cohen's Letter of Transmittal

Criticism:

Cohen's letter criticizes use of "aggregated or averaged data" and specifically mentions that such data could be misleading in analyzing the effect of institutional transactions, the quantity of short-selling or floor trading in particular issues, or how specialists perform in individual stocks. He says that "aggregated or averaged data" on such matters are not adequate for public information.

Department Comments:

We could use more detailed information on specific types of transactions likely to be criticized in forthcoming sections of SEC report that will deal with the Exchange. After 1964, when our computer system is installed, we might make more detailed analyses of trading regularly available to the public.

Chapter IV -- Primary and Secondary Distributions

Recommendation: (IV-C-(5))

Broker-dealers managing an unregistered distribution on the board or off should be required to file notice with the SEC. A waiting period of perhaps 48 hours between the time of filing and the distribution is also suggested.

Department Comment:

Dealer Survey about this

This would seriously interfere with effectiveness of Exchange Distributions and could lead to more off-board activity. While this is primarily a matter for the Floor Department, it affects the Institutional Investors Program of PI/PR. We favor an all-out effort to dissuade SEC from putting into effect the proposed 48-hour rule. As possible counter-proposals to the SEC, we could consider whether to (1) require member firms handling distribution to adhere to stipulated standards of information they give to prospective buyers, whether by telephone, in personal conversation, or

in writing; (2) require firms accepting a block for sale through a distribution method to go on record for the stock as an official buy recommendation.

Chapter IX -- Obligations of Issuers

Recommendations #1 through 7: (IX-B-(10))

The report endorses requirements of the Fulbright-Frear type for unlisted companies.

Department Comment:

We suggest public announcement, as soon as practicable, of our endorsement of this proposal -- pointing out that we have long favored legislation of this type.

Recommendation #2: (IX-C-(7))

Congress should enact a law imposing criminal and civil penalties for false and misleading corporate publicity.

Department Comment:

We believe such a law, quite apart from difficulty of framing any workable language, would do more harm than good. It would most certainly reduce the flow of information to shareowners, another way of saying it would infringe on traditional freedom of speech. We think the problem would be better handled by voluntary, educational methods.

Recommendation #3: (IX-C-(7))

SEC indicates it plans to amend its rules to require disclosure by issuing companies of compensation paid to public relations counsels or firms.

Department Comment:

This department has been planning to advocate such a disclosure requirement as an addition to the self-regulatory actions of the Exchange. Now that the SEC evidently plans to make it the subject of a rule, the Exchange should stand aside. Our interest would be not so much in the amount of the compensation as in its form -- particularly whether compensation to public relations firms is paid in the form of stock or stock options. PI-PR believes it would be in the interests of shareowners to require disclosure of such arrangements, though we do not think it necessary to insist on disclosure of the amount of compensation.

Recommendation #1 (IX-C-(7))

The exchanges, corporations, the public relations profession and the press should act to raise ethical standards in financial public relations.

Department Comment:

The Exchange should take leadership in this area. One major method would be to proceed with our plans for a conference of listed company public relations officials and/or their public relations counsel for the purpose of discussing specific measures to improve communications and standards in this area. We are preparing a detailed proposal on this subject. Among the ideas to be discussed at such a conference would be (1) the proposal that listed companies disclose to the Exchange their contractual arrangements with outside public relations counsel when such arrangements include compensation in the form of stock or stock options; (2) the possibility that the Exchange recommend to listed companies requiring reports to the companies from their outside public relations counsel on trading in their stock by personnel of counseling firms; (3) the possible recommendation to listed companies that they require their personnel and outside PR counsel to abide by the spirit of Section 17(b) of the Securities Act, which is aimed at commercial bribery of financial editors and publishers.

Criticism (IX-C-(6))

The SEC comments on the Listed Company Guide published by the Exchange, saying that the Exchange 'seeks to use public relations departments of listed companies and firms hired by listed companies as an extension of its own public relations program, aimed at persuading the public to 'own your own share in American business.' " The SEC goes on to complain that the Exchange, however, makes only a limited attempt to control the content of corporate publicity.

Department Comment:

We should continue providing listed companies with informational assistance. We plan to change over from an annual Guide in book form to a periodic newsletter-type service.

Factual Inaccuracies: (IX-P.73)

The Listed Company Guide is not published for the purpose of enlisting corporate assistance in the "own your share" campaign. Its purpose is to improve financial communications of listed companies to their various audiences: i.e., Stockholders, employes, and the general public. Exchange materials play a very minor role in the Guide.

10-161—1-63

NEW YORK STOCK EXCHANGE

MEMORANDUM

April 30, 1963

TO: Mr. Ruddick C. Lawrence

FROM: William H. Kendrick Bill

SUBJECT: Comments on S.E.C. Study Recommendations

A. Chapter III - Selling Practices
(b. Sales Promotion, PP 15-16)

1. Criticism:

The Study said lecture courses are a valuable public service when properly presented but can also be abused as a promotional technique. It gives one flagrant example---that of a firm (not identified as NYSE) selling speculative securities to university students during and after such lectures.

2. Department Comments:

While the Study makes no recommendation on regulating speaking activities of firms, some of Chapter III's criticisms of other activities may apply:

a. Advertising to attract audiences (potential clients).
b. Possible promotion of investing for everybody.
c. Boasting of the firm's research facilities.
d. Recommending specific (including speculative) stocks and industries from the speaker's platform.

We are spot-checking member firm Investors' Information Committee courses to make sure the approach is educational rather than promotional. We also have Standards and Guidelines for speakers which we plan to release to the firms. And we have developed Rules and a system of spot-checking the speaking activities of all member firms, if these become necessary.

M E M O R A N D U M

May 1, 1963

SUBJECT: Comment on SEC Special Study Recommendations on Matters Affecting the Work of the Department of Member Firms

In the following memo, SEC recommendations are briefly summarized in a paragraph numbered as in the Report of the Special Study Group. Indented immediately below is Exchange comment.

II.F(2) - Suggests that present statutory disqualifications for SEC registration and NASD membership be combined and made applicable alike to firms, principals, supervisors, and salesmen. Statutory disqualifications would be broadened to include conviction within 10 years of crimes involving theft, fraud, embezzlement, defalcation or criminal breach of fiduciary duty of any kind, or other crimes arising out of conduct of the securities business.

> NYSE standards for disqualification are already more strict than those mentioned here. The SEC has stated that the Exchange could continue to operate with higher standards than specified for SEC or NASD registration.

II.F(3) - Securities firms would be required to supply initially and keep current with the SEC considerably more detailed information than at present concerning major activities, memberships, branch offices, clearing correspondent and wire connections, salesmen, research personnel, supervisors, and their experience.

> The Exchange itself does not have on a continuing basis all of the information which the SEC proposes requiring, and some of the information which we do have is not required to be as current as the SEC would require it. The usefulness of having all this information filed continuously with the SEC or the self-regulatory organizations is questionable. Information which is simply filed and not used is costly and wasteful. It seems more efficient to continue the present system of requiring such information whenever it is needed.

II.F(4) - SEC licensing and registering of individual salesmen, supervisors and other categories of personnel is suggested. A basic registration form would be made available to regulatory and self-regulatory agencies. Changes in employment and disciplinary actions would be reportable as they occur.

> Depending on the way it is implemented, this suggestion could add another layer of administrative burden on firm already required to qualify their men with several agencies, or it could greatly simplify these procedures by putting much of the registration information in standard form. Problems to be considered in its

implementation are a possible registration fee for individuals, provision for securing additional information needed by the Exchange, and preservation of the Exchange's right to require reregistration of an individual on transfer from one firm to another.

II.F(5) - The Commission would be given power to bring administrative proceedings directly against individuals involved in violations of the securities laws, rather than only against firms as at present.

The Exchange already has this jurisdiction over individuals and it seems equitable that the SEC should also take action against individuals rather than firms when appropriate. The possibility of an individual being in triple jeopardy of Exchange, NASD and SEC discipline for the same matter would arise. The self-regulatory organizations are already cooperating to eliminate double jeopardy and under this proposal would also work with the SEC in an attempt to use regulatory and self-regulatory manpower more efficiently. In this connection, a more complete exchange of information between the several agencies seems desirable, especially from the SEC.

II.F(7) - Present examinations should be considerably improved, refined and coordinated with a core of basic subjects for salesmen, supervisors and principals, with appropriate supplemental questions for supervisors and principals, and with further supplementation as any particular agency may desire for its own purposes.

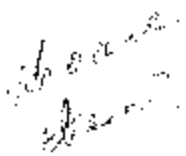
Supplementary questions should be provided for certain recognized specialties. Examinations and training should be coordinated through a National Board of Securities Examiners.

Exchange examinations are already of the type suggested in the recommendation. The Exchange has worked effectively with the NASD and 22 states administering examinations in working toward common examination objectives. This kind of informal cooperation appears at present to be achieving effective voluntary cooperation.

The Exchange does not believe in a permanent limited registration of the type contemplated in this recommendation. When the Exchange polled state securities commissioners two years ago, most said that they wished a general examination qualifying for securities sales of all kinds, rather than several separate examinations for limited activity. However, we understand that adoption of a policy of permanent limited registration by the SEC or NASD would not prevent the Exchange maintaining its present standard.

II.F(8) - An experience requirement is suggested for at least one principal in each registered firm and, if other than such principal, the individual designated as being in charge of regulatory and self-regulatory matters, the supervisor of selling activities, the supervisor or manager of each branch office, and the supervisor of research activities. Such experience requirements are already largely embodied in Exchange policy.

An open question is whether research personnel should gain their qualification through a self-regulatory research agency which the Exchange would recognize.



Following publication of the rest of the SEC report, the Exchange should give consideration to requirements for certain types of supervisors for which Exchange qualification is not now required.

II.F(9) - Part-time salesmen should not be excluded, but should be subject to exactly the same qualification requirements as full-time salesmen.

The Exchange would be able to maintain its standard that all registered representatives must be full-time employees.

II.F(10) - A system of local "character and fitness" committees as in the legal profession should be established to judge character and integrity of candidates for registration with the NASD. In addition, regulatory and ethical standards should receive greater emphasis in training and examination programs of the self-regulatory agencies.

The information gathered and decisions made by the legal character and fitness committees appears substantially similar to that which the Exchange now gathers concerning prospective mambers, allied membess, and registered representatives. It should be possible for the Exchange and the NASD to come to an agreement on division of labor to avoid duplication of effort in this area, possibly by the NASD automatically accepting qualification of a registered employee, member or allied member by the Exchange.

Securities regulation and ethics are already strongly emphasized in Exchange recommended training programs and examinations.

III.B(1)(2) - Supervision by broker-dealers of the selling activities should be strengthened by the designation of one home office senior executive responsible for internal supervision, tightened home office controls of branches, increasing the branch manager's supervisory role while de-emphasizing his selling activities in larger branches. The self-regulatory agencies should strengthen surveillance of standards such as that in the recent NYSE guide to supervision, with more frequent examinations of branch offices, including interviewing of salesmen and customers when accounts showed heavy trading or concentration in speculative issues.

The Exchange's program of supervisory standards and office inspections appears to cover all of the areas suggested in this recommendation.

III.B(3) - SEC rules concerning selling practices are suggested in such areas as: requiring every retail transaction to be designated "solicited" or "unsolicited" in each firm's permanent records, centralization of all customer complaints by firms in a single file available for inspection and examination by the Commission and the self-regulatory agencies, and required records on customers' investment goals, occupation, and type of service desired.

Centralization of complaints appears to be a sound practice of many member firms at present. Many firms also maintain current written information on investment objectives and related information. The area of greatest difficulty in this recommendation is that of defining "solicited" orders. The feasibility of such marking of orders would depend almost completely upon the SEC's definition of a solicited order.

III.B(4) - Greater emphasis should be given by the Commission and the self-regulatory bodies to the concept of suitability of particular securities for particular customers. The NYSE should make greater efforts to define suitability, possibly through statements of policy, and undertake necessary surveillance in enforcement. Three examples of the subject matter of statements of policy mentioned are: possible guide lines on categories or amounts of securities deemed clearly unsuitable in specified circumstances; indiscriminate recommending or selling of specific securities to other than known customers; approved and disapproved practices in handling of discretionary accounts.

The Exchange community certainly recognizes any clear abuse of suitability concepts and the Exchange has adequate general rules to act against such abuse.

III.B(6) - Moderation is suggested of sales compensation practices, such as: making monthly compensation less specifically dependent on each month's production, eliminating a step-up of commission rates for transactions in a given month on reaching a stated volume for the month, discouraging undue compensation differentials for sales of different categories of securities, requiring disclosure of extra compensation for particular types of transactions.

Up until 1949 the Exchange had a rule which prohibited member firms from paying registered representatives on a commission basis and limited salary changes to not more frequently than every three months. As a result of the views of a number of member firms, this was changed, with the acquiesence of the Commission, and the present permissive basis of compensation was adopted. The specific suggestions are problems which must be worked out between the industry and the Commission.

III.D(2)(3) - The Commission would be empowered to adopt rules for segregation of excess margin and fully paid securities and their hypothecation.

The Exchange already has rules along this line. The SEC has withheld coming to a determination as to what it wants to do on this recommendation.

III.D(4) - Greater flexibility is suggested in the "haircut" provisions of the net capital ratio rules, particularly toward exempting specified quantities of securities in the inventory of a "primary market maker".

The SEC has not yet determined whether or not it will support this recommendation.

III.D(5) - Amendments to the Bankruptcy Act.

Similarly, the SEC has not determined its position on this recommendation.

III.E(4) - Continuing attention is suggested by the industry and the Commission to the possibilities of improving securities handling, clearing and delivery systems.

These are areas in which the Study Group merely suggests further study. However, it is interesting to note that the Study Group apparently is in favor of some method for the central handling of securities.

III.F - Continued efforts of the self-regulatory organizations in defining ethical standards in parts of the securities business which involve potential conflicts of interest and obligations are suggested. Areas mentioned are typical combinations of broker and dealer functions, underwriting functions, quasi-banking functions, and advisory relationships with issuers of securities and with customers.

The Commission has stated that this is a general rather than a specific recommendation, which the SEC and the self-regulatory organizations should pursue.

IV.C(1) - Managers of unregistered distributions would be required to file with the Commission prior information, and a 48-hour period of delay between the filing of the notification and the commencement of the distribution is suggested.

Although the SEC feels that this type of information should be filed with it, it desires to study the other aspects of this recommendation before coming to a conclusion.

IV.F(1) - This recommendation proposes the special "short form" registration statement and prospectus which the Department of Stock List will comment on.

Added here is the comment that the recommendation appears inadequate for the problem of shelf registrations.

Capital Requirements - II.F(11)(12); III.D(1)

In several places in the Report, the Study Group suggests new capital requirements for securities firms as follows:

Each broker-dealer would have minimum capital requirements which would be the higher of either of the following:

(A) $5,000, plus $2,5000 for each office, and $500 for each salesman.
(B) If engaged in underwritings, $50,000 plus 2% of its total underwritings for the previous year.

Another proposal is that firms should be required to maintain a reserve in cash or short-term governments of 15% of their customers' free credit balances, with any deficiency in this reserve levied as a charge against their net capital.

The impact of such capital requirements has been studied in comparison with the present requirements of Rule 325 for Exchange member firms. For all member firms with Exchange capital requirements, except one, the Rule 325 requirement was greater than the proposed $5,000 - $2,500 - $500 recommendation. However, among 95 firms not subject to Rule 325, three would not meet this SEC recommendation.

The additional SEC recommendations were studied in special computations for a sample of 61 representative member firms. In 35% of these firms the suggested requirement for underwriting firms created a capital requirement greater than that under Rule 325. Thirteen per cent would have been very close to or in capital violation if subject to the SEC recommendations.

Eighteen per cent of the sample had cash and governments on hand which were less than the suggested reserve of 15% of their customer's free credit balances, and consequently would have had the deficiency charged against their capital. Among these, two firms would have fallen below the Rule 325 requirement if the deficiency had been an additional charge, but they would have met the proposed SEC requirement.

The recommendation concerning reserves of customers' free credit balances also suggested broker-dealers should be required to give customers at least quarterly notice of such balances, including statements that the balances may be withdrawn at any time, that they are not segregated, and may be lent to other customers or used in the business of the firm, that interest is not paid, and that financial statements of the firm are available for inspection.

This part of the recommendation would impose discriminatory standards on broker-dealers and is not paralleled by any provision for other financial institutions holding customer funds.

The extension of the reserve principle used in banking does not appear parallel to conditions in the securities business. Because of the structure of banking, it would be a very rare bank that could meet the Rule 325 capital requirements. Exchange firms are required to be much more liquid than banks and to have greater net capital in relation to their aggregate indebtedness. Consequently, the additional protection of a cash reserve of customers' free credit balances appears questionable.

NEW YORK STOCK EXCHANGE

MEMORANDUM

May 3, 1963

TO: Mr. Edward C. Gray, Executive Vice President

FROM: Phillip L. West

SUBJECT: S.E.C. Special Study Group Proposals
Stock List Comment

IV B -4

Relates to "hot issues" and underwriters' compensation and mostly affects NASD and Exchange's relationships with member firms. Stock List comment limited to the following one factor:

Recommendation

In the case of "first issues" 40 day delivery of prospectuses be extended to 90 days and in case of issuers subject to continuous reporting under Sections 13, 14 and 16 the 40 day period be shortened to the completion of sale by underwriters.

Comments

"First issues" no listing problem as admission to dealings is usually at least 90 days after offering. In the case of prime investment issues fully sold shortly after offering this could have a nuisance factor. Reduction of 40 day period in other cases is good.

Suggestion

S.E.C. permit reduction in 90 day period for investment issues such as where Form S-9 could be used instead of S-1.

IV C -1

Deals with unregistered distributions and states registration is required only when the offering is by the issuer or a controlling person.

Recommendation

A notification be filed with S.E.C. for an unregistered offering 48 hours before such offering.

IV C

Comments

This should not be necessary for listed security under NYSE safeguards.

The principal problem with this Section is that which is omitted. Over the years the courts have narrowed interpretations under the 1933 Act and a tremendous gray zone exists. Sale of stock after exercise of an option, sale or acquisition of another company, merger, consolidation, private placement, the effect of letters of investment -- none of this is covered. Even when registered and sale is made on the Exchange the delivery of prospectuses is a gray zone. The only cure would be exemption under certain conditions of listed securities from the 1933 Act.

IV D

Intra-state exemption

Recommendation

Advance notice of such an offering be filed with S.E.C.

Comment

Size and character of listed issues make this of little importance.

IV E

Real Estate Securities

Recommendation

All distributions of or dealers in real estate securities be members of a registered securities association.

Comment

Listing of real estate investment trusts is being studied -- none are listed now -- probably a good suggestion.

IV F - 1

"Short form" registration statement

Recommendation

Companies reporting under Sections 13,14 and 16 be permitted to file a special "short form" registration statement and prospectus under the 1933 Act.

Comment

Under this proposal financial statements thereto filed under the 1934 Act would become subject to the additional liabilities of the 1933 Act where an individual does not have to prove reliance. This in itself may cause Companies not to take advantage of it.

Our previous proposal for an exemption under the 1933 Act with appropriate safeguards should be considered here. The Study Group points out that some secondary offerings are as large or larger than others which need to be registered and purchasers of the new block need information, as much as, but not more than, those purchasing outstanding securities.

Phillip L. West

PLW:gh

NEW YORK STOCK EXCHANGE

MEMORANDUM

May 3, 1963

TO: Mr. Edward C. Gray, Executive Vice President

FROM: Phillip L. West

SUBJECT: S.E.C. Special Study Group Proposals
Stock List Comment

Chapter IX, B-1

Recommendation B-1

Sections 13, 14 and 16 of the 1934 Act should be extended to all issuers having 300 or more equity security holders.

Comment

Section 12 covering registration of securities should also be covered since Section 13 only keeps up to date that filed under Section 12.

24% of the Companies surveyed did not solicit proxies. No requirement to solicit proxies is made. To be effective this should be done.

Banks would be covered only subject to exemptive powers of S.E.C. They claim proxy rules and report requirements of Comptroller of Currency is only a modest step. They do not say that Comptroller examined S.E.C. rules before making up his own to take into consideration the special nature of banks and the special power he has over banks far and above that of the S.E.C. This will result in a jurisdictional fight. Banks are exempt from 1933 Act and should also be exempt from 1934 Act. This looks like an attempt to keep S.E.C. jurisdiction unless other agencies bow their heads.

Insurance Companies would also be covered but since 110 companies presently report as having registered under 1933 Act and there is no Federal Agency covering them, it appears in order.

Chapter IX B-2

Recommendation

Amendment Section 15(d) of 1934 Act to cover companies having 300 or more equity security holders.

Comment

This merely implements previous recommendation and appears to be in order.

Chapter IX B-3

Recommendation

Repeal Sections 12(f)(3) of 1934 Act permitting unlisted trading privileges on an Exchange where equivalent information is available.

Comment

This would make the issuer determine where his stock should be traded and only affects other Exchanges. It seems appropriate but does not preclude a regional exchange from having unlisted trading in a security listed on another Exchange.

Chapter IX B-4

Recommendation

There should be no exemptions merely because issuers file under other laws but S.E.C. should have power to exempt where comparable information for the protection of investors is filed with other agencies.

Comment

This appears aimed at the banks commented on above.

Chapter IX B-5

Recommendation

No need of broad exemption of broker dealer from Section 16(b) for securities of issuers on whose Board of Directors they are represented.

Chapter IX B-5

Comment

Provision to be made for exceptional circumstances or unique situations possibly for a limited period of time.

Several member firms have advised that as a matter of policy they do not make markets in securities where they are represented on Board of Directors. Therefore, they seek early listing.

Study group thinks firms would give up the directorate rather than the market. The probabilities are the reverse would be true.

Possible problem area is that Exchange looks for two outside directors on Company Boards and too many obstacles might diminish the supply.

Chapter IX B-6

Recommendation

The term "OTC-listed" would become the hallmark for those required to comply with Sections 13,14 and 16 and would permit those not required to file to do so voluntarily to obtain this distinction.

Comment

"OTC-listed" would connote action by the issuer similar to listing on an Exchange,which is not the case -- would suggest "OTC registered" instead.

Voluntary filing by those with less than 300 holders could be dangerous. Even where there are 300 holders it is an open question whether this is sufficient for a free and open market. With substantially less than this number it might give a "hallmark" to a market which was relatively non-existent.

Any distinction depends upon what the newspapers will do. At present the distinction between listed and unlisted on an Exchange as published in the press for all practical purposes is non-existent.

Chapter IX B-7

a. - Recommendation

Financial statements in reports to stockholders should be prepared and presented on substantially the same basis as officially filed reports.

Comment

Only one instance is cited by Study Group (I.E., Atlantic Research Corp., traded on Amex). NYSE compares results and while there might be minor differences, the have been satisfactorily resolved. Perhaps in including OTC companies this is necessary. This should be limited to financial statements since if the text of the report were included, it might limit the information due stockholders. Reports should comment on operations, economic factors and trend of the business. To bring this under 1934 Act liability would have an adverse result.

b. - Recommendation

NASD should adopt proxy soliciting rules like NYSE and S.E.C. should have power to control manner of giving proxies proxies on customers' securities.

Comment

NYSE proxy rules govern conduct of members and apply both to listed and unlisted issues.

S.E.C. at one time proposed a set of rules and then abandoned them after representations by us.

This could cause many problems if controlled by law and we should try to keep self regulation in this area. NYSE rules have been time tested.

c. Recommendation

Supreme Court decision of Blau vs. Lehman should be reversed by legislation.

what is the all about?

Comment

Study group does not attempt to analyze this case but merely indicates it left a broad loophole in insider trading ban.

Chapter IX B-7 -- c.

Comment - continued

A broad study needs to be made in order to avoid implications which are not necessarily present.

This could further limit the area of outside directorships.

Chapter IX B-8

Recommendation

Officially filed information should be presented in a form for inexpensive duplication and distribution and broker dealers making markets and recommending purchases should have copies or actually distribute to customers.

Comments

Moody's and Standard & Poor's now obtain information from officially filed sources. Naturally these services determine for themselves what is material for the purpose of reporting. No attempt was made to determine how adequate this is. Expense involved could be astronomical. Possible liability of broker dealer in not so distributing in all cases if this were a rule could be great both for listed and unlisted securities. Wider dissemination of information should be fostered but this seems to be an evolutionary and educational process.

Chapter IX C-1

Recommendation

Exchanges and NASD should establish high standards for dissemination of corporate publicity and cover both positive and negative aspects.

Comment

NYSE has such regulations on the positive side. The negative side is taken care of on an individual basis. There were three instances in 1962 where companies were cautioned. Several cases were discussed before the Study Group and they appeared satisfied.

Chapter IX C - 1

Comment - continued

The Study Group mainly covers the negative side. Much more important is the positive side. It is difficult to convince conservative management that statements should be made before definitive action is taken. The Study Group made no attempt to study the lack of information where publicity should have been given.

Chapter IX C - 2

Recommendation

Enact statute providing criminal sanctions and civil liability for dissemination of false or misleading statements or unwarranted forecasts.

Comment

Any attempt to curtail by statute the free flow of information would cause stagnation in this area. Publicity requested by the Exchange because of rumors affecting the market would be delayed or even refused because of liability before positive actions were taken. Immediate releases would be delayed so counsel could pass upon them. Stockholders would not be as well informed. The text of annual reports would be curtailed. The reckless few should not make the rules for the many. We have experienced how corporate mouths are buttoned while a registration statement is in progress. Any such legislation might make this happen all the time.

Chapter IX C - 3

Recommendation

Disclosure of compensation to public relations counsels or firms in the form of equity securities, options, warrants or rights.

Comment

Disclosure of this information would appear to be appropriate.

Phillip L. West

PLW:gh

NEW YORK STOCK EXCHANGE

MEMORANDUM

May 6, 1963

TO: Mr. G. Keith Funston

FROM: Ruddick C. Lawrence

SUBJECT: SEC Recommendations and Criticisms

Attached are reports from my Departments on the recommendations and criticisms from the chapters of the SEC Study which have been released to date. The comments reflect my thinking as well as that of the various Departments.

There are several areas, particularly in George Bookman's memorandum, which include comments and criticisms that may affect other Departments as well, but naturally we will pass along and coordinate our thinking with the other Departments in the Exchange.

RCL