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MEMORANDUM

April 21, 1970

TO: The Chairman

FROM: Hurd Baruch, Special Counsel *HB*  
Division of Trading and Markets

RE: Appearance of New York Stock Exchange Officials Before  
the Commission on April 21, 1970

Commissioner Owens invited the New York Stock Exchange officials (Messrs. Lasker, D'Anunzio, Haack, Cunningham and Stock) to listen to a presentation by Mr. Sporkin regarding the financial problems of various New York Stock Exchange member firms, which were of grave concern to the Commission. Mr. Sporkin mentioned the dozen firms known to the Staff to have net capital computations in excess of 1200%, and then detailed the specific problems of four of them: Blair, Schwabacher; Hayden, Stone; Dempsey-Tegeler; and F. I. DuPont. He stated that the situation with Blair, Schwabacher was extremely critical due to the firm having both operational and capital problems, and that liquidation was a serious possibility. He noted that both Hayden, Stone and Dempsey-Tegeler were in net capital violation, and expressed concern at their continuing losses and at the poor "quality" of their recent capital infusions (i.e., the subordinated capital made up of restricted stock in issues which were not freely traded). He further noted that the Staff had just found out that the Exchange, by letter of April 14th to Dempsey-Tegeler, had told the firm to suspend application of the Exchange's recently announced policy of not allowing short-difference reserves to be counted as good capital. If such reserves had been excluded from net capital, Dempsey-Tegeler would have been in violation of the Exchange's Rule at the time the King money was put up, contrary to the Exchange's certification, and its net capital ratio would now be over 5000%. Other problems touched on included DuPont's inability to make significant progress in reducing the number of complaints filed against it.

Speaking for the Exchange, Mr. Cunningham agreed that the financial situation of member concerns was of concern to it. He emphasized that at the current level of volume, operating losses could be expected to continue, and he presented recent figures as to the extent of the losses at certain firms: F. I. DuPont--\$4.8 million (1st Quarter); Goodbody--\$1.1 million (March); Hayden, Stone--\$600,000 per month; Hornblower, Weeks--\$5 million (two months); Langley--\$200,000 (two months); Blair, Schwabacher--\$1 million (one month). He felt that the operational problems had been overcome by the industry as a whole, as demonstrated by fail

statistics and other data presented to the Commission, although individual firms might run into trouble from time to time due to a specific cause, such as conversion to a computer system. Mr. Cunningham next stated that the figures with respect to Blair, Schwabacher were "not as severe" as presented by Mr. Sporkin, and that in his judgment the firm could clean up its problems in four months. He gave the latest net capital ratio as 1738%.

A general discussion of the issues presented by Mr. Sporkin ensued. Commissioner Needham questioned the New York Stock Exchange officials about the consistency of their interpretations of their net capital rule, particularly in view of their testimony before Congress that their rule was stricter than the Commission's. He suggested that it might help in dealing with troubled firms if everybody knew the truth about their condition and, to that end, he suggested that a firm and consistent application of the Rule would be best. In reply, Mr. Haack stated, "If we had been absolutely literal we probably would have had half of Wall Street out of business." Mr. D'Anunzio added that "We have a broad Rule and we have used a broad interpretation on the theory that, by helping the firm, --stretching the Rule-- we were helping the public." In reply, Commissioner Needham made it clear that he was not excluding the possibility of workouts, once a firm had been found in violation, although he did feel that in such cases a commitment of the New York Stock Exchange Trust Fund would be appropriate.

Commissioner Owens asked for an explanation of the circumstances under which the Trust Fund could be employed. Mr. Cunningham started by stating that the partners of the firm first had to sign a liquidation agreement. Commissioner Owens questioned this, stating that it had not been done in the case of Dempsey-Tegeler, yet the Board of Governors had recognized a commitment--not in terms of a specific amount of dollars, but a commitment nevertheless. Despite the fact that Mr. Cunningham had just mentioned showing the Board the letter which the NYSE staff sent to the Commission on Dempsey-Tegeler, Mr. Lasker broke in to say that he was the Chairman of the New York Stock Exchange Board of Governors and he knew of no commitment of Trust funds to that firm. Mr. D'Anunzio stated that Mr. Cunningham had indeed brought the matter to the attention of the Board of Governors and had informed it that in his (Cunningham's) view, the Exchange had more responsibility than in the ordinary case because of the length of time the Exchange had carried the firm in violation.

With respect to the concern expressed by Commissioner Smith and Mr. Sporkin about the "quality" of the capital which had been infused into Dempsey-Tegeler and Hayden, Stone, Mr. Haack stated, "Beggars can't be choosers. We have had to do things to be expedient or put the firms in the red."

Commissioner Owens asked whether the recent commission surcharge was helping the firms, and whether there was any prospect of a turn-up in

the market. Mr. Haack indicated that the surcharge was only half as effective as it was projected to be, due to the fact that volume was so much lower than in 1969. Mr. Lasker told the Commission that he felt only an easing of the credit situation would help the market, and that that did not seem likely. Accordingly, Commissioner Owens asked whether the Exchange's plans shouldn't be made on the basis of the present level of volume, rather than on hopes for increased trading. Mr. Lasker responded that perhaps they had been too hopeful, and that maybe it would be better to plan a bit more on the basis of their fears. The Exchange was then asked whether an increase in trading hours would be of much help. The answer was that it might or might not help, but everybody wanted to give it a try. Mr. Lasker stated that in the event of a real catastrophe -- the failure of firms like Hayden, Stone, Goodbody, DuPont -- even an \$80 million Trust Fund would be a drop in the bucket.

Commissioner Owens noted that everybody could survive in good times, such as 1968, but that some firms might inevitably perish in hard times, such as we were now experiencing. He wondered whether the Exchange was automatically trying to keep every firm alive through the infusion of new money, no matter how bad its problems. Mr. Cunningham stated that they encouraged certain firms to merge rather than to struggle on -- even in cases where the firm was not clearly in financial difficulty. He noted that it was difficult to spot all dangerous situations in advance; for example, the Exchange only found out about Gregory & Sons a few days before it went into liquidation. However, Mr. Sporkin pointed out that a number of the situations which gave the Commission concern, such as Dempsey-Tegeler and Hayden, Stone, had been obvious problems for months past.