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# SECURITIES MARKETS INVESTIGATION

## HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE HOUSE OF REPRESENTATIVES

EIGHTY-SEVENTH CONGRESS  
FIRST SESSION

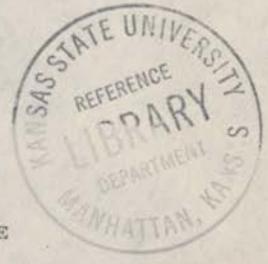
ON

### H.J. Res. 438

JOINT RESOLUTION TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 SO AS TO AUTHORIZE AND DIRECT THE SECURITIES AND EXCHANGE COMMISSION TO CONDUCT A STUDY AND INVESTIGATION OF THE ADEQUACY, FOR THE PROTECTION OF INVESTORS, OF THE RULES OF NATIONAL SECURITIES EXCHANGES AND NATIONAL SECURITIES ASSOCIATIONS

JUNE 27, 28, 29, AND JULY 10, 1961

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## SECURITIES MARKETS INVESTIGATION

TUESDAY, JUNE 27, 1961

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCE AND FINANCE  
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room 1334, House Office Building, Hon. Peter F. Mack (chairman of the subcommittee) presiding.

Mr. MACK. The subcommittee will be in order.

The Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce today is beginning hearing on House Joint Resolution 438, a joint resolution directing the Securities and Exchange Commission to make a study and investigation of the adequacy for the protection of investors, of the rules of the stock exchanges and of the National Association of Securities Dealers.

(H. J. Res. 438 follows:)

[H.J. Res. 438, 87th Cong., 1st sess.]

JOINT RESOLUTION To amend the Securities Exchange Act of 1934 so as to authorize and direct the Securities and Exchange Commission to conduct a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations:

*Resolved by the Senate and House of Representatives of the United States of America in Congress assembled,* That section 19 of the Securities Exchange Act of 1934 is amended by adding at the end thereof a new subsection as follows:

"(d) The Commission is authorized and directed to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including rules for the expulsion, suspension, or disciplining of a member for conduct inconsistent with just and equitable principles of trade. The Commission shall report to the Congress on or before January 3, 1963, the results of its study and investigation, together with its recommendations, including such recommendations for legislation as it deems advisable. To carry out such study and investigation there is hereby authorized to be appropriated the sum of \$750,000."

Mr. MACK. I have been alarmed by recent developments in the securities markets and it appears that others share my concern.

In the past few weeks the president of the New York Stock Exchange has issued two very firm warnings against speculation in the stock market. The Securities and Exchange Commission has initiated an investigation of the American Stock Exchange to determine whether additional rules or laws are required to insure proper operation of the exchange.

A few weeks ago, the Commission disclosed that they had more manipulation cases in various stages of administrative and criminal proceedings than ever before. The Chairman of the Commission

testified before the House Appropriations Committee that the recent action in newly offered over-the-counter securities raised questions as to whether there are forms of manipulation. The National Association of Securities Dealers has written to all members indicating concern over the very large total of outstanding undelivered transactions (fails). This letter warned that there were \$1,400 million of outstanding over-the-counter contracts upon which delivery had not been made. The country's largest brokerage firm has run a dozen newspaper ads in the past 2 months urging investor caution. Other brokerage houses have alerted employees to the danger of uninformed public speculation. Here is a quotation from a bulletin which one brokerage firm sent to its managers and registered representatives:

To any of you who were in the securities business in 1930 the above-listed items would be sufficient to alert you and tell you that there could be very rough times ahead for the securities business. To those of you who have recently entered this profession, I will tell you flatly that the warning flags are flying, and it behooves every one of you to recognize this signal and to conduct yourself accordingly.

The congressional investigations of 1930-31 were bitter ones as far as our industry is concerned. Out of these investigations came the Securities Act of 1933, the Securities Exchange Act of 1934, and the SEC, but something far worse than that came from the investigations. Our entire industry was cast in an unfortunate role insofar as the public was concerned and we became the most popular "whipping boys" available. Our entire industry suffered under the last for many long years. It is only recently that the public has again come back into the market in strength and has made it possible for many of you to earn handsome salaries and live as successful businessmen.

I for one do not care to go through the early 1930's again. There are several things that all of us can do right now.

1. The rules and regulations of the SEC, NASD, and the New York Stock Exchange are clearly written and are available for study by each one of you. It is the policy of this firm to abide by all of these rules. During the recent active markets—which of course have caused the events described in the first paragraph—many registered representatives have been critical of some of the rules under which we operate and work, and newly acquired customers have agreed with the criticisms. We do not write these rules but we do propose to abide by them and we can tell you that it is to your own advantage if you also accept and abide by the rules. At this stage of the market and for the reasons outlined above, acceptance of the rules can be your major contribution toward your profession.

2. Our network with busy wardroom offices provides a perfect workshop for manipulation of the securities market. Manipulation and "rigging" of markets is as old as our business. At the present time it is against the law. Let each one of us make absolutely certain that we are not being used by irresponsible persons for the purpose of manipulating or affecting the price of any security. Be extremely cautious about entering orders for any group of speculators. We must carefully guard against being "used" by irresponsible and avaricious groups or individuals of any kind.

Our subcommittee cannot but be aware of these various pronouncements concerning the current situation in the securities markets nor can it be unmindful of the responsibilities which it has to the Congress and to the public as to the adequacy of the protection afforded to investors and to the public by the various securities acts which are now on the books.

The Securities Act of 1933, relating to the truthful disclosure of information about new security offerings, the Securities Exchange Act of 1934, relating to disclosure of information about listed securities and regulating practices in exchange and over-the-counter operations, and succeeding legislation which is administered by the Securities and Exchange Commission, represent legislation of which the

House Committee on Interstate and Foreign Commerce and Congress are justly proud. These statutes have gone a long way in the mitigation and elimination of undesirable practices in the securities field, in the restoration of confidence in the securities markets, and in the protection of the investing public.

Experience in the administration of these acts, however, naturally has given rise over the years to various suggestions as to their improvement and their workability, which obviously could not all be anticipated at the time of their original enactment. A program for revision in the light of such experience was interrupted by the war. At the instance of the House Committee on Interstate and Foreign Commerce, the Commission renewed discussions with industry relating to a revision program, and from time to time since has presented the result of such discussions to the committee for consideration.

In addition to the responsibilities and duties with which the SEC is charged relating to disclosure of information about listed securities and regulating practices in exchange and over-the-counter operations, the Securities Exchange Act of 1934, as amended, imposed certain duties and responsibilities upon national securities exchanges and upon national securities associations. That act requires that both the exchange and the over-the-counter markets should be governed by certain rules for the protection of the public in the conduct of their operations. That legislation when enacted not only provided for certain items which should be contained in their rules but also directed the Commission to make a study of the rules and report to the Congress the results of its investigation together with its recommendations.

That study, together with the Commission's hearings into the difficulties of Richard Whitney & Co., led to a program of reforms drafted with the cooperation of the Commission, which was approved by the New York Stock Exchange in October 1938. In view of the more than 20 years which have elapsed since that time and the experience which necessarily grows out of the administration of such programs and of the statutes, and in view of the comments which recently and currently have been made as to today's market conditions, it has seemed to us that it is now highly appropriate again to review these rules governing the activities of the various securities markets to see whether they are adequate to protect investors, to determine just how they are being administered by the exchanges and the over-the-counter associations, and whether changes, modifications, or expansions of the rules or statutes are desirable now in the public interest.

It is our feeling that the SEC properly, as an arm of the Congress, now should bring up to date and enlarge upon the study which it was authorized to make some 26 years ago. For this purpose, I have introduced House Joint Resolution 438, which would authorize to be appropriated the sum of \$750,000 for the Commission to make such study and investigation and report to the Congress by January 3, 1963, the results of its study together with its recommendations.

Our first witness this morning is William Cary, Chairman of the Securities and Exchange Commission.

Chairman Cary, I believe this is your first appearance before our subcommittee and I wish to welcome you here as well as to express to you and to your fellow Commissioners the continuing interest which this subcommittee has in the successful and effective administration by you of the various statutes which have been entrusted to you.

STATEMENT OF WILLIAM L. CARY, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION; ACCOMPANIED BY COMMISSIONER BYRON D. WOODSIDE; COMMISSIONER J. ALLEN FREAR; FRANK J. DONATY, COMPTROLLER; PHILLIP A. LOOMIS, JR., DIRECTOR OF THE DIVISION OF TRADING AND EXCHANGES; MANUEL F. COHEN, DIRECTOR OF THE DIVISION OF CORPORATION FINANCE; WALTER P. NORTH, ASSISTANT GENERAL COUNSEL; ALLAN CONWILL, GENERAL COUNSEL; AND ARTHUR FLEISCHER, JR., LEGAL ASSISTANT TO THE CHAIRMAN

Mr. CARY. Thank you, Mr. Chairman.

Mr. Chairman, I am William L. Cary, Chairman of the Securities and Exchange Commission. I am accompanied today by my colleagues, Commissioner Woodside and Senator Frear on this side, and by certain members of my staff, including Mr. Donaty, our Comptroller, Mr. Loomis, the Director of the Division of Trading and Exchanges, Mr. Cohen, the Director of the Division of Corporation Finance, Walter North, our Assistant General Counsel, Allan Conwill, our General Counsel, and my legal assistant, Arthur Fleischer.

I have a prepared statement, but in pursuance of your general policy I would prefer not to read it, although I may read one or two excerpts directly, but to summarize it as we go along.

Mr. MACK. Mr. Chairman, you may read your entire statement, or we can insert the entire statement into the record at this point.

Mr. CARY. I think you have copies of the statement. I would like to insert that as part of the record, and then to summarize it, if I may.

Mr. MACK. Without objection, the entire statement will be inserted at this point.

(Mr. Cary's statement follows:)

STATEMENT OF WILLIAM L. CARY, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman and members of the committee, I am William L. Cary, Chairman of the Securities and Exchange Commission. I am accompanied today by Commissioner Woodside and Commissioner Frear, and by certain members of the Commission's staff.

I. INTRODUCTION

We are here at your invitation to testify on House Joint Resolution 438. We welcome and heartily support this resolution and consider it a most timely proposal. This resolution would amend the Securities Exchange Act of 1934 by adding a new subsection, to be designated subsection (d), of section 19 of that act. Subsection (d) would authorize and direct this Commission to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including rules for the expulsion, suspension, or disciplining of members for conduct inconsistent with just and equitable principles of trade. The Commission is also directed to report to the Congress on or before January 3, 1963, the results of its study and securities markets have occurred with respect to the amount and kind of public participation, the size of the markets themselves, the methods of distributing and selling securities, and the trading practices on the exchanges and in the over-the-counter market.

Because of the lack of detailed information about many of the developments in the securities markets, a void which would be cured at least in part by the proposed investigation, I caution that my remarks which follow form at most a general indication of the direction of any inquiry. We have not yet had the opportunity to formulate a detailed plan. If House Joint Resolution 438

is enacted, further preparation and the course of the investigation itself will undoubtedly suggest pertinent and essential areas of inquiry beyond those which I discuss today.

#### V. CHANGES IN THE SECURITIES MARKETS

As background I should like now to turn to a discussion of certain of the basic changes in the securities markets.

##### 1. *Growth of public participation and trading volume*

Perhaps the most significant market changes, which are largely responsible for many of the others I shall discuss, are the sheer increase in size of the securities markets and the growth of public participation. As to this latter point, all published data indicate that the base of stock ownership has greatly expanded and that the rate of growth of public participation in the markets has been accelerating. For example, a census of shareholders made by the New York Stock Exchange shows that, during the 7-year period from 1952 to 1959, the number of shareholders doubled, and that during the period from 1956 to 1959 the number of shareholders increased at a rate of nearly 1½ million a year.

It is highly probably that this diffusion of stock ownership has injected into the market an increasing number of persons having slight acquaintance with the intricacies of corporate finance and stock market operations.

The greater public participation in the securities markets has accompanied a startling growth in the volume of trading in those markets. For example, trading on the New York Stock Exchange has expanded from an average daily volume of 1,980,000 shares in 1950 to an average daily volume of 4,500,000 shares thus far in 1961. In the over-the-counter market, the number of stock issues quoted in the "sheets" has expanded from approximately 5,200 in 1951 to over 7,500 at the present time. Note especially that there has been an increase of approximately 1,500 traded issues in the last 2 years.

##### 2. *Changes in methods of distribution and marketing*

Accompanying the growth of public participation in the securities markets have been changes in the methods of distributing and selling securities, such as the spread of branch offices, the employment of part-time salesmen, and the use of novel methods to distribute certain securities. These changes raise questions as to possible assaults upon the integrity of marketing procedures.

The number of customers' men registered with the New York Stock Exchange has increased from 10,608 in 1950 to 27,896 in 1961; the number of customers' men registered with the National Association of Securities Dealers, Inc., has increased from 28,794 in 1950 to 93,351 in 1961. Many securities salesmen work on a part-time basis; many have no particular qualifications to sell securities; and most important, many are not subject to the kind of supervision which insures high ethical standards. The possibility exists that these factors may have led to questionable merchandising techniques. They also have undermined the important personal relationship between broker and customer in which the broker seeks to ascertain whether the security is suitable for a particular customer.

The growth of branch offices is another aspect of the trend to seek a mass market for securities. The number of branch offices maintained by member firms of the New York Stock Exchange has increased from 1,661 in 1950 to 3,166 at the end of 1960. Some member firms during this period have trebled the number of their retail outlets. This development has increased the problems of training and supervision of salesmen, the regulation of whom is so important because of their immediate contact with the public. Moreover, the task of supervision is aggravated by the employment of part-time or inexperienced registered representatives, particularly in the mutual fund area. Furthermore, some registered representatives may solicit from door to door and operate from private residences remote from their supervisors.

The above-described diffusion of responsibility throughout the trading and distribution process presents serious problems. On the purely mechanical level, the heavy trading volume has made it difficult for many broker-dealers to keep current the books and records required by statute and rules of this Commission. As a further illustration, there appear to be a growing number of instances in which broker-dealers have failed to deliver securities or the proceeds of sale of securities. The decentralization of control, coupled with the influx of inexperienced salesmen, suggests the possible development of a lowering of standards in market operations.

## VI. THE OVER-THE-COUNTER MARKET

The expanding over-the-counter market, and the issues traded in that market, present problems which clearly are within the scope of the inquiry directed by House Joint Resolution 438. There is a lack of basic information concerning the over-the-counter market. For example, unlike the exchange markets, the volume of trading is not known. Thus, it is difficult to determine which securities are active and which inactive or whether price increases or decreases in a security have been accompanied by slight or heavy trading.

Fundamental information is also absent with respect to the issues traded in the over-the-counter market. We note that issuers having securities registered on a national securities exchange are required to file with the Commission monthly, semiannual and annual reports essentially detailing the material events which have occurred during the reporting period, including financial data, mergers, and transactions with insiders. Similar reports must be filed by other issuers which have registered, under the Securities Act of 1933, securities of a class aggregating more than \$2 million. A large but unknown number of issuers, in whose securities there is a substantial public interest, are not subject to these reporting requirements. Thus, the investing public is deprived of financial information with respect to these companies, a void emphasized by the fact that many of them do not even appear in the standard financial reference works. This absence of data is particularly unfortunate in the over-the-counter market area, where a great number of companies are speculative or unseasoned ventures. In summary, we note this gap in the full disclosure requirements of the securities laws and state our view that any investigation should concern itself with this fundamental problem of the over-the-counter market.

Other questions for inquiry with respect to the over-the-counter market relate to marketing and trading processes, which are conducted by a multitude of brokers and dealers. Adequate information concerning many aspects of these processes is not known. As mentioned above, data concerning volume of trading, both in the aggregate and in particular issues, is not available and disclosure concerning many issuers whose securities are traded in this market is inadequate. Among the problems which have arisen is that presented by securities whose market price rises sharply immediately after an initial public offering. It will be necessary to consider whether these increases result solely from normal forces of supply and demand or whether unwholesome or even manipulative practices have contributed. The proposed study should provide important information concerning the actual operation of the over-the-counter market and the adequacy of the rules governing trading in that market.

## VII. EXCHANGE RULES

Although the Exchange Act grants to the Commission broad powers over the exchanges, the Commission has in general left to the exchanges the policing of their own members. This approach reflects the view that the exchanges can and should exercise a substantial measure of self-regulation and self-discipline subject to the statutory standards and the ultimate authority of the Commission.

As this committee knows, the Commission recently announced that it was investigating the rules, policies, and procedures of the American Stock Exchange relating to the conduct of specialists and other members. I do not know what the results of the investigation will show, and I believe that it would be improper and unfair to make any comment on it before the staff has completed its study and reported to the Commission. I would anticipate that, if House Joint Resolution 438 were enacted, we would coordinate our investigation of the American Stock Exchange with a study of the rules and practices of other exchanges to determine whether, and the extent to which, any changes in such rules and practices may be necessary.

## VIII. PROBLEMS OF FINANCING

Two aspects of the employment of credit in the securities markets warrant special attention. The first is the extension of credit by banks on over-the-counter securities. This is largely unregulated under existing laws. The second is the apparent growth of nonbank credit, including loans by moneylenders.

Under the existing provisions of the Securities Exchange Act, the promulgation and interpretation of regulations concerning credit extension are the re-

sponsibility of the Board of Governors of the Federal Reserve System. It is the duty of this Commission to enforce these regulations. Generally, members of exchanges and broker-dealers who do business through members are prohibited from extending credit on over-the-counter securities and may lend only in the amount provided by regulation T, presently 30 percent, on securities traded on an exchange. Regulation U, applicable to banks, provides that no bank shall make a loan secured directly or indirectly by stock for the purpose of purchasing or carrying stock registered on an exchange in an amount exceeding the maximum loan value of the collateral, presently 30 percent. Extension of credit by persons other than banks and broker-dealers is not regulated. Thus there are gaps and inconsistencies in the present pattern of securities credit regulation. It would be appropriate to inquire whether credit restrictions should be imposed on banks with respect to over-the-counter securities, and further whether persons other than banks and broker-dealers should be subject to the margin requirements.

#### IX. DISTRIBUTION ON EXCHANGES

Finally, mention should be made of distributions of securities through the facilities of the stock exchanges. While the Commission's rules permit distributions to be effected on exchanges under plans designed to prevent manipulative or deceptive practices, there is evidence that substantial distributions not controlled by these plans have occurred through the trading facilities of the exchanges. It is not clear that all such transactions have been made under circumstances providing adequate protection to the public. The extent of this practice, the problems arising under it and the possible need for the establishment of special controls require study.

#### X. CONCLUSION

Since the market collapse which led to the enactment of the Federal securities laws, there has been a rebuilding of public confidence in the securities markets. This restoration of confidence is the result of both efforts at self-regulation by industry and the enactment of the Federal securities laws and their administration by this Commission. A thorough investigation of the character contemplated by the resolution is both necessary and appropriate in the light of changing conditions in the securities markets.

#### XI. MODIFICATIONS PROPOSED

Finally, I would like to suggest two modifications which we believe should be made in House Joint Resolution 438. First, the resolution should be amended to provide that the Commission may report from time to time the results of its study to the Congress, but that the final report should be made on or before January 3, 1963. If the results of our study indicate that any particular area requires prompt legislative action, the Commission should be free to report and make recommendations to the Congress on that matter without waiting until the study is completed. Second, the resolution should be amended to provide that personnel required by the Commission for the conduct of the study and investigation may be employed without regard to existing civil service requirements. The resolution as written would appear to subject the recruiting of all personnel except attorneys to the rules and limitations of the civil service system. It would facilitate the employment of qualified personnel on a temporary basis if we were not required to conform to civil service requirements. We suggest, therefore, that the resolution be amended to permit us to (a) appoint and fix the compensation of a director and such assistant directors as may be required without regard to the provisions of the laws applicable to the employment and compensation of officers and employees of the United States, provided that individual compensation will not exceed \$18,500 per annum; (b) appoint professional and technical employees for carrying out the study and investigation without regard to the civil service laws, rules, and regulations; and (c) secure the temporary or intermittent services of experts or consultants at rates for individuals not to exceed \$100 per diem.

Mr. CARY. As you have already stated, we are here to testify on House Joint Resolution 438. I want to say first of all that we welcome and heartily support this resolution and consider it a very timely proposal. In effect, as I see it, this resolution would, first of all,

authorize and direct the SEC to study and investigate the adequacy for the protection of investors of the rules of the national securities exchanges, and the national securities associations; further, that we should report to Congress on or before January 3, 1963, the result of our investigation plus recommendations; and, finally, the joint resolution provides for an appropriation of \$750,000.

With respect to that \$750,000 appropriation, I would like to make a special comment. I think it is most needed. Our present budget, as I see it, and our manpower, will not support a thorough study of the exchanges and over-the-counter markets at this time. As I have said in the prepared statement, the constant danger in our Commission is that with market activities and flotations at an all time high, we become so overwhelmed with immediate problems, just the administration of the acts, that we are virtually forced to concentrate all our funds and manpower upon them and cannot do any long-range planning.

I think that is what this appropriation and this study would offer to us.

I have inserted along with the statement, an appendix, Mr. Chairman, dealing with precedents for our study, preceding studies made pursuant to authorization by Congress. I would like also to insert that as a part of the record, if I may.

Mr. MACK. Without objection, it will be included in the record. (Appendix referred to above follows:)

#### APPENDIX TO SEC STATEMENT ON HOUSE JOINT RESOLUTION 438

##### STUDIES CONDUCTED BY THE SEC

The Securities Exchange Act of 1934 directed this Commission to make several studies. Thus:

(a) Section 11(e) called for a study which the Commission made on the feasibility and advisability of completely segregating the functions of a dealer from those of a broker. A report was made thereon to Congress on June 20, 1936, recommending against such segregation.

(b) The original section 12(f) ordered a study by the Commission of unlisted trading on the stock exchanges. The present section 12(f), enacted in 1936, was the result.

(c) Section 19 directed the Commission to study certain aspects of the rules of the stock exchanges. The results of this study were set forth in a report to Congress on January 25, 1935, which contained recommendations in 11 areas. The recommendations were not, however, for legislative action but rather for action to be taken by the exchanges themselves. The exchanges took such action.

(d) Section 211 of title II of the 1934 act, which was actually an amendment to and became section 28 of the Securities Act of 1933, led to an exhaustive study and an eight-volume report by the Commission which was in turn followed by the enactment of both chapter X of the Bankruptcy Act and the Trust Indenture Act of 1939.

The Public Utility Holding Company Act of 1935 included a direction in section 30 that this Commission study and report to Congress upon numerous aspects of investment trusts. The resulting report led to the enactment of the Investment Company Act of 1940.

The Investment Company Act contains a continuing authorization in section 14(b) for the Commission to study and report to Congress from time to time on the size of investment companies and resulting problems which involve the public interest or protection of public investors. Such a study has been substantially completed through portions of the report are yet to be prepared. It should be noted that although we have been able to carry the cost of this study (a little over \$85,000 to date) within our regular operating budget by spreading it over several successive years, the bulk of the manpower required to make

the study and report has been supplied by the securities research unit of the Wharton School of Finance and Commerce of the University of Pennsylvania, which was retained by the Commission for that purpose, and that a minimum of the time of the Commission's own staff has been devoted to the study.

In addition to the foregoing express statutory directions and authorizations by Congress for this Commission to make studies and reports of the type under consideration, which are the truly comparable historical precedents for the resolution now under consideration, other studies and reports or comments by the Commission have resulted from time to time from requests by committees of Congress that this agency submit its comments or give testimony on proposed legislation.

Mr. CARY. Without going into those precedents, I would like to go back to this study as proposed. It seems to me that it is important because we do not have current data on market practices, the last study being something over 20 years ago. There has been a tremendous increase in the size of the securities markets, a growth in trading volume, changes in methods of distribution and trading, and new types of investment media. We have, naturally, some acquaintance with these changes, but we lack any refined data upon them.

The question, therefore, comes up to us now whether our present rules adequately protect investors in the light of these changed market conditions. What new rules are needed? What now unregulated areas of the securities markets need regulations? What rules need change?

The remarks that follow provide only a general indication of the nature of the inquiry. If House Joint Resolution 438 is enacted, I am sure that further preparation and study will suggest pertinent areas of inquiry beyond those that are discussed in this opening statement.

Now I would like to move on to sort-of-a-background picture of the economic changes that have taken place. First of all, perhaps the most significant change is the growth in public participation. Public ownership of securities has expanded. A New York Stock Exchange survey shows that during 1952-59, the number of stockholders doubled. What is the importance of this data? The proliferation or increase of stock ownership has injected into the market an increasing number of inexperienced investors. In addition, there has been a substantial growth in trading. Trading on the New York Stock Exchange has increased from 1.9 million in 1950 to over 4 million shares in 1961. On the over-the-counter market, the number of issues in the sheets has increased from 5,200 in 1951, to over 7,500 at present. By the way, there has been an increase of 1,500 in the last 2 years, 1,500 out of 7,500.

There have also been changes in marketing methods. Today, many buyers and sellers in the market are uninformed, except in a vague, general way, about corporate financing and market operations. Thus, it is important to have a personal relationship between the brokers and the customers in which the broker seeks to ascertain whether a security is suitable for a particular customer.

Recent developments in marketing methods may have undermined this relationship, this personal relationship, and it also may have led to questionable merchandising techniques. These recent developments to which I refer include the fact that there has been an enormous increase in customers men. Brokers registered with the New York Stock Exchange have increased from 10,600 in 1950 to 27,800 in 1961. In the National Association of Securities Dealers, the increase has

been from 28,794 in 1950 to 93,300 in 1961. Beside these numbers problem, there are further difficulties flowing from the fact that many salesmen work part time. They have no particular qualifications. And they are not subject to the type of supervision which emphasizes ethical standards.

Another element of growth has been of branch offices. The number maintained by member firms of the New York Stock Exchange has increased from 1,661 in 1950 to 3,166 at the end of 1960. This has increased the problem of training and supervising employees, which has, in turn, been aggravated by the number of inexperienced salesmen, particularly in the mutual fund field. There has been door-to-door soliciting and operation from private residence away from any supervision.

With this diffusion of responsibility, coupled with the influx of inexperienced salesmen, there is a possibility, at least worthy of examination and study, of the development of a lowering of standards in market operations. To give two examples, there has been evidence of the failure of brokers and dealers to keep required books and records. They simply cannot keep up with the volume. There has also been a failure of broker-dealers to deliver securities and the proceeds of sale to customers. This is sometimes known in the industry as "fails."

The next point I would like to refer to is the over-the-counter market. Here I would like to read from my statement, if I may.

The expanding over-the-counter market, and the issues traded in that market, present problems which clearly are within the scope of the inquiry directed by House Joint Resolution 438. There is a lack of basic information concerning the over-the-counter market. For example, unlike the exchange markets, the volume of trading is not known. Thus, it is difficult to determine which securities are active and which inactive or whether price increases or decreases in a security have been accompanied by slight or heavy trading.

Fundamental information is also absent with respect to issues traded in the over-the-counter market. We note that issuers having securities registered on a national securities exchange are required to file with the Commission monthly, semiannual and annual reports essentially detailing the material events which have occurred during the reporting period, including financial data, mergers, and transactions with insiders.

Similar reports must be filed by other issuers which have registered, under the Securities Act of 1933, securities of a class aggregating more than \$2 million. A large but unknown number of issuers, in whose securities there is a substantial public interest, are not subject to these reporting requirements. Thus, the investing public is deprived of financial information with respect to these companies, a void emphasized by the fact that many of them do not even appear in the standard financial reference works. This absence of data is particularly unfortunate in the over-the-counter market area, where a great number of companies are speculative or unseasoned ventures. In summary, we note this gap in the full disclosure requirements of the securities laws and state our view that any investigation should concern itself with this fundamental problem of the over-the-counter market.

Other questions for inquiry with respect to the over-the-counter markets relate to marketing and trading processes, which are conducted by a multitude of brokers and dealers. Adequate information concerning many aspects of these processes is not known. As mentioned above, data concerning volume of trading, both in the aggregate and in particular issues, is not available and disclosure concerning many issuers whose securities are traded in this market is inadequate. Among the problems which have arisen is that presented by securities whose market price rises sharply immediately after an initial public offering. It will be necessary to consider whether these increases result solely from normal forces of supply and demand or whether unwholesome or even manipulative practices have contributed.

The proposed study should provide important information concerning the actual operation of the over-the-counter market and the adequacy of the rules governing trading in that market.

Now, moving away from the prepared statement to a summary of it, I would like to touch briefly upon the question of the exchange rules. The Exchange Act grants to the Commission broad powers over the exchanges. But the Commission has generally left to the exchanges the policing of its own members. The view has been that the exchanges can and should exercise a substantial measure of self-regulation, subject to statutory standards and the ultimate authority of the Commission. At this time, however, and pursuant to that policy, there is pending, as you know, an investigation of the rules, policies, and procedures of the American stock exchange relating to the conduct of specialists and other members. I will not make any comment on that at this time. The investigation itself, is just recently underway. However, I can say that if this House Joint Resolution 438 is enacted, we expect to coordinate this American Stock Exchange study with a general study of the rules and practices of other exchanges.

That brings me to the next problem I want to refer to, the problem of financing. It seems to me that there are at least two major problems or aspects of the employment of credit in respect of securities loans. One, there is the extension of credit by banks on over-the-counter securities, and, two, the apparent growth of nonbank credit, including loans by moneylenders.

In the prepared statement which you have, we have set out a general outline of the margin requirements. Of course, the promulgation and the interpretation of rules with respect to margin responsibility is vested in the Board of Governors of the Federal Reserve System. The Commission enforces these regulations. If I can speak generally about this field of credit, I would say that there are no prohibitions on banks lending against over-the-counter securities, and there is no present regulation of others than banks and broker dealers. In other words, no present regulation really directly of moneylenders.

The extent, if any, of further control would, of course, be a question for this study. There are gaps and inconsistencies in the present pattern of securities credit regulation. I think we would have to inquire whether we should impose credit restrictions on banks with respect to over-the-counter securities—when I say “we,” I mean whether the Federal Reserve Board should set them—and then whether or not we should subject persons other than brokers and dealers and banks to margin requirements.

Now, moving on to a few general conclusions, there has been a rebuilding of public confidence in the market since the crash of 1929, through self-regulation by industry, the enactment of the Federal securities laws and administration by the Commission. We believe that an investigation of the character contemplated is necessary and appropriate in the light of changing conditions in the securities markets.

With respect to the joint resolution itself, there are a few proposals for modification of a relatively minor nature, which I do wish to bring to your attention.

The first is that the Commission should be expected and permitted to report to you from time to time. Naturally, there will be a final report on or before January 3, 1963, as your resolution indicates, but I would hope that the Commission would be free to report to Congress without waiting until the completion of the study, if we find a particular matter which needs remedy either through legislation or, indeed, if we find that we have the power, through tightening our rules and regulations and perhaps having proposals to that effect.

I also would suggest that the House joint resolution should provide that personnel required for the study may be employed without regard to existing civil service regulations and requirements. I have detailed in the statement the precise forms of exceptions in that area which we would like.

I believe that concludes my opening statement, Mr. Chairman. I am here to attempt to answer your questions.

Mr. MACK. Thank you very much, Mr. Chairman. We are glad to have your statement and to know that you are supporting the proposed resolution.

Mr. CARY. Indeed we are. We heartily support it.

Mr. MACK. I would like to inquire whether or not you feel that the \$750,000 included in the resolution would be adequate to conduct a thorough study into the exchanges and over-the-counter markets.

Mr. CARY. Mr. Chairman, we may have some of the tendencies of all governmental agencies that we don't think any amount is sufficient. But on the other hand, starting with the proposal as we look at it, we believe that it would provide us with a very substantial base. If we find that our studies have proceeded and proved to be worthwhile we might come back to you for more. But at the present time, we would accept that figure as a start and expect to try to live within it, and try to produce a good study.

Mr. MACK. You do think at this time it would be sufficient.

Mr. CARY. I do, yes.

Mr. MACK. I noticed that you included in your appendix several additional studies which the Commission has conducted. I appreciate having that appendix included along with your statement. The first study called for a study by the Commission, which the Commission made on feasibilities and advisability of completely segregating the functions of a dealer from those of a broker.

Mr. CARY. Yes.

Mr. MACK. That study I see was concluded on June 20, 1936. Do you think this matter would appropriately be included in a study as set out in this resolution?

Mr. CARY. On that question, Mr. Chairman, since I have been so briefly with the Commission, I think I would like to get the views of our Director of Trading and Exchanges, Mr. Loomis.

Mr. MACK. Would you identify yourself for the record?

Mr. CARY. It is Phillip Loomis, Director of the Trading Exchange of the Commission.

Mr. LOOMIS. I am not sure that it would be necessary to go into it as exhaustively as was done at that time, or feasible within the general limitations of this overall study, but I would presume that we would take another look at that subject also, if this study was commenced.

Mr. MACK. You feel that the resolution is broad enough to permit the Commission to study this area?

Mr. LOOMIS. I do, sir, because this could be done by exchange rules if so desired or by legislation.

Mr. MACK. Thank you very much.

The Chair would like to recognize the other members of the subcommittee at this time. Mr. Dingell, do you have any questions?

Mr. DINGELL. Thank you, Mr. Chairman.

Mr. Chairman, I commend you on a very fine statement. I have in mind some questions about the resolution, House Joint Resolution 438. I would like to refer you to page 1, at the bottom, the subsection, and the top of page 2, wherein there is language setting forth the scope of authority of the Commission to investigate the securities market operations within that organization. I was wondering if you can tell us whether this will include authority to the Commission to make a study of mutual funds, management practices in handling of mutual funds, issuances of new mutual fund stocks and shares?

Mr. CARY. I am glad you asked that question, Congressman Dingell. If you read this resolution narrowly, there might be a question of whether or not it is aimed at mutual funds, because it deals with the study and investigation of the rules of national exchanges and of national securities associations. However, I would believe that since, for example, the NASD, which is the association relating to over-the-counter securities, has jurisdiction over distribution practices with respect to mutual funds, at least then a part of the mutual fund problem would fall within this resolution.

Now, may I add this further, that even if this resolution had not been proposed, it has been our thought that a study is necessary generally of the problems relating to mutual funds. As a consequence, we already have at least one or two people on our staff thinking about the problems in that area, which we may pursue pursuant to our general powers under the Investment Company Act.

I may say further this ties in with the budget. It may well be that, if we found the problems in this area of very great substance, such a finding might be a basis for coming back to this committee and asking for additional funds.

So in general, may I say that I would believe at least a part of the problems relating to investment companies falls within this resolution. Indeed, I would like to get some legislative interpretation by you with respect to that. Secondly, that quite independently of it, we are thinking about the investment company problem at the present time.

Mr. DINGELL. I would like to refer you, if I might, to a stop order issued by the Commission previous to your appointment to that body, on July 30, 1959. It was in the matter of Managed Funds, Inc., file No. 2-11061. It involved a stop order under section 8(d). In this matter, the registrant entered into a series of agreements, largely with itself, operating as different agencies and under slightly different names. A number of practices were involved, including declaring quarterly capital gains, the sale of securities to meet the amount of capital gains fixed by the capital gains distribution in a manner detrimental to stockholder interest; a most cursory, if not outright careless, scrutiny, and supervision of the affairs of the company by the board of directors; a series of practices which were severely castigated by the Securities and Exchange, which resulted in the issuance of the stop order under section 8(d). The practices were characterized generally as poor management and as excessive profiting by the Slaytons by the Securities and Exchange Commission.

Do you envision the practices involved by the previous sentences as being within the purview of House Joint Resolution 438?

Mr. CARY. It is clearly within the preview of the Commission and certainly a part of the study that we are planning to make generally on mutual funds. As to whether or not it falls within this House joint resolution, I do not have a clear impression. I think it would take a fairly broad reading of those phrases. Mr. Cohen advises me that in his opinion, a limited aspect of the problem, at least, would fall within the purview of the House joint resolution. I would, if I might, in fact, like to call on Mr. Cohen, the Director of the Division of Corporation Finance, who has more familiarity with that case than I have. It was decided before my arrival.

Mr. DINGELL. I think his views would be helpful.

Mr. COHEN. As the Chairman has indicated, there are certain aspects of that case which related to the activities of a firm which was a member of the New York Stock Exchange, and persons associated with that firm, and the firm's activities in relation to discretionary accounts and related matters, which fairly fall within exchange rules, regulations, and controls. To that extent, I believe that the resolution would encompass a survey of practices of that character. However, with respect to the major problems which you have described, that relates to an area of general problems arising more nearly under the Investment Company Act, and not, I believe, fairly within the scope of this resolution.

Mr. DINGELL. In other words, are you telling us that as you read this resolution, it would give you no authority to go into the Investment Company Act?

Mr. COHEN. We have that authority under the Investment Company Act, sir.

Mr. DINGELL. I am concerned, because as I read the financial pages, there are billions of dollars in mutual funds which, by and large, are over-the-counter securities. Am I correct?

Mr. CARY. That is correct, sir.

Mr. DINGELL. Is there any further protection offered to the investor on these over-the-counter sales of the mutual funds?

Mr. CARY. I will ask Mr. Cohen to speak to that.

Mr. COHEN. If I may supplement the answer: I dealt with one aspect of the problem involved in the *Managed Funds* case, and that was the participation in the activities described in the Commission's opinion by a member of the New York Stock Exchange and persons associated with it.

However, under the Investment Company Act, the NASD has a large responsibility and a duty with respect generally to the sale, distribution, and redemption of the shares of investment funds. Those activities of the NASD, and its rules and regulations, are fairly within the ambit of this resolution. I think using that as a basis, many, if not all, of the abuses which, in a sense, came from these relationships with members of the NASD and the New York Stock Exchange, could fall within the ambit of the resolution. I meant only to indicate earlier that the general problems of poor management and investment policies as you have described them would not fairly fall within the resolution. But all of the activities in that case can be traced in one way or another to persons subject to the jurisdiction of the exchange or the NASD, and I think through that procedure many of these events in that case would become subject to Commission scrutiny and study.

Mr. DINGELL. It is a rather tenuous way of approaching an investigation, to make such a roundabout scrutiny. Wouldn't it be better to just include a straight-out, simple declaration, authorizing the investigation of over-the-counter markets, too, through this resolution?

Mr. CARY. It would not be amiss, Congressman Dingell, if you choose, to amend this resolution to include, more explicitly, problems involving mutual funds. I do think that we will take that responsibility, and, indeed, feel that responsibility, whether or not that amendment is made.

Mr. DINGELL. I was wondering—this case brought to mind a number of questions. Do you have any authority within the Commission at this time to scrutinize the amount of fees and commissions paid to investment advisers of these managed funds and mutual funds?

Mr. CARY. Mr. Chairman, this is a problem that is quite clearly before us at the present time, and because it is a fairly complicated problem I have gone so far as to prepare a brief statement on this general question. As you indicate, there are a very large number of suits relating to fees with respect to investment companies.

I think I would like to read that statement for the record.

Mr. DINGELL. We would be happy for you to proceed.

Mr. CARY. The Commission has carefully followed the recent developments in certain private investment company litigation which is now pending in various Federal and State courts involving, among other things, allegations that certain investment companies have been paying excessive fees to their investment advisers, that the arrangements between these companies and their advisers, brokers, and underwriters are unfair to the funds, that independent investment company directors are not adequately discharging their responsibilities in consistently approving these arrangements, and have abdicated their responsibilities in favor of affiliated directors in the interest of advisers, brokers, and underwriters, and that the named investment companies are generally operated in the interest of persons other than the funds' direct shareholders. In effect, I am quoting the general context or general statements in these complaints that have been filed.

Mr. DINGELL. This is not a statement of opinion on the part of the Commission, but this is a summary of the allegations.

Mr. CARY. Precisely. This is a summary of allegations and not a statement of the Commission with respect to them.

The Commission's concern with the problems raised by these cases has been demonstrated by its participation as *amicus curiae* in several actions in which it sought to establish the existence of private rights of action on the part of investment company shareholders for violations of the Investment Company Act. It is expected that this legal issue will be clarified in the near future. Obviously, the Commission's concern in this area does not stop with the jurisdictional border, but also encompasses the substantive charges of violation of the act which are alleged. The staff of the Commission is studying the facts in these and other cases to determine whether action by the Commission would be appropriate. Where facts come to the Commission's attention which indicate a need for prompt action, the Commission has taken action and will continue to do so. Recent instances illustrating this policy of the Commission's action in the *Managed Funds* case to which you referred, and with respect to the Townsend Corp. of America, in respect of which a decision was recently handed down in the U.S. Court—

Mr. DINGELL. Mr. Chairman, at that point, would you say that the general level of these allegations and the general tenor of these allegations, at least in regard to the *Managed Funds* case, were true?

Mr. CARY. Clearly, I think my limited knowledge is such that I would rather prefer to ask Mr. Walter North to speak on that, who actually participated in that case before the Federal courts.

Mr. NORTH. In the *Managed Funds* case, we not only did as Congressman Dingell says, put a stop order on the sale of Managed Funds shares but we instituted action against the Managed Funds officers alleging violations of the Investment Company Act of 1940, including gross abuse of trust and gross misconduct on the part of the officers and directors of the company. I personally attended the taking of the final decree against them in the courts out in St. Louis, Mo. So we not only felt that they came within the prohibitions of the act, but we actually obtained a court decree to that effect.

Mr. DINGELL. You proved it.

Mr. NORTH. Right.

Mr. DINGELL. Returning, Mr. Chairman, to the fact of the amount of fees paid, do you or the Commission have any authority to superintend the amount of fees paid to the investment adviser under the law?

Mr. CARY. In general, my answer would be "No." If there is any amplification, I would like to check with Mr. Cohen if he has anything further.

Mr. COHEN. There is no provision in the act vesting in the Commission power to deal with the matter of fees charged by investment advisers of investment companies. The statute provides a procedure for the submission of contracts of that character to investors and for their approval or disapproval, and for renewal under certain circumstances.

Mr. DINGELL. If we can refer to that, that is section 15; is that correct?

Mr. COHEN. Section 15 (a), (b), and (c).

Mr. DINGELL. In effect, once that is voted on, it can be approved annually or biannually, or at least periodically, by either the investors, by vote of the shares, or by the board of directors; am I correct?

Mr. COHEN. Yes, sir.

Mr. DINGELL. In other words, the board of directors can continue to ratify this fee which is paid to the investment adviser, am I correct, without further scrutiny or superintendence of the shareholders; is that right?

Mr. COHEN. The board of directors may continue to approve the contract; that is quite correct, sir.

Mr. DINGELL. Do you have any authority under the law to approve the amount of fees paid under the contract approved by the shareholders?

Mr. COHEN. No, sir.

Mr. DINGELL. Does that appear to you to be an adequate protection to the shareholders?

Mr. CARY. On this point, sir, may I continue with my statement? I was relating myself in the middle of my statement to the *Managed Funds* case, as you will recall, and also the Townsend Corp. of America.

In the view of the Commission, aside from the specific charges involving individual investment companies, this litigation and the two cases to which I have just referred, and others, raise certain basic problems which concern the relationship between investment companies and their advisers, underwriters and brokers, and the responsibilities of both affiliated and nonaffiliated fund directors under the Investment Company Act. These basic problems lend themselves to industrywide consideration and treatment.

In view of the foregoing, the Commission has undertaken a review of investment company relations with their investment advisers, brokers, and underwriters; the role of the director; the actions and influence of affiliated directors in their role as fiduciaries of the fund; and practices such as reciprocal brokerage and selling techniques. This review will be undertaken with a view toward determining whether a long-range program in the investment company area should be proposed. It is anticipated that if the need for legislation is indicated by the Commission's review, specific proposals would be presented to Congress as soon as reasonably feasible after obtaining the views of those interested.

If I may just summarize from that, I would say that in respect to these fee cases, there is a question as to what extent the SEC at the present time can effectively participate. It may well be that, after completion of the study which we are making, we will be considering whether or not there should be further legislation in this area.

Mr. DINGELL. As a matter of fact, Mr. Chairman, you will recall under sections 15 (a), (b), and (c), the Commission has absolutely no authority to scrutinize these contracts with regard to the—or to approve these contracts—to the amount of fees paid to investment advisers; am I correct?

Mr. COHEN. Well, in the sense of fixing or disapproving a fee, that is quite correct. But quite obviously, the Commission has responsibilities to secure adequate disclosure to investors and, obviously, I think, if a fee were conscionable, the relevant facts would be brought to

the attention of the investor. This might also bring into play other responsibilities of the Commission with respect to those who have such a status in regard to investment companies. In other words, if they were to levy fees which were clearly unconscionable or outrageous, the Commission might then consider whether, under other sections of the act, it had a responsibility to act.

Mr. DINGELL. Can you tell us what other section of the act you would have authority to act under if these fees were unconscionable?

Mr. COHEN. If it could be established that the fees were unconscionable in the sense that I have used it, this might give rise to an action on the part of the Commission under section 36 of the act, which is a provision vesting in the Commission authority to seek the ouster of officers, directors, and investment advisers, when they have been demonstrated to be guilty of gross abuse of trust, gross misconduct, or gross negligence.

Mr. DINGELL. But with regard to the amount of the fee, barring gross misconduct or gross abuse, the Commission has no power to act or to make approval or disapproval; am I correct?

Mr. COHEN. I think that is right, sir.

Mr. DINGELL. Let us look at them. Generally these fees run a half of 1 percent of the gross value of the fund, adjusted day by day over the course of a year; am I correct?

Mr. CARY. That is right, sir.

Mr. DINGELL. On a billion-dollar fund, this would run what?

Mr. CARY. \$5 million.

Mr. DINGELL. And on a \$500 million fund, of which there happens to be in existence several, it would be about \$2½ million a year; am I correct?

Mr. CARY. Yes, sir.

Mr. DINGELL. Mr. Chairman, does the Commission view this as being a fair and reasonable fee to be paid to investment advisers?

Mr. CARY. Congressman Dingell, I don't think that we are at this time in a position to take a position one way or another whether a particular fee agreed upon by the parties is or is not proper. I do think that this general problem is certainly a part of the study which we should be making and are making.

Mr. DINGELL. Do you contemplate to scrutinize the various aspects, then, of the *Managed Funds* case insofar as they might affect other mutual funds and also the amount of the fees which are paid to investment advisers in the course of this investigation if you receive authority to carry it out?

Mr. CARY. All of these are problems which fall within the study and we are already examining them.

Mr. NORTH. May I amend one answer that was given to Congressman Dingell's question? He asked about the directors being able to pass on these fees or the shareholders themselves under the annual contract.

There is this much additional protection in 15(c), that the annual renewal must be not only by the Board, but passed by a majority of the Board who are not affiliated with management. There is that much additional protection on the annual renewal of the contract.

Mr. DINGELL. That is a very small additional protection.

Mr. NORTH. I realize that, but it is not quite an accurate statement to say that the Board of Directors as a whole can renew it annually.

Mr. DINGELL. As a matter of fact, the average investor who goes into the market usually does not read these contracts very carefully at the time he votes on them, either with regard to proxies or with regard to approval of funds, and so forth. Am I correct?

Mr. COHEN. Mr. Dingell, the prospectus is required to set out the salient terms of the contract and also to indicate for the last fiscal year the amount of money that that produced for the investment adviser. Periodically thereafter, the investor in the fund is given information of a similar character.

Mr. DINGELL. As a practical matter, however, though, usually the investor does not scrutinize these items too closely; does he, sir? As a matter of fact, the investor does not scrutinize these items with regard either to the amount paid or the percentage points to be paid the investment adviser or other fees to be paid to the various members, to the various persons, and entities which perform services for the fund. Isn't that correct?

Mr. COHEN. Well, we have made no study of that general character, but from the nature of correspondence that we have received through the years, there is certainly an indication that a fair number of people do scrutinize those items, because they write us letters inquiring about them.

Mr. DINGELL. You do not receive letters from those who do not write you letters?

Mr. COHEN. No, sir.

Mr. CARY. Congressman Dingell, may I add one word to your previous questioning?

I gave the impression, I believe, that I was referring to this as if it were entirely a future study. May I say that over a period of the last 2 years we have had a study known as the size study, which has been subcontracted, in effect, to the Wharton School of Finance at the University of Pennsylvania, for the purpose of ascertaining facts with respect to the investment company industry. That study is just about coming to a point of completion. There are several volumes already prepared.

It is our thought that this study will be considered and examined in the light of our needs. Also, we are adding people to the staff at the present time.

I have one person, a very distinguished lawyer, who is working on this subject a great deal of his time. I am hoping to bring in two others in the very near future, really not relating themselves to the administration of the act as it stands, but thinking about what the problems are in the whole field.

Mr. Cohen would like to add a word to that, if you please.

Mr. COHEN. Congressman Dingell, in December of last year, as a further aspect of the size study, to which the chairman has referred, the Commission circulated to investment advisers, to investment companies, and to distributors of securities, a special questionnaire which is designed to elicit precise and up-to-date information in many of the areas to which you refer.

If it is of any interest to the committee, I have a copy of the questionnaire available, and I will submit it for the record.

Mr. DINGELL. I think that would be helpful, but it is a matter for the chairman to determine.

Mr. MACK. Without objection, it will be included at this point.  
(The questionnaire referred to follows:)

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

QUESTIONNAIRE CONCERNING INVESTMENT COMPANIES AND THEIR INVESTMENT ADVISERS AND PRINCIPAL UNDERWRITERS

Information in response to this questionnaire should be transmitted as expeditiously as possible and not later than March 15, 1961, to the Securities Research Unit, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pa. Unless otherwise specified the information called for shall be given as at December 31, 1960.<sup>1</sup>

Information called for under sections I, III, and IV shall be furnished by the investment adviser and where appropriate may be based upon material obtained from the investment company or the principal underwriter, as the case may be.

Information called for under section V shall be furnished by the principal underwriter and where appropriate may be based upon material obtained from the investment company or the investment adviser, as the case may be.

Information called for under sections II and VI shall be furnished by the investment company and where appropriate may be based upon material obtained from the investment adviser or the principal underwriter, as the case may be.

Name of investment company;

Name(s) of investment adviser;

Name(s) of principal underwriter.

SECTION I—ORGANIZATION AND OPERATION OF EACH INVESTMENT ADVISER<sup>2</sup>

1. State name and type of organization of the investment adviser. Indicate date of organization and if a corporation name the State or other jurisdiction in which incorporated.

2. If the investment adviser was organized within the past 5 years, list the names, addresses, and primary business affiliations of persons who initiated or directed its organization.

3. State as of the most recent practicable date the number of holders of record of each class of securities of the investment adviser, and indicate the shareholder rights attaching to each class. If, to the knowledge of the investment company or the investment adviser, any person owns beneficially (whether or not of record) 5 percent or more of the outstanding securities of any class, name such person, state the amount of securities of each class so owned by such person and indicate the percentage of outstanding securities of each class represented by the amount so owned. State the amount of securities of each class owned by the officers and directors of the investment adviser and, to the knowledge of any officers or directors of the investment adviser, by any members of their immediate families (as defined in item 4 of sec. II). If the investment adviser is a partnership, state the number of partners and name the partners having the three largest partnership interests (computed by whatever method is appropriate in the particular case).

4. (a) With respect to each person named in answer to items 2 or 3 name each securities dealer or broker (not including the principal underwriter of the investment company) with whom he is, or within the past year has been, to the knowledge of any officers or directors of the investment adviser, associated in any of the following categories: as an officer, director, employee, partner or holder of 5 percent or more of the outstanding securities of any class. Indicate the capacity in which named.

(b) For each such dealer or broker set forth the net brokerage commissions received directly or indirectly within the last fiscal year by virtue of the purchase or sale of portfolio securities of the investment company. Determine net

<sup>1</sup> If unable to present information as of Dec. 31, 1960, the information may be presented as of the most recent practicable date subsequent to June 30, 1960. State the date if other than Dec. 31, 1960. Information requested which has previously been furnished specifically and in detail in response to the questionnaire distributed in 1959 may be supplied by reference.

<sup>2</sup> A separate report is to be submitted with respect to each investment adviser.

brokerage commissions by adding, to the aggregate amount of commissions received by such dealer or broker for executing directly portfolio transactions, the aggregate amount received by such broker from other brokers or dealers at the direction or request of the investment company, its principal underwriter or its investment adviser, and then deducting the total of sums paid to other brokers or dealers at the direction or request of the investment company, its principal underwriter or its investment adviser. State separately the gross additions and the aggregate gross deduction used in computing the net brokerage commissions. (Include as brokerage, for purposes of this question, the amount of the profit or commission on those principal transactions (i.e., new issues and secondary distributions) where the profit or commission is fixed by agreement under the rules of a national securities exchange, or where the discount or concession is fixed by prospectus.)

(c) If any such dealer or broker within the past fiscal year has purchased portfolio securities from, or sold portfolio securities to, the investment company, state the total amount of such purchases and sales. (Do not include, in this total, principal transactions in which the profit or commission to the dealer is fixed by the rules of a national securities exchange, or in which the discount or concession is fixed by prospectus.)

Instruction: If records with respect to broker-dealer participation are kept on a combined basis for investment companies which have the same investment adviser or principal underwriter, the information called for in (b) and (c) of this item may in the alternative be given with respect to transactions in the portfolio securities of all investment companies for which the investment adviser or the principal underwriter acted in such capacity.

5. State the total number of employees (excluding partners and officers) of the investment adviser. Indicate the number thereof in each of the following categories and the gross compensation paid directly by the investment adviser during the last fiscal year for each such category:

- (a) Financial or security analysts.
- (b) Engineers or other technical.
- (c) General administration and management.
- (d) Principal underwriting and wholesaling of securities of investment companies.
- (e) Retail selling of investment company securities.
- (f) Other.

NOTE.—Number of employees may be shown in terms of man-years.

State the gross compensation paid directly by the investment adviser during the past fiscal year to officers and directors of the investment adviser as a group.

6. List the names and total net assets at December 31, 1960 of each registered investment company for whom the investment adviser acts as investment adviser or fund manager pursuant to contract.

Name of registered investment company <sup>1</sup>	Total net assets at Dec. 31, 1960, amount (thousands)

<sup>1</sup> Each series of a multiseries company shall be treated as a separate company.

7. Schedule of fees for investment companies:

(a) For each registered investment company to whom the investment adviser provides investment advice, pursuant to contract, state the aggregate investment advisory or management fees received during the investment adviser's last fiscal year and the method of calculation thereof. Describe briefly any contract provisions placing limits on the total operating expense of each investment company. If, in the case of a multiseries company, the method of calculation of such fees or such contract provisions differ between series, set forth separate information for each series.

(b) Check services listed below which are supplied or paid for by the investment adviser in connection with the management contract for each registered investment company. If such services are supplied or paid for by any person, other than the investment company or the investment adviser, so note and identify such person. Where the services provided or paid for differ between series of a multiseries company the information is to be furnished separately for each series.

- a. Occupancy and office rental.
- b. Clerical and bookkeeping.
- c. Accounting services.
- d. Auditing services.
- e. Legal fees.
- f. Registration and filing fees.
- g. Stationery, supplies, and printing.
- h. Salaries and compensation of directors of the investment companies.
- i. Salaries and compensation of officers of the investment companies.
- j. Reports to stockholders.
- k. Determination of offering and redemption prices.

Other (specify) :

- l. -----
- m. -----

(c) If any person, other than the investment adviser, principal underwriter, or personnel of the investment company furnishes administrative, statistical, bookkeeping, or similar services to the registered investment company, itemize the services performed and the amount charged therefor in the past fiscal year.

8. (a) State whether the investment adviser acts as such pursuant to contract or other arrangement for clients other than registered investment companies.

If so, for each type of client (e.g., insurance companies, pension funds, individuals, etc.) state separately the schedule of fees and method of calculation for such services and indicate whether investment advisory service includes administration and recordkeeping of clients' securities. Also state the number of such clients, and the aggregate net asset value of portfolios managed for all such clients.

(b) List the three most important activities of the investment adviser in order of their importance measured by relative gross income from the various activities.

Instructions:

(1) The investment advisory function with respect to investment companies and with respect to other investment advisory clients, should be considered as separate activities.

(2) The gross income from the activities listed need not be shown.

(3) If any significant activities are designed for the realization of capital gains, this factor should be considered in listing the three most important activities.

(c) State the net worth of the investment adviser as of the end of its most recent fiscal year as reflected by the books.

9. If during the past 5 years the investment adviser has sold its securities pursuant to a public offering, state the number and class of securities sold, the unit offering price(s) and the date(s) of the offer(s).

10. If within the past 5 years any person who owned more than 25 percent of the voting securities of, or who was an officer or director of, the investment adviser has sold an aggregate of 10 percent or more of securities of any class of the investment adviser (other than a bank) owned by him, state the number and class of securities sold, the price(s) per unit, and the date(s) of sale.

If the investment adviser is a partnership, state whether any part who owned more than a 25 percent partnership interest has sold within the past 5 years an interest in the partnership aggregating 10 percent or more and indicate the date(s) of sale.

11. (a) Is there a policy or practice with respect to the use, by officers, directors, members of an advisory board or committee, partners or employees of the investment company, the investment adviser or the principal underwriter, of investment research information developed by or on behalf of the investment adviser in connection with its investment advisory services to the investment company? If so, set forth the policy or practice, and state to whom it applies.

(b) If the investment adviser acts as such to more than one investment com-

pany, is there a policy or practice with respect to the execution of purchase and sale orders in implementation of investment advice which has been given to more than one such investment company? If so, set forth the policy or practice.

(c) Is there a policy or practice with respect to the deposit by the investment company or custodian for the investment company of part or all of the investment company's funds or equivalent in banks other than the custodian bank or banks. If so, describe such policy or practice.

#### SECTION II—TRANSACTIONS IN THE INVESTMENT COMPANY'S PORTFOLIO

1. With respect to the process of selection and recommendation for purchases and sales of portfolio securities, furnish the following information:

(a) To whom are recommendations made by the investment adviser and indicate whether such are made in writing or orally.

(b) Is the execution of the recommendations made only following action by the board of directors of the investment company.

(c) If the recommendations of purchases and sales are carried out prior to action of the board of directors with respect thereto, by whom is the decision made.

(d) If the decision is made by an executive committee or other group acting on behalf of the fund, identify the members of such group and state their relationships to the investment adviser and/or the principal underwriter.

(e) State how frequently the board of directors of the fund meets and generally the matters considered at such meetings.

(f) Is approval of the investment company's directors who are not affiliated or associated with the investment adviser, the principal underwriter, or any broker specifically required with respect to purchases and sales of portfolio securities.

2. Indicate briefly the organizational structure relevant to and the steps involved in the formulation of the recommendation by the investment adviser for the purchases and sales of portfolio securities. If pursuant to any understanding, formal or otherwise, any person not a full-time employee regularly furnished to the investment adviser or the investment company during the past fiscal year advice or information (other than solely through uniform publications distributed generally) concerning purchases and sales of securities for the portfolio of the investment company, name such person, describe the circumstances involved, and report the remuneration (including commissions paid in connection with transactions in portfolio securities of the investment company) paid for such advice.

3. (a) Do dealers who sell shares of the investment company, or broker-dealers who furnish benefits in the form of payment of expenses or otherwise (but not including investment advice or information covered under item 2) to the investment company or to its investment adviser or to dealers who sell shares of the investment company, participate in commissions paid in connection with purchases and sales of portfolio securities for the investment company, either directly in payment for executing purchase and sale orders or indirectly by participating in the commissions paid to the brokers who execute purchase and sale orders?

(b) If the answer to (a) is "Yes," describe briefly the policy followed with respect to the degree of participation of such dealers or brokers and the basis or bases upon which such participation is allocated, including the nature of the benefits made available to the investment adviser or investment company. In connection with this description set forth the names and positions held, in the investment company, investment adviser, underwriter or otherwise, of the person or persons who advise with respect to such participation, and the names and positions held of the person or persons who direct such participation.

State whether or not there has been any material change in this policy during the 3 most recent fiscal years. If there has been such a change, describe the previous policy in the same manner, and state when the change in policy was made.

(c) Set forth, in order for the last fiscal year, the 20 dealers selling the largest dollar amount of shares of the investment company. Show the total dollar amount of shares sold by each. Also set forth the brokerage commissions received by each by virtue of direct or indirect participation in the purchase and sale of portfolio securities for the investment company. Show separately gross commissions received for executing portfolio transactions; amounts received from other brokers or dealers at the request of the investment company,

its principal underwriter or its investment adviser; amounts paid to other brokers or dealers or other persons at the direction or request of the investment company, its principal underwriter or its investment adviser. (For purposes of this item and item (d) below, consider as brokerage the amount of the profit or commission on those principal transactions (i.e., new issues and secondary distributions) where the profit or commission is fixed by agreement under the rules of a national securities exchange, or where the discount or concession is fixed by prospectus.)

(d) Set forth, in order for the last fiscal year, the 20 brokers who received the greatest amount of brokerage commissions by virtue of direct or indirect participation in the purchase or sale of portfolio securities of the investment company. For each, give the brokerage commissions received, set forth as called for by item (c) above.

(e) Set forth for the last fiscal year the total cost of portfolio securities (including Government securities) purchased by the investment company from, and the total proceeds of portfolio securities sold by the investment company to, each dealer or broker named in answer to (c) and (d) acting as principal, and each other dealer or broker among the 20 dealers or brokers who engaged as principals in the largest amount of such purchase and sale transactions. (Do not consider, for purposes of this question, principal transactions in which the profit or commission to the dealer is fixed by the rules of a national securities exchange, or in which the discount or concession is fixed by prospectus.)

(f) If, pursuant to any arrangement or understanding or practice, whether occasional or regular, orders for the purchase or sale of securities on behalf of one investment company are placed with a broker or dealer in return for advice, information or other services provided to another investment company, explain the nature of any such arrangement or practice and indicate the number and amount of such transactions within the past fiscal year. Identify the broker or dealer in each such case.

State whether or not there has been any material change in this arrangement or practice during the 3 most recent fiscal years. If there has been such a change, describe the previous arrangement or practice in the same manner, and state when the change was made.

Instruction: If records with respect to broker-dealer participation are kept on a combined basis for investment companies which have the same investment adviser or principal underwriter, the information called for in (c), (d), (e) and (f) of this item may in the alternative be given with respect to transactions in the portfolio securities of all investment companies for which the investment adviser or the principal underwriter acted in such capacity.

4. Name each broker or dealer participating, directly or indirectly in brokerage commissions paid in connection with transactions in portfolio securities of the investment company, any officer, director, partner, or registered representative of which is, to the knowledge of any of the persons named in response to item 3(b) or of any officer, director, partner or owner of 5 percent or more of outstanding voting securities of the investment adviser, a member of the immediate family of any person named in response to item 3(b) or of any officer, director, partner or owner of 5 percent or more of outstanding voting securities of the investment company, the investment adviser, or the principal underwriter. With respect to each such family relationship, give the names, relationships to each other, and the respective positions held by the persons concerned. Also show the brokerage commissions (set forth as required by item 3(c)) received by each such broker or dealer during the most recent fiscal year.

As used herein "immediate family" shall include any of the following: spouse, son, daughter, father, mother, brother, sister, son-in-law, daughter-in-law, brother-in-law, sister-in-law, father-in-law, mother-in-law, uncle, aunt, nephew, and niece. For the purpose of determining whether any of these relations exists a legally adopted child of a person shall be considered a child of such person.

## SECTION III—DIRECTORS AND OFFICERS OF INVESTMENT ADVISER

1. With respect to each director, officer, member of an advisory board or committee of, and any person (other than employees or persons providing statistical service) who pursuant to contract or other arrangement regularly furnishes investment advice or information to, the investment adviser and with respect to each partner having one of the three largest partnership interests or each owner of 5 percent or more of the outstanding voting securities of the investment adviser, as the case may be:

(a) State the name and relationship to the investment adviser of each such person and the principal occupation or employment in which he is engaged. Give the name and principal business of any corporation or other organization in which such employment is carried on.

(b) State when he was first elected or appointed to each such position with the investment adviser. As to each named partner and each such owner of 5 percent or more state the date as of which he qualified as such.

(c) Indicate the interest he may have in the principal underwriter or any broker for the investment company. In the case of publicly owned companies only an interest of 5 percent or more need be shown. In the case of a partnership only indicate whether or not he has one of the three largest partnership interests.

(d) If there is an advisory board or committee indicate its functions and the frequency of its meetings.

2. Describe each transaction within the last fiscal year between the investment company, its principal underwriter or any broker named in response to item 3 of section II, and (a) any director of the investment adviser, (b) any officer of the investment adviser or (c) to the knowledge of any officer or director of the investment adviser, any other corporation or organization of which any such officer or director was an affiliated person, other than by virtue of being a director thereof.

## Instruction:

(a) Include the name of each person whose interest in any transaction is described and the nature of the relationship by reason of which such interest is described.

(b) As to any transaction involving the purchase or sale of assets state the cost of the assets to the purchaser and the cost thereof to the seller if he seller was such officer, director, or other corporation or organization, and such assets were acquired by the seller within 2 years prior to the transaction. If the interest of any person arises from the position of such person as a partner in a partnership, only the amount involved in the transaction with the partnership need be stated.

(c) No information need be given with respect to normal brokerage, commercial and investment banking, legal, accounting, public utility and telephone services or with respect to services solely as an officer, director or employee.

(d) No information need be given with respect to transactions not involving remuneration for services where the aggregate amount did not exceed \$1,000 nor with respect to transactions involving remuneration for services where the remuneration did not exceed \$1,000.

## SECTION IV.—Financial statement of investment adviser

Name of investment adviser.....  
 Statement of income and expense as per accounts for year ending .....  
 (Omit cents)

	(a)	(b)	(c)
	Investment advisory services to clients	Other related services to investment advisory clients <sup>1</sup>	Underwriting and distribu- tion of regis- tered invest- ment com- pany shares <sup>2</sup>
1. Income:			
(a) From registered investment companies.....			
(b) From other clients.....			
OPERATING EXPENSE			
2. Salaries of officers, directors, and partners: <sup>3</sup>			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
3. All other salaries: <sup>3</sup>			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
4. Fees paid for technical and other investment consul- tant services:			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
5. Payments for statistical, research, and related services:			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
6. Other selling and sales promotion expense:			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
7. General and administrative expense, excluding salaries:			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
8. Special charges or credits: <sup>4</sup>			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
9. Total operating expense:			
(a) Direct.....			
(b) Allocated for own use.....			
(c) Allocated for this report.....			
10. Net before income taxes.....			
11. Income taxes <sup>5</sup> .....			
12. Net after income taxes.....			

<sup>1</sup> Include custodian, transfer and dividend disbursing fees for investment companies. Do not include brokerage. Specify items included.

<sup>2</sup> Net, after deduction for dealers' or wholesalers' commissions.

<sup>3</sup> Include all other remuneration and profit-sharing plan contributions. Also include partners' with-  
drawals or any portion thereof, if such amounts are considered compensation or payments in lieu of salaries.

<sup>4</sup> Special charges or credits—list and describe .....

<sup>5</sup> If subject to corporation income tax.

NOTE.—Include in cols. (a) through (c) the expense items as allocated to sources of income in the com-  
pany's accounts showing separately direct charges and allocations by formula or otherwise. If possible  
use direct charges; otherwise use allocation made for internal purposes. If neither of these is available  
allocate charges for the purpose of this report indicating the basis of allocation by footnote.

## SECTION V.—DIRECTORS AND OFFICERS OF PRINCIPAL UNDERWRITER

1. With respect to each director and officer of the principal underwriter, and with respect to each partner having one of the three largest partnership interests or each owner of 5 percent or more of the outstanding voting securities of the principal underwriter, as the case may be:

(a) State the name and relationship to the principal underwriter of each such person and the principal occupation or employment in which he is engaged. Give the name and principal business of any corporation or other organization in which such employment is carried on.

(b) State when he was first elected or appointed to each such position with the principal underwriter. As to each named partner and each such owner of 5 percent or more, state the date as of which he qualified as such.

(c) Indicate the interest he may have in the investment adviser or any broker for the investment company. In the case of a publicly owned company only an interest of 5 percent or more need be shown. In the case of a partnership only indicate whether he has one of the three largest partnership interests.

2. Describe each transaction within the last fiscal year between the investment company, its investment adviser or any broker named in answer to item 3 of section II and (a) any director of the principal underwriter, (b) any officer of the principal underwriter, or (c) to the knowledge of any officer or director of the principal underwriter, any other corporation or organization of which any such officer or director was an affiliated person other than by virtue of being a director thereof.

Instruction:

(a) Include the name of each person whose interest in any transaction is described and the nature of the relationship by reason of which such interest is described.

(b) As to any transaction involving the purchase or sale of assets state the cost of the assets to the purchaser and the cost thereof to the seller if the seller was such officer, director or other corporation or organization, and such assets were acquired by the seller within 2 years prior to the transaction. If the interest of any person arises from the position of such person as a partner in a partnership, only the amount involved in the transaction with the partnership need be stated.

(c) No information need be given with respect to normal brokerage, commercial and investment banking, legal, accounting, public utility, and telephone services or with respect to services solely as an officer, director, or employee.

(d) No information need be given with respect to transactions not involving remuneration for services where the aggregate amount did not exceed \$1,000, nor with respect to transaction involving remuneration for services where the remuneration did not exceed \$1,000.

SECTION VI—DIRECTORS AND OFFICERS OF THE INVESTMENT COMPANY

1. With respect to each director and officer of the investment company:

(a) State the name and relationship to the investment company of each such person and the principal occupation or employment in which he is engaged. Give the name and principal business of any corporation or other organization in which such employment is carried on.

(b) State when he was first elected or appointed to each such position with the investment company. State by whom he was proposed to be a director or officer of the investment company and describe any understanding or arrangement pursuant to which he was so elected.

(c) Indicate the interest, if any, he may have in any investment adviser, principal underwriter or broker for the investment company. In the case of a publicly held company only an interest of 5 percent or more need be shown. In the case of a partnership only indicate whether he has one of the three largest partnership interests.

(d) Indicate each immediate family relationship with any other director or officer of the investment company or with any director, officer or other affiliated person of the investment adviser, or principal underwriter of the investment company or any broker named in item 3 of section II.

Instruction: "Immediate family" shall include the persons listed in the instruction to item 4 of section II.

2. Describe each transaction within the last fiscal year between the investment adviser, the principal underwriter or any broker named in answer to item 3 of section II and any director or officer of the investment company who is not affiliated with the investment adviser, the principal underwriter, or the broker, as the case may be, or to the knowledge of any officer or director of the investment company, with any other corporation or organization of which any such officer or director was an affiliated person other than by virtue of being a director thereof.

## Instruction:

- (a) Include the name of each person whose interest in any transaction is described and the nature of the relationship by reason of which such interest is described.
- (b) As to any transaction involving the purchase or sale of assets state the cost of the assets to the purchaser and the cost thereof to the seller if the seller was such officer, director, or other corporation or organization, and such assets were acquired by the seller within 2 years prior to the transaction. If the interest of any person arises from the position of such person as a partner in a partnership, only the amount involved in the transaction with the partnership need be stated.
- (c) No information need be given with respect to normal brokerage, commercial or investment banking, legal, accounting, public utility, and telephone services or with respect to services solely as an officer, director, or employee.
- (d) No information need be given with respect to transactions not involving remuneration for services where the aggregate amount did not exceed \$1,000, nor with respect to transactions involving remuneration for services where the remuneration did not exceed \$1,000.
3. If at any time within the last 2 fiscal years any director or officer of the investment company who was not then affiliated with the investment adviser or principal underwriter, as the case may be, has been indebted (other than by virtue of margin accounts) in amount exceeding \$1,000 to the investment adviser of, the principal underwriter of, or any director, officer, or other affiliated person of the investment adviser or principal underwriter of, the investment company (a) name each such person to whom he was so indebted, (b) state the largest aggregate amount of indebtedness to each such person at any time during such period and the amount presently outstanding, and (c) state the rate of interest paid or charged thereon.
4. State whether the board of directors of the investment company has delegated authority to act for it between board meetings. If so, identify the person or group and indicate the nature and extent of such delegation.
5. If the investment company has an advisory board or committee indicate its functions and the frequency of its meetings.

## EXHIBITS

The following shall be attached to or submitted with the report in response to the questionnaire:

1. Copy of the fund's current prospectus.
2. Copy of the fund's annual report to shareholders for each of the last 2 fiscal years.
3. Copy of the investment adviser's annual report to shareholders for each of the last 2 fiscal years if the adviser is publicly held and if such report has been distributed to shareholders.
4. Copy of the principal underwriter's annual report to shareholders for each of the last 2 fiscal years if the underwriter is publicly held and if such report has been distributed to shareholders.
5. Copy of prospectus relating to any offering to the public made within the past 3 years of securities of the investment adviser and/or principal underwriter.

Mr. MACK. Mr. Glenn?

Mr. GLENN. Could you comment on whether or not the \$750,000 would be sufficient for the conduct of this investigation?

Mr. CARY. Congressman Glenn, I said that at the moment I deemed it to be sufficient. We might at some later date come back to you if we found that the study required a deeper survey in one or two areas than we originally anticipated. Moreover, if our study in respect of mutual funds were included within the ambit of the resolution, this might require additional funds.

Mr. GLENN. Do you have in mind any organization at this time as to officers and employees?

Mr. CARY. Yes, Congressman Glenn. I asked our budget officer, our comptroller, to prepare for you a chart which I hope you will not hold us to exactly, a chart of the type of organization we would have for the purposes of this study and roughly how it would be budgeted out.

I therefore have a chart and also an estimated cost of the proposed organization of this study which I would be very happy to submit for the record, if you would like.

Mr. MACK. Without objection, that will be done.

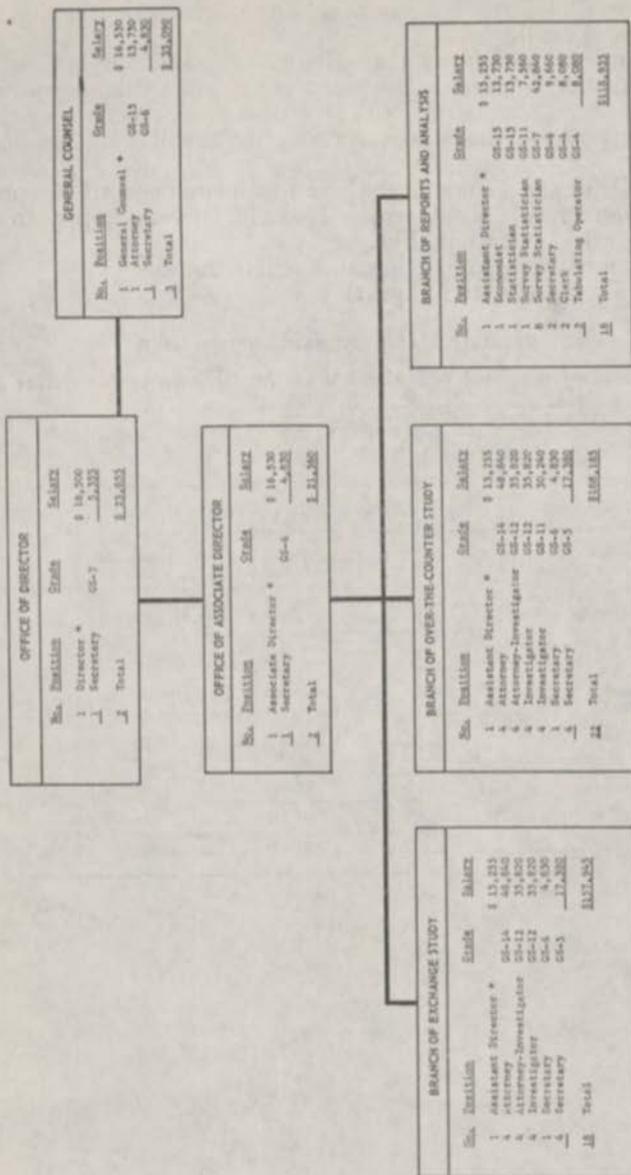
(The chart referred to follows:)

## SECURITIES AND EXCHANGE COMMISSION

*Estimated cost of proposed organization of the Division of Securities Markets*

Expense	Fiscal 1962, Sept. 1, 1961, to June 30, 1962		Fiscal 1963, July 1, 1962, to Dec. 31, 1962		Total	
	Positions	Cost	Positions	Cost	Positions	Cost
Personal services.....	65	\$545,370	65	\$545,370	65	-----
Less: Adjustment for lapse.....		214,070		275,370		-----
Net personal services.....		331,300		270,000		\$601,300
Positions other than permanent.....		6,000		4,000		10,000
Total cost of personal services.....		337,300		274,000		611,300
Other expenses:						
Personal benefits.....		24,200		12,100		36,300
Travel.....		10,000		2,000		12,000
Communications and rental of space and equipment.....		41,300		20,600		61,900
Printing.....		3,000		4,000		7,000
Supplies.....		1,700		800		2,500
Equipment.....		19,000				19,000
Subtotal, other expenses.....		99,200		39,500		138,700
Grand total.....		436,500		313,500		750,000

SECURITIES AND EXCHANGE COMMISSION  
 PROPOSED ORGANIZATION  
 DIVISION OF SECURITIES MARKETS



\* Appointment and compensation to be made without regard to the provisions of the laws applicable to the employment and compensation of officers and employees of the United States, provided that official compensation will not exceed \$12,500 per annum.

Total Number of Positions 45  
 Total Annual Salary Cost \$460,376

June 27, 1961

Mr. CARY. It assumes a portion, of course, of this year. Probably as a practical matter we could not get a large number of people on the payroll until, let us say, September. Then there would be a full part of next year. It would assume further that ultimately we would have about 65 people on the payroll in this job.

I will submit this, if that is all right. I will submit both of them for the record.

I would be glad to distribute to you at this time a copy of the chart, for those who might like to look at it at this time, and also ask me questions concerning it.

Mr. GLENN. Mr. Cary, the present administration has used the term of "consultants" quite frequently in the employment of persons in the departments of Government. I believe that they have used it so generally that they have had need to give these people positions for one reason or another and have not had the proper title to employ them.

How do you use it in your statement when you say that you will have to employ the intermittent services of experts or consultants? Would you explain the distinction between experts and consultants, how they will be used?

Mr. CARY. Yes, sir. Let us take the point of consultant first, Congressman Glenn. I can give you examples of the type of persons we would like to bring in. These are persons that I have recently persuaded to come and work for the Commission, but who cannot work on a full-time basis. They are otherwise involved.

One of them is a very distinguished lawyer who has been willing to give up his association with a company in order to come and work with us as a consultant over the past 3 months. Another, for example, is a former partner of a large New York law firm who is presently a professor at the Yale Law School. I have talked with him as recently as last Saturday in the hope that I could get his services to work most of this summer.

Mr. CURTIN. Did I understand you to say Yale?

Mr. CARY. Yale Law School; yes, sir.

That kind of person cannot leave the university in his particular instance entirely, and yet he would be willing to offer his services on a consultantship basis. Those are the types of people who I assume we can get for this study. This will not be a long-term employment with the Securities and Exchange Commission. Indeed, as you note, the report is to be due January 3, 1963. Therefore, we would hope to bring them in for a term or on a part-time basis in order to give us the benefit of their experience.

That is one type of person I had in mind with respect to consultants. As to differentiating the word "consultant," which you raised, from the word "expert," obviously both of the two people I have referred to are extremely expert in the field of corporation law and finance. I would not have them unless they were.

I suppose by the same token, we shall have to bring in not necessarily as consultants, but in most instances as consultants, persons who are experts. For example, I know of one economist who I talked with last Friday in connection with this very study who, himself, has made a long-term study of the problem of specialists on the exchanges. Such a man is definitely an expert. Whether or not I can bring him in as

a full-time person for the next year and a half, assuming this is approved, or whether or not I shall have to hire him as a consultant, I do not know at this time.

Mr. GLENN. Can you refer to page 6 of your statement, where you say there has been over a 100-percent increase in the maintenance of branch offices by the member firms of the New York Stock Exchange in the past 10 years?

Do you have any idea as to whether or not these branch offices are all around the world or are they confined to the United States?

Mr. CARY. I think I will ask Mr. Loomis to speak about that. I happen to know that some of them do have branch offices in foreign countries. But the extent of that, I think, I would have to leave to him.

Mr. LOOMIS. The great bulk of these branch offices are in the United States. I do not have an exact figure. I might estimate over 95 percent. On the other hand, some of the larger securities firms, the very big ones, have branch offices in various points in Europe, and there are a few firms—smaller firms—who do a considerable foreign business and who likewise have branch offices in Europe, and I think there are a few branch offices in Asia. Whether there are any in Africa yet I am not sure. There are some in South America as well, but the bulk of them are here.

Mr. GLENN. Thank you very much.

Thank you, Mr. Chairman.

Mr. MACK. Mr. Hemphill?

Mr. HEMPHILL. Thank you, Mr. Chairman.

One of the leading papers of the country had an article I noticed this morning headed "Stock Shennanigans." It went on to say in the headlines that many brokers are worried of Government probes in the American Exchange.

Why is that necessary at this late date after having had a Securities and Exchange Commission for going on 27 years now?

Mr. CARY. Congressman Hemphill, the reasons lying behind it are these, and I would like to ask Mr. Loomis to speak on this, too: The basic reasons are that the policy generally of the Securities and Exchange Act was to provide for a very substantial amount of self-regulation by the exchanges.

The particular area most emphasized by the article to which you refer was one involving specialists and the way specialist activities are conducted pursuant to exchange rules. Most specifically, it narrows down in large part to the private investigation which you mentioned, which we are making with respect to the activities of specialists on the American Stock Exchange.

It may be in that area, in the light of a case which is presently sub judicea, and, therefore, which we would not plan to discuss in this hearing—

Mr. HEMPHILL. I did not ask you to discuss it.

Mr. CARY. I know. That case has raised problems with respect to whether or not the rules relating to specialists on that exchange are adequate at the present time, and whether such rules as already exist are presently being adequately enforced.

Those are the basic problems. In other words, whether or not the self-regulation up to this time has been adequate. I think, for any further detail on that point, I might ask Mr. Loomis to speak.

Mr. HEMPHILL. I was not asking you for the detail. I wanted the big picture. The thing that concerns me is not the particular matter involved, which I do not intend to discuss, because I think it is in the courts, and properly so.

Mr. CARY. Yes.

Mr. HEMPHILL. But the thing that concerns me is that the American people have been led to believe that we have a regulatory commission which is protecting their interests, and evidently the interests of the American people have not been protected.

Now we have here in the scope of this resolution a proposed investigation in which we say we are going to investigate to see what is wrong. Why, after 27 years of experience and of regulation and cases do we have to go into an investigation now? If we do not know with all that experience, what good is it going to do to spend \$750,000 to create some bureaucratic empire?

Mr. CARY. May I say first of all that the investigation to which you refer was instituted by the Commission as a private investigation before this resolution was suggested. I have no doubt that at times the Securities and Exchange Commission, as all other commissions, is slow in reacting to a particular situation.

But the facts of the matter are that, as soon as these facts involving several people in respect of the American Stock Exchange were brought to our attention, we took immediate action and, indeed, are looking into it to see whether those facts, as they were brought to our attention, should lead to a further tightening of the rules. Whether or not we could be in a position to prevent all such activities from taking place is certainly doubtful in my mind.

Therefore, I do not want to claim that we are doing in every way the most superb job in the world; nevertheless; this investigation is a demonstration in itself of the fact that we are trying to meet those problems which arise, and I think will inevitably arise, in a period when there is such high market activity.

I would like to have Mr. Loomis speak to that further.

Mr. HEMPHILL. It would be impractical to say that you could prevent every sort of manipulation. We have a lot of laws and a lot of enforcement officers, but people still break the laws.

Over the past few months I have been noticing in the newspapers, and I have to give some credence to it, the fact that the president of the stock exchange and other people in authority in that industry have been making all of these statements warning the public about buying, making these statements that they think the public is being misled.

I assume that those newspaper articles have come to the attention of the Commission, have they not?

Mr. CARY. Indeed they have, sir; yes.

Mr. HEMPHILL. How much fire is there under all the smoke?

Mr. CARY. In a general answer, I would say that there have been evidences of a substantial amount of manipulation. Indeed, in our presentation before Congress on the budget, we demonstrated that we are making more investigations than we have made in the past in order to ascertain whether or not manipulative practices do exist.

Secondly, I think that we can say that we have taken action in certain areas. For example, we have issued proposed regulations with respect to lurid advertising. We are constantly taking action which

is intended to prevent the existence, or try to prevent the growth, of the type of activity and of manipulation to which you refer.

I would like to ask Mr. Loomis to speak more specifically on this.

Mr. LOOMIS. There is not a great deal I can add to what the chairman said. As he mentioned, the basic scheme of this act, insofar as the exchanges are concerned, is that they shall engage in a substantial amount of self-regulation. They have rules which are fairly elaborate, which are designed to prevent manipulations.

As the market conditions developed over the recent years in such a way that it indicated that there was a greater opportunity and perhaps a greater likelihood of improper activities, the Commission instituted certain investigations which have given rise to the action to which you refer. As a result of that investigation, which was an extensive one, we learned a certain amount about how these things can be done under modern conditions.

As the Chairman has mentioned, we then instituted a broader inquiry with respect to the operations of rules and practices on that exchange to make sure, so to speak, or to try and see if they are keeping pace with the times. If this resolution is enacted, that inquiry will be considerably broadened.

The inquiries which have been made so far, and the ones now in progress, are being done by detailing a relatively small group of our enforcement officers to work on this matter. We do not have a great surplus of capable enforcement officers. That small group of enforcement officers could not do what is contemplated by the pending resolution. That would take a larger group and a different type of person to do it.

But we have, within the limitations of our resources, responded to the changing conditions on the markets which appeared to give an opportunity for this type of thing. How much fire there really is behind this smoke I am not sure we know, but we intend to find out.

Mr. HEMPHILL. Mr. Dingell wanted to ask a question.

Mr. DINGELL (presiding). If from what you say is true, in the last months there has been evidence of a significant amount of manipulation of one type or another, would it not appear desirable that there had been some scrutiny not only by the SEC, but also by the exchanges and the NASD of their rules and regulations for policing themselves?

Mr. LOOMIS. Yes, sir; and there has been. The American Stock Exchange has been engaged in the last 6 months or so in revising certain of its rules. I know for a fact that the NASD has also devoted quite a lot of thought to modifying its rules in various areas of concern, including the mutual fund area that you alluded to earlier.

There is no doubt that there is need for the exchange and the NASD to reexamine their rules and practices. I am pretty sure that they are doing so. Undoubtedly they will give you more information when they are heard.

Mr. DINGELL. Have you any idea when the NASD and the two major exchanges commenced their scrutiny of their rules and regulations?

Mr. LOOMIS. I would assume that that is a continuing process. I would not be able to say that they began it on a certain day. I

think they do it continuously, although I do feel, just from my own experience, that within the last—approximately the period of 1 year—I have seen a little more activity in this line than I had noticed before. Whether that gives the answer, I do not know.

MR. CARY. Mr. Chairman, may I advert to one question which was asked a moment ago by Congressman Hemphill?

MR. DINGELL. I yield the floor back to Mr. Hemphill.

MR. CARY. I simply wanted to ask whether or not your committee would be interested in the material, including several charts, which I have available demonstrating our activity in the field of investigations.

MR. DINGELL. I believe we have them.

MR. CARY. You have those; that is correct. I did not know whether, in order to answer more fully the point made by Congressman Hemphill as to what we are doing, you would be interested in my making some statements in respect to our activities in stop order proceedings, investigating criminal cases, which have grown, and administrative proceedings, involving the denial or revocation of licenses of brokers and dealers.

MR. HEMPHILL. I would be interested, but I think I have already used too much of my time. Here is the thing that concerns me as a representative of the people. The people of this country who invest for a large part are people who do not know anything about the market. The local salesman comes by and he wants to sell a mutual fund or something else, and he has some nice looking literature saying that his company invests in what we call the blue ribbons, and it looks mighty good. Then the person invests.

From that point on he has no control, because in the first place his investment is not large enough for him to take his time, it may be a widow or some lady without some business experience except she has funds, and the salesman happens to have been a friend of her husband or something, but she loses control at that point. She has put the money in. From that point on, she is in the hands of the Philistines, unless the Securities and Exchange Commission is the policeman it is supposed to be.

The question in my mind is whether or not the American public is getting the protection it thinks it should have since we have the regulatory agency, and the next question in my mind is whether or not this investigation or study, if we approve the resolution, would produce as the American public would think it should produce.

The average person on the street does not know anything about the market, and if we pass this resolution, we would be telling them that we are going to produce, when, as a matter of fact, this study may not produce.

I am concerned because I think the average person thinks that because we have a Securities and Exchange Commission that they have much broader protection than in actuality they have. It concerns me, because that is my responsibility since I represent the people, and I think your responsibility is to carry out the statutes in keeping with the intent of Congress.

I am not saying this in criticism, but this thing has concerned me ever since I have been privileged to be on this subcommittee. We have your agency and then we turn up with all these statements,

with headlines of stock shennanigans, and one thing and another, and the public has a right to ask, "What are you going to do about it? Why haven't you done something before?"

I would like to have your comments.

Mr. CARY. It is very difficult to answer that precisely, Congressman Hemphill, but I would say these things: First of all, the primary thrust of our acts is twofold. One is forcing disclosure of information, no matter how unkind it is, so that the public actually is informed in connection with the sale of securities; and the second is this broad group of activities under the Securities and Exchange Act attempting to prevent fraud and manipulation of all types. Thirdly, we have some further regulatory functions, as, for example, the Investment Company Act with respect to mutual funds.

As to whether or not our powers are adequate or our rules are tight enough, it is true that we have all of our manpower at the present time concentrated in these activities which are at their all-time high in registration of securities and in attempting to prevent fraud and manipulation of all types.

As a consequence, we have not had enough opportunity to back away and look at the problems. One of the most helpful features of this study will be that, while the manpower that we presently have is engaged in administration, other people can investigate whether we are going far enough, whether our present rules are adequate, and whether we should do more.

That is really the basis for this study.

Mr. HEMPHILL. If we pass this resolution, you are prepared to come back to us on January 3, 1963, and say to us as a committee of Congress that, "For the protection of the American public, we make these recommendations"?

Mr. CARY. We will, and, indeed, we hope to come back before January 1963 in some instances when points have arisen which require immediate action.

Mr. HEMPHILL. And that would include people as in the example I gave you?

Mr. CARY. That is correct, sir.

Mr. HEMPHILL. There would be some protection for the innocent American who trusts a friend and, in turn, who trusts a company, who may just be a salesman for them. The fact that she may lose control as a background, the Securities and Exchange Commission will not let her be defrauded?

Mr. CARY. We try to prevent any defrauding of anyone.

Mr. HEMPHILL. You would make some recommendations along that line if this study were authorized?

Mr. CARY. That is correct.

Mr. HEMPHILL. I thank you for your help this morning.

Thank you, Mr. Chairman.

Mr. MACK. Mr. Keith?

Mr. KEITH. Mr. Chairman, I would like to have you confirm or otherwise reject a thought that one might gather from a question that Mr. Dingell put to you, that a majority of the mutual funds were invested in over-the-counter ventures. This was not my impression. I thought that by and large the mutual funds invested their moneys in whatever market was best.

Certainly in Boston the mutual funds very often invest in blue chip stocks, and they are not, generally speaking, over-the-counter transactions.

Mr. CARY. Congressman Keith, may I draw a distinction between what the investment companies invest in and the shares of those companies. For example, the X investment company will be investing very frequently in, as you say, blue chips, including securities traded on the New York Stock Exchange and the other exchanges.

That is different from the securities of the investment company, itself, which are issued by the investment company. The salesmen who sell the shares of the investment company, not the assets, are frequently members of the National Association of Security Dealers and thereby subject to the supervision of that organization.

I think that is what we were referring to.

Mr. KEITH. As I understood the exchange between the two of you, the investments were going into the over-the-counter types of transactions, the investments of the investment companies. I am glad to have that corrected.

Mr. CARY. It is true, sir, that in some instances, investment companies may invest in over-the-counter and, indeed, some securities which are illiquid.

Mr. KEITH. But this would be in accordance with your regulations, would it not?

Mr. CARY. It would so indicate; yes, sir.

Mr. KEITH. I was interested in the exchange concerning the cost of this service to the funds as a whole. I did a little arithmetic, too. The average investment in such an account might be in the vicinity of \$10,000. One-half of 1 percent on that is how much money?

Mr. CARY. Is it \$500? No, it is \$50.

Mr. KEITH. You see, there is quite a difference between \$500 and \$50. This man who has \$10,000 in the market is getting for \$50 some rather competent advice, it seems to me.

I have only once or twice ventured into the market, and I would think in retrospect it might have been better for me to stop worrying about the overhead on some of these investment funds and to have my share of the growth of the economy of this country by not concerning myself about that one-half of 1 percent for whoever this man is that is getting it.

Who is getting it? Who is the one or what is the firm that gets the one-half of 1 percent? Is there one firm or are there several?

Mr. CARY. Congressman Keith, this bears on the question of how mutual funds are organized today. Normally, when a mutual fund or investment company is organized, the investment advice is rendered to that fund by a separate organization, known as an investment adviser.

They are subject to a contract with the investment company pursuant to which they receive, as you say, a fraction of a percent of the total assets of the company on an annual basis.

Mr. KEITH. What I am trying to determine is whether or not we have one giant organization that gets all of this business for a fixed fee and is, in effect, controlling tremendous amounts of capital, with perhaps a monopoly on this type of service, and where the market might suffer very substantially through the fact that there was one

agency or one company, in effect, determining the policy for many mutual funds.

Mr. CARY. Generally, there is one investment adviser for each mutual fund and for no others. However, I want to amend that briefly.

First of all, of course, there are some mutual funds that are very large, as you know, over a billion dollars.

Secondly, it may be that in some instances a particular organization has what is known as X fund No. 1, X fund No. 2, X fund No. 3, which they sell, and which have different types of investment portfolios. In respect of each of these, the same investment adviser might perform an advisory function. Generally, however, an investment adviser would serve only a group of funds having a common name, rather than serving the X fund, and then the Y fund, and then the Z fund.

Mr. Cohen, I think, might be able to comment on this more deeply than I have.

Mr. COHEN. No, I think you have fairly covered the range of possibilities.

Mr. KEITH. What I want to know is, is it competitive between one investment advisory firm and another? It was implied in an earlier exchange that there was a uniform rate, so there would still be competition as to which one got the best results for that uniform rate.

I was just curious to know whether, when you looked behind the scene in all of these things, you found one firm was, in effect, handling a majority of the investment accounts of a majority of the mutual funds?

Mr. CARY. It cannot be said, that there is one firm dominating them all.

Mr. KEITH. There was a question about the amount of fire behind the smoke. Who is fanning the fire, or is there anybody fanning the fire, in this particular area?

Mr. CARY. When you say in this particular area, you mean on the security market generally?

Mr. KEITH. No, in the mutual funds and the question of fees paid.

Mr. CARY. I believe that the basis for the question raised by Congressman Dingell is a series of lawsuits that have been filed against investment company officials—I don't know whether it is 50 suits.

Mr. NORTH. Approximately 50 suits that have come to the attention of the Commission, but that does not necessarily mean that we know of all of them because they are private litigation.

On the other hand, it does not mean that the officials of 50 investment companies or mutual funds are under attack. In some instances there are several suits pending involving the same investment company.

In other words, different groups of stockholders bring actions involving the same company or perhaps the same group will bring one action in the Federal courts and one in the State court, the second action being a staying action pending the time that they can prove whether they have an action under Federal Law or not.

Mr. CARY. These suits are by individual shareholders of the investment companies, on behalf of the companies, against the managements so-called shareholder derivative actions.

Mr. KEITH. These are not being stimulated, so far as you know, by anybody with any close tie-ins with the Securities and Exchange Commission, present or past?

Mr. CARY. Indeed, no. This is private litigation.

Mr. KEITH. I understand, but the people involved are in no way connected, at present or in the past, with the Securities and Exchange Commission?

Mr. CARY. No, indeed, not that we know of. It may be that some alumni of the SEC are counsel, but I am sure that they will be on both sides of every issue.

Mr. COHEN. I might say that there is one gentleman who was an employee of the Commission for a short period of time, who has appeared as counsel in a number of these suits.

It has been suggested to the Commission in the past that perhaps there was something here that required some inquiry. The Commission has, at least on two occasions, inquired into this matter very deeply, and there was no basis for suggesting that there was an impropriety under the rules or laws as we understand them.

Mr. KEITH. I think I may support the expansion of this study into the mutual-fund field, primarily because I feel that the public acceptance of this unique method of investment can contribute very greatly to the expansion of our economy and at the same time give the small investor an opportunity to get a share of the increased productivity of this country as represented by its capital investment.

But I hope that in the course of this investigation you will not scare the public unnecessarily, scare them away from this unique opportunity that we have in our system of investment here in this country.

Thank you, Mr. Chairman.

Mr. MACK. Mr. Curtin.

Mr. CURTIN. Thank you, Mr. Chairman.

Mr. Chairman, I understand that there is a great quantity of securities sold in this country, by virtue of solicitation from foreign countries. I appreciate the difficulty of the authorities in this country to control this, and I also appreciate what control we do have is not restricted to the SEC.

However, I was wondering, in the event this resolution is enacted into law, whether or not your investigation would go into this phase of the securities business?

Mr. CARY. On that point I would like to ask Mr. Loomis to speak.

Mr. LOOMIS. I presume, Mr. Curtin, that you are referring to sales from Canada, primarily, because there have not been a great many direct sales from other portions of the world.

Mr. CURTIN. That is right.

Mr. LOOMIS. This particular study, at least in the framework of the language used, would not appear to refer very much to that problem.

There are certain developments with regard to that problem which may be of interest. Until recently, most of these sales from Canada were coming from two places, Ontario and Quebec.

There has been very little of it from Quebec recently because of the Quebec Securities Commission having maintained quite effective control.

Recently, only within a period of 2 months, an initiative was taken in Toronto by the Toronto Stock Exchange and the Broker-Dealer Association of Toronto, to require that sales from Ontario into the United States to be made only in compliance with the Federal securities laws.

If this works out, the problem will be, I think, at least greatly improved.

Another significant development here is the fact that over the years there has been a question as to whether the Canadian Provincial Securities Commissions could control sales that were made outside the Province and into the United States or whether that, under Canadian constitutional law, this was a matter of Interstate or International Commerce.

On June 12 of this year, the Supreme Court of Canada decided that the Provincial Securities Commissions had that authority, and upheld the action of the Quebec Securities Commission in stopping these transactions.

So I think that while we will continue to work with and study this problem, we are hopeful concerning the future for it. And, as I say, it does not seem to me that it is quite within the scope of a resolution which focuses primarily on the activities of domestic organizations, the exchanges and the associations.

Mr. CURTIN. You have told us what they have done in Canada. But has the SEC been able to do anything in this field?

Mr. LOOMIS. Yes, sir; it has. There are various measures that we have taken in working with the Canadians, who are the only people who can stop or control this at the source. We maintain a restricted list of Canadian securities which have been or are being offered illegally in this country, and no broker or dealer in the United States will deal in those securities which dampens these operations.

In addition, we have conducted a number of investigations in cooperation with Canadian authorities, which have produced actions, criminal indictments, convictions, in the United States and in Canada.

Very recently we sent to jail one of the most notorious operators who was so unwise as to stray this side of the border, and we have obtained indictments and referred to the Department of Justice a number of very important Canadian cases which we investigated within the past 6 months in cooperation with Canadian authorities.

These people do not like to be indicted on either side of the border, and that is one of our best weapons.

Mr. CURTIN. Do you intend to continue your activities in that regard?

Mr. LOOMIS. We intend to continue, yes.

Mr. CURTIN. Thank you, Mr. Chairman.

Mr. MACK. Mr. Cary, in my opening statement I referred to your statement before the House Appropriations Committee, wherein you indicated that you had over 1,000 full-scale investigations underway.

Mr. CARY. Yes, sir.

Mr. MACK. I think that was compared with only 481 only 5 years ago. We would be interested in having your comment as to what has caused the additional investigations. The irregularities in the securities area or the volumes traded which may have caused it. What has been responsible for your moving?

Mr. CARY. Congressman Mack, as I indicated a moment ago, we do have here a few charts, some of which may be of interest to you. I would call your attention to chart 5, which does not make the distinction that you have indicated. It is just entitled "Securities Investigations."

That, basically, shows the number of securities investigations we have been making in the recent years. It shows that we have sort of reached a plateau, the reason being that in the old days we referred to this as purely a securities investigation without a qualitative differential between full-scale and others.

Now the fact is that the need has been so great for investigations, that I think rather than increasing the number of investigations we have increased the number of full-scale investigations.

The facts of the matter are that, with this active market and with the possibilities of manipulation existing in it, there has been, as you indicate, and as I indicated in my earlier testimony before the House Appropriations Committee, a very substantial increase in the number of investigations.

On this point, I think Mr. Loomis might be able to give us some of the further details.

Mr. LOOMIS. As the chairman has said, we now have over 1,100 pending investigations, of which slightly over 1,000 are full-scale investigations. Those cases have been opened because there has come to our attention sufficiently serious indications of possible violations, that it has been felt that a full-scale investigation was necessary.

The number is higher than it should be, but, in general, we can't avoid opening cases in some of these situations which come to our attention. We just have to handle them as best we can.

Mr. MACK. What is your full-scale investigation?

Mr. LOOMIS. The distinction there is that we have two types, a full-scale or docketed investigation, and a preliminary investigation.

A preliminary investigation is a relatively brief inquiry which is primarily directed at determining whether or not there appears to be something in the situation that we have to go into. We run down leads and maybe it doesn't amount to anything, or maybe it is a situation we have to go into. If we determine that it is a situation we have to go into, it then becomes a full-scale investigation, attorneys and investigators are assigned to conduct it, and it goes forward.

Because of the conditions we have encountered, we have had an increasing number of these full-scale investigations, and have cut down on the number of preliminary, partly because we don't have the time to run down every lead, and partly because more of them seem to warrant looking into than was true in some earlier periods.

For example, our Seattle regional office has almost stopped opening preliminary investigations. They haven't had any in some time. They just make a preliminary check and then launch right into a case.

Mr. MACK. You have to make a preliminary check or a preliminary investigation, don't you?

Mr. LOOMIS. They probably make their preliminary check without even opening a preliminary investigation file because they figure that it wouldn't be necessary.

Mr. DINGELL. Will the chairman yield briefly?

Mr. MACK. Yes.

Mr. DINGELL. Are you entering that they make preliminary checks in the nature of a spot check and that usually this spot check leads immediately then into a full-scale investigation?

Mr. LOOMIS. No, sir. I am referring to this type of situation: We get a letter from an investigator complaining about a securities transaction, for example. We will look into that letter, first preliminarily to see if it is a situation within our jurisdiction and amounts to anything.

If it turns out that it is either not a case within our jurisdiction or there was no violation, we will close the preliminary check.

If, on the other hand, it appears that the man may have, in fact, be defrauded, then we may open a full investigation of the situation. That is the distinction I was attempting to describe.

Mr. DINGELL. Thank you, Mr. Chairman.

Mr. MACK. Mr. Chairman, in your testimony you referred to the devious methods used to perpetrate fraud, in referring to the increased number of cases and investigations that you have had, and that they are more complex for this reason.

Could you tell the committee what you mean by devious methods used to perpetrate a fraud?

Mr. CARY. I think on that point again, sir, I would like to yield to Mr. Loomis.

Mr. MACK. I presume it is new in this field?

Mr. LOOMIS. Well, it may not be new, because many people who perpetrate frauds have always been devious about it. But I think that there is more of it by reason of the Commission's enforcement work and for other reasons.

People have taken more pains to cover their tracks by operating through intermediaries, banks in Switzerland, nominees in California, and, in general, to attempt to complicate or frustrate investigation by moving securities through numerous national and sometimes, international, channels in an effort to conceal the identity and the participation of the people who are really behind the scheme, but who, on the surface, don't appear to have anything to do with it.

Mr. MACK. Who would these people be? Would it involve broker-dealers?

Mr. LOOMIS. They are a sort of cross section of the criminal population. They are broker-dealers, sometimes, individuals of varying background. Sometimes they are officers of corporations. It is quite a cross section.

Mr. MACK. 1,000 investigations is quite a large number. What percentage of these cases would have these unusual means to perpetrate a fraud?

Mr. LOOMIS. That is a little hard to say. First, I might mention that these investigations run the gamut of all types of violations of the securities laws. They are not all fraud cases by any means.

Some of them are sales of securities without registration or operation of a broker-dealer firm without observing the various rules.

They break down into those three categories or combinations of them. Of the fraud cases, a considerable percentage and not having read all of the 1,000 files, I can't tell you precisely, do involve these devious devices, a substantial percentage.

Mr. CARY. On that point you might be interested to know the number of criminal cases, which are usually matters of very substantial moment, and in which some of these very types of activities exist that you have noted.

On that, we have had a very substantial rise in criminal cases of referrals to the Department of Justice in recent years. That is chart 6 of the group of charts which you have before you.

Mr. MACK. This is also included, as I recall, in your testimony before the Appropriations Committee.

Mr. CARY. That is correct, sir.

Mr. MACK. Mr. Loomis, can you give us an example of a case not pending where you had involved a broker-dealer in this operation?

Mr. LOOMIS. Let me make sure I understand you, involving a broker-dealers violations or involving a fraud perpetrated by broker-dealers?

Mr. MACK. A fraud case, where the broker-dealer participated indirectly or directly.

Mr. LOOMIS. We have had a number of those. One instance, for example, involved a Canadian—well, take the one that involved an American corporation which was dormant. It had been formed in the Western States many years ago as a mining company, and had gone out of business, in substance.

A nominee, acting for a promoter, purchased all of the stock of this venture for some \$5,000. The promoter then took control of the corporation and split its stock about 100 to 1 and distributed that stock among about 20 or 30 people who acted, in turn, as his nominees. This stock was then transported by prearrangement up to Canada, and then was ostensibly purchased from persons in Canada who were also nominees for the promoter at a substantial markup by a broker-dealer firm controlled by the promoter although he did not appear in its management.

This broker-dealer firm which then had purportedly bought this stock for \$2 or \$3 a share, proceeded to resell it widely to the American public, based on representation that this company had all kinds of properties way out in the West, which really represented some very dubious mining properties which the promoter had picked up and put into it.

That is one example of the type of case of which we have had several in the last year or so, or 2 years.

Mr. MACK. In a case such as that, you would take action against the broker-dealer?

Mr. LOOMIS. Yes, sir. In that case that you refer to, the broker-dealer firm was put out of business, and the principals were indicted and pleaded guilty.

Mr. MACK. These new fraud cases that you referred to, Mr. Chairman, those would be violations of the rules, the present rules or statutes, would they not?

Mr. CARY. Yes, sir; primarily of either the Securities and Exchange Act or the Securities Act.

Mr. MACK. We have a rollcall on at the present time. Mr. Chairman, would it be possible for you to return at 2 o'clock?

Mr. CARY. We will be here.

Mr. MACK. The committee stands in recess until 2 o'clock this afternoon.

(Whereupon, at 12:15 p.m., the subcommittee recessed, to reconvene at 2 p.m., the same day.)

## AFTER RECESS

(The subcommittee reconvened at 2 p.m., Hon. Peter F. Mack, chairman of the subcommittee, presiding.)

Mr. MACK. The committee will come to order.

Mr. Chairman, when we adjourned this morning, I was asking a question concerning loopholes in the statutes or the rules of the exchanges or the National Association of Security Dealers.

I assume this resolution would cover that area.

**STATEMENT OF WILLIAM L. CARY, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION; ACCOMPANIED BY COMMISSIONER BYRON D. WOODSIDE; COMMISSIONER J. ALLEN FREAR; FRANK J. DONATY, COMPTROLLER; PHILLIP A. LOOMIS, JR., DIRECTOR, DIVISION OF TRADING AND EXCHANGES; MANUEL F. COHEN, DIRECTOR, DIVISION OF CORPORATION FINANCE; WALTER P. NORTH, ASSISTANT GENERAL COUNSEL; ALLAN CONWILL, GENERAL COUNSEL; AND ARTHUR FLEISCHER, JR., LEGAL ASSISTANT TO THE CHAIRMAN—Resumed**

Mr. CARY. That is correct, sir.

Mr. MACK. In your testimony before the Appropriations Committee, you referred to the increase in the criminal cases. I believe it was from 8 cases in 1955 to something like 53 or 58 cases in 1960.

Mr. CARY. Mr. Chairman, on that, as I indicated to you, we have a chart which may give some indication of the situation with respect to criminal cases. It is chart No. 6 of the charts submitted to you. To go into further detail with respect to it, I would like to ask Walter North, our General Counsel, to speak.

Mr. MACK. Mr. Chairman, have these charts been made available to us?

Mr. CARY. They have been made available to the committee. Perhaps we have additional copies further than those that were distributed. This is simply a chart, Mr. Chairman, which shows the number of cases concluded, the number pending in the Department of Justice, which would give our total workload from the period 1955 to 1960, and shows the immense increase in the numbers specifically which are pending in the Department of Justice.

I think there are more details on this that might be developed by Mr. North.

Mr. NORTH. Mr. Chairman, in that area our chairman's statement before the Appropriations Committee should not be misunderstood. In lifting it out of context it perhaps gave the impression that we are trying to claim our criminal load has increased sixfold or sevenfold. That is not true.

Nineteen hundred and fifty-five happened to be the low year in recent years, and 1960 was the high year. Speaking in terms of averages from 1950 through 1958, the load went up and down from this low of 8 to a high of 27, but it averaged 18 cases over that 9-year span.

Then all of a sudden came 1959 and 1960, and in those 2 years alone we referred 101 cases. So you had nearly a 200-percent increase, but certainly not anything like a sixfold or sevenfold increase. We are not attempting to establish that.

Mr. CARY. Many of these are very large cases which require not only the work of the U.S. attorney's office, but sometimes as many as three or four of our own people working with them, frequently day and night, for an extended period of time in order to develop a case for a criminal trial.

Mr. MACK. It is still a substantial increase.

Mr. CARY. Indeed it is.

Mr. MACK. Even if you take the average.

Mr. NORTH. That is right. It is nearly 200 percent. In this current year, I might add, up to the week before last, we had referred 41 cases. I think last week we referred 2, and we still have 2 or 3 more in the shop that may be referred before the end of the month, so again this year our total will run about 45 or thereabouts.

Mr. MACK. Is this based on the fiscal year?

Mr. NORTH. Fiscal year ending June 30; yes, sir.

Mr. MACK. It will exceed the number referred in the last fiscal year?

Mr. NORTH. No. It will be about half a dozen less. Last year we had 53. This year it looks like our total will be around 45. One reason for the dropoff is that our field personnel are so busy working with the U.S. attorney's offices on the 101 cases we referred in the past 2 years that they do not have as much time to develop new cases as they had before we thrust that peak on them of the past 2 years.

Mr. MACK. I presume there are some of the 53 cases pending from the fiscal year 1960.

Mr. NORTH. The majority are pending. We made a little study of that. They asked our office to put together figures on the length of time it took a criminal case to get—from the time our Commission refers it until it is finally disposed of, either by a plea or by a trial, or however it may end up, or dismissal.

Our figures showed that on the average—some are much longer than this and some much shorter—it took about 16 months from the time we referred a case until it was finally disposed of. If that average holds good for the cases we referred in 1960, more than half of them would still be pending in the U.S. attorney's offices throughout the United States.

Mr. MACK. Could you tell me the nature of some of the cases pending without getting into the individual cases?

Mr. CARY. I think I might call on Mr. Loomis to give us some picture of that.

Mr. LOOMIS. Some of them involve the type of fraud that I referred to this morning, these devious devices, if I may say so. Others involve manipulation. There are two or three, at least, manipulation cases in there. Others involve misconduct of a grave nature in the operation of a broker-dealer firm where somebody in the firm misappropriated or looted the customers' property.

Others involve large-scale and deliberate distributions of securities in violation of the Securities Act, accompanied on occasion by counts charging manipulation.

Mr. MACK. Then in many of the cases pending, the investors would have lost money innocently.

Mr. LOOMIS. That is correct; yes.

Mr. MACK. Now, Mr. Chairman, do you feel that this resolution as introduced would cause the Commission to look into this area to determine whether we have proper sanctions for these violations?

Mr. CARY. Yes, Mr. Chairman. Undoubtedly this would help in that direction.

Mr. MACK. Mr. Chairman, we will have to adjourn the hearing for perhaps a 15-minute period. We have a rollcall on the House floor. If you don't mind waiting for a few minutes, we will answer the call and then continue the hearings.

The committee will stand in recess for 15 minutes.

(A short recess was taken.)

Mr. MACK. The committee will be in order.

Mr. Chairman, we were discussing the number of criminal cases which have been referred to the Department of Justice. There has been a substantial increase in the number referred. You have indicated the nature of the cases.

Do you have any views concerning the increase in the number and whether that is caused by new activity, or whether it is just an increase in the volume?

Mr. CARY. I am sure, Mr. Chairman, that part of it is a function of the increased business activity and market activity. Certainly there have been a number of very substantial criminal cases, perhaps comparatively more than there have been in the past. As to any details on that, I might ask Mr. Loomis whether he has anything to add.

Mr. LOOMIS. I think that is about the answer. There has been more activity, and also we have felt that because some of these cases were increasingly serious, we should use the criminal sanctions in the statute more often instead of certain other types of remedies.

Mr. CARY. There is one other area that might be mentioned, and that is, namely, we have had a number of criminal cases where there has been failure of reporting under the Securities Act. A great deal of the discussion we have had in the last hour has basically been with respect to fraud and manipulation under the Securities Exchange Act.

There have been major cases involving failure to report very material information in registration statements, which has led to successful criminal prosecution.

Mr. MACK. In your testimony, you also gave certain data concerning the increase in administrative proceedings looking toward the denying or revoking of registration of brokers and dealers.

Mr. CARY. With respect to that, sir, I also had a chart which was used again in the Appropriations Committee, and that was chart No. 7, which you have, entitled "Administrative Proceedings To Deny or Revoke Registrations of Brokers and Dealers, or To Expel From the NASD."

That chart shows a continuously rising trend both in the number of administrative proceedings concluded and also the number pending at the end of each year. The total, of course, the number concluded, and the number pending, demonstrate our workload. Indeed, there has been a very substantial increase.

I can give you the figures from this chart or perhaps it might be better to ask Mr. Loomis if he would give them in further detail.

Mr. LOOMIS. There has been, as indicated in the chart, a substantial increase in the number of administrative proceedings commenced, particularly in 1960. That was a big year for them. I think we will not have quite as many commenced this year, partially because of the workload on the trial lawyers and the hearing examiners makes it hard to carry a heavier load of them.

Mr. MACK. Is there some particular reason for this increase in 1960?

Mr. LOOMIS. I think again it is a function of the increased activity in the markets and the result of the fact that we have had more broker-dealers engaging in some type of misconduct because of the opportunities for that type of thing in these markets, and also there has been an increase in the number of cases in which broker-dealers, perhaps because they felt they were too busy, did not conduct their business properly. They violated the capital rule or various of the other rules dealing with the conduct of the business to such a degree that we felt that there should be a proceeding.

Mr. MACK. Would this also cover cases where insufficient records are kept?

Mr. LOOMIS. Yes, there are a number of those cases. We often find a combination of failure to keep records and violation of the capital rules. The two seem to tend to go together quite often.

Mr. MACK. Mr. Keith?

Mr. KEITH. On this question, what percentage of the total number of brokers and dealers would this be? Would this not be relatively uniform? There has been an increase in the total number of brokers. You might put this on a percentage basis on a more even keel.

Mr. LOOMIS. There has been an increase in the total number of broker-dealers, but I do not think that increase is as steep as the number of proceedings. For example, in 1958 there were 4,600 broker-dealers registered, and we now have 5,400, which is an increase of about 1,000 or 800, perhaps a 20-percent increase, if my mathematics are right. The number of proceedings has risen more rapidly.

Mr. MACK. When you were before the Appropriations Committee, Mr. Loomis, you made a statement on this subject, and I would like to quote, concerning the evidence of rigging:

I think we have had perhaps more manipulation cases in various stages of administrative and criminal proceedings than I ever recall. Of course, they are fairly old. It is difficult to say how much is going on at this time. There is one indication on that. In addition to our formal investigative proceeding, we have what is known as quizzes where we suspect something is wrong by reason of a market movement and we go into the various brokers and identify who bought the securities and who brought in the various orders, to see if there is any manipulation going on.

During the whole last fiscal year we had 88. In the last 9 months we have had 89. There are more in the last 9 months than in the entire fiscal year. This compares with 53 cases for the comparable period last year.

Are the quizzes preliminary investigations that you referred to?

Mr. LOOMIS. It resembles a preliminary investigation, but it is not included in the figures of preliminary investigations that were given to you earlier. It is a separate type of preliminary inquiry.

It is correct that we have shown an increase. I have the figures over the past 5 years. In 1957 fiscal year we had 37 commenced; in 1958, 66; in 1959, 89; in 1960, 88; in this fiscal year 112.

So the number of quizzes commenced has approximately doubled in the last 4 years.

Mr. MACK. Do these quizzes lead to formal proceedings by you or by the stock exchange?

Mr. LOOMIS. They may do so. Of course, they don't always. In fact, probably in the majority of these instances we do not find evidence of an actionable manipulation. If there is evidence, we will have a formal investigation and it may become an administrative proceeding or a criminal case, or it may be referred to an exchange for their attention.

Mr. MACK. You don't deal with the manipulation and rigging cases by administrative procedure, do you?

Mr. LOOMIS. Yes, we will sometimes take action against a broker-dealer in an administration proceeding charging him with some form of manipulation. If it is a very aggravated case it may become a criminal case. Not infrequently it will be both. We may have first an administrative proceeding to get him out of the business and then refer the matter to the Department of Justice.

Mr. MACK. In cases of manipulation or rigging, damage is done to investors and it would seem that an administrative proceeding would not be appropriate.

Mr. LOOMIS. I am glad you mentioned this. If we catch the thing while it is still going on, we can go into court and seek an injunction to stop it. If, on the other hand, it is all over by the time the evidence is assembled, then we have no choice except administrative and criminal proceedings.

Mr. MACK. So that most of the cases would be administrative and criminal proceedings and not only administrative proceedings when there were cases of rigging or manipulation involved.

Mr. LOOMIS. If there was any serious manipulation or rigging involved we would try to make a criminal case out of it, that is right, sir.

Mr. MACK. Mr. Chairman, I don't guess you have had too much experience with regard to the amendments to the Investors Act which became a law last year. I think every one of us has had experience with literature and advertisements purporting to put us on a hot issue. Just what is being done in this area?

Mr. CARY. Mr. Chairman, we have published one statement on that. I think that is a matter which I would like to leave to Mr. Loomis.

Mr. LOOMIS. The Commission, acting under the Investment Advisers Act amendments, published late last year, a proposed rule dealing with advertising by investment advisers. That proposed rule was designed to deal with the problem that you have in mind, and in formulating it we were guided by some of the types of lurid literature that we either received or observed from other sources. The proposed rule would in effect prohibit, in investment adviser advertising, the use of testimonials, the practice of referring to specific past recommendations as evidence of what may happen in the future—I got IBM in 1936—the representation that a particular graph, chart, or formula would in itself furnish the answers to investment problems, and a general prohibition upon the use of advertisements which are false and misleading. That proposal was circulated and published for comment in accordance with the requirements of the Administra-

tive Procedure Act. Quite a large number of comments were received from investment advisers, brokers and dealers, and citizens. We have completed evaluating those comments and summarizing them, and we will be going forward with this proposition, taking advantage of some of the useful suggestions which have been made, I think, in the very near future.

Mr. MACK. Many innocent investors have been lured into the securities field through these advertisements.

Mr. LOOMIS. The advertisements certainly appear to be calculated to do that and some of the people who have written to us indicated that that happened to them.

Mr. MACK. Mr. Cary, you have stated that you could not over-emphasize the importance of the investment company field. You have mentioned the large growth which has taken place in this industry. Your inspection of investment companies is now on a 10½-year cycle. You indicated that you hope to get it down to an 8-year cycle. It seems to me that this is a long period of time and that situation should be greatly improved. You indicate that one of the items into which to look is whether there is an excessive turning of portfolios to create brokerage commissions. Whether there are transactions with affiliated persons. Whether the portfolio is in line with their announced investment policy. This is of great interest to the committee. I was wondering if you could tell us something about what is going on in this field. I know that many of us have felt at various times that there were excessive turnovers of the portfolio.

The managers would stand to gain through that arrangement.

Mr. CARY. On that point I would first like to advert to chart No. 8, which is among the ones submitted to you earlier today. This chart indicates in a general way the continuing growth in the number of investment companies, and the continuing growth also in the number of shareholders accounts and, of course, as one might expect the continuing growth in the market value of assets. We have now reached a point, as you well know, where the total amount held by mutual funds is substantially in excess of \$20 billion. You have raised a question with respect to the inspection cycle, and quite properly, it seems to me, raised the question as to the adequacy of our cycle if we say we are simply getting it down from 10 years to 8 years. At the outset in our administration of this act, as I understand it, there was no regular inspection being done, and such inspection was instituted relatively recently. The effort, of course, will be to get increased personnel to make these inspections. It may be, in fact, if it becomes a choice between the different areas in which we have to marshal our manpower, that perhaps more of it should be allocated to this function. We have the competing primary demands of getting the registration statements out—in connection with the 1933 act, registration and full disclosure program. I note also the competing demand of the field of fraud and manipulation to which we have just adverted. I do feel that the immense growth in the number of investment companies, the number of shareholders and the quantity of assets, all lead us inevitably to a belief that more personnel and more effort will have to be directed toward this area, including, I might say, inspection. Now, as to getting into certain points with respect to turnover and other matters that you mentioned, I would like to ask Mr. Cohen to speak more in detail.

Mr. COHEN. Mr. Dingell referred this morning to the *Managed Funds* case. That case perhaps illustrates the situation in which a number of the things to which you have adverted occurred. There was, as the Commission found, a churning of the portfolio to produce profits which would enhance the picture of that company when the salesmen attempted to sell the shares of that company. It was also found that in some respects the activities in that company did not conform to the statements of policy. This is, as you have pointed out, related to our inspection program. It is also related to our review of the material filed by these companies with the Commission throughout the year and in revised prospectuses. The Commission has found in other instances, situations which may suggest the possibility of undue activity. However, apart from the *Managed Funds* case, there is not any other case that I can cite at the moment as to which the Commission has made a public pronouncement. At any rate, this experience that this Commission has had in part led to the development of the questionnaire to which I adverted this morning, which has now been introduced into the record, in an attempt to develop information.

I think that all of this may be related to the ambit of the resolution in the sense that at least it has been suggested that this churning or undue activity may in some way be stimulated by a desire to increase sales of the securities of the fund. To that extent it would bring us within the ambit of the resolution.

Mr. MACK. Did I understand you to say that this is a *Managed Fund* case and the only case where you found the churning of the portfolio.

Mr. COHEN. I said the *Managed Funds* case is the only one I am aware of in which the Commission has issued a public announcement discussing churning.

Mr. MACK. There are other cases that have come up before the Commission?

Mr. COHEN. There are other cases which have come to the attention of the Commission and we have looked at them. I think the word churning may be perhaps an unfortunate term in reference to those cases. Where there has been some unusual activity we have made inquiry. In most cases, it is an understandable activity related to the investment policy of the fund. Where the activity seemed to be otherwise unusual appropriate corrections have been made.

Mr. MACK. On the surface it appeared to be excessive turnover of the portfolio.

Mr. COHEN. It is difficult to respond yes or no to that question because it does have a relationship to the policy of the particular fund. One fund may have a policy of generating income as the main policy. Another may be interested in developing what are referred to as capital gains and growth. But in any event there have been some situations where it has been suggested, or it appeared, as you have said, that some inquiry should be made into the activity of that particular fund. We do this as the result of inspections and as the result of our review of the material filed with us.

Mr. MACK. The *Managed Fund* case was not revealed as the result of a routine inspection, as I recall.

Mr. NORTH. That is exactly how we ran onto it.

Mr. COHEN. Yes. The *Managed Funds* case was developed from an inspection which was then followed by more intensive investigation.

Mr. MACK. Your routine inspections, then, which are underway at the present time, look into this particular matter of excessive turnover.

Mr. COHEN. Yes, sir; they do. By the very nature of things, these inspections are affairs that take considerable time and expertise and review of complex documents. That is one of the reasons why it has been difficult for the Commission to accomplish a great many more inspections.

Mr. MACK. I certainly hope that this cycle can be reduced considerably. Eight to ten years seems to me to be a long time.

Mr. COHEN. That is a short-time goal, Mr. Chairman, I think the Commission would agree, but viewing it from our present position, an 8-year cycle seems to be a substantial improvement.

Mr. MACK. It is substantial improvement. I feel personally that it should be reduced.

Mr. CARY. I think we will join you in that and do our very best.

Mr. MACK. Mr. Cary, in connection with the promotional literature, I have a comment from Commissioner McEntire, who was before our committee several years ago:

The development of mutual funds, if kept reasonably free of abuse, may well point toward a further broadening of the base of American capitalism. At the same time, it places a great responsibility on our doorstep, for the expansion has not been accomplished without high-pressure salesmanship and the new investors to whom the mutual fund has appealed are, as a whole, somewhat inexperienced and naive as compared to those who have traditionally invested in American enterprise.

As large as the growth of mutual funds was after the war, at the time that Commissioner McEntire spoke, the growth since that time has been rather astounding. Of course, we are interested in the increasing activity of sales literature that you have at the present time, and also as to what is being done by the association, the National Association of Security Dealers, to control this.

Mr. CARY. I think on that question I would like to ask Mr. Cohen to speak.

Mr. COHEN. I think the remarks of Commissioner McEntire were based on experience of the Commission in the late forties in promotion of the sale of shares of mutual funds and other investment companies.

Beginning in about 1948, the Commission and the NASD as a joint venture undertook to examine into this entire field. It was a rather exhaustive investigation of all of the sales materials used by all companies over a period of years. After a study of these documents for approximately 2 years, the Commission, in 1950, promulgated a very elaborate statement of policy.

The statement of policy is largely an interpretation and an explanation of the antifraud provisions as they relate to the sale of investment company shares under the Securities Act of 1933 and the comparable provisions under the Investment Company Act of 1940. That statement of policy was, as I say, adopted in 1950.

With experience accumulating, it was then amended materially in 1955, based on a 5-year experience, and amended again in 1957. At the outset, the NASD undertook, by virtue of its responsibilities under the Maloney Act, and as a measure of self-regulation, to police the literature of its own members. It has a rule which provides that

literature must be submitted to that organization within 3 days of its use.

In actual practice, it requires, practically requires, all of its members to submit the material in advance of use. That material is reviewed by the NASD. If they have any problems about it, they usually come running over to our shop and we discuss it.

From time to time there are questions that have arisen under the statement of policy. The NASD has adopted and circulated widely interpretations of these provisions and explanations of their application in various circumstances. These, too, were promulgated or published after consultation with the Commission.

Even where the NASD undertakes this review, the material must also be filed with the Commission. The statute requires that it be filed within 10 days of its use. It is reviewed normally by our people in connection with their review of reports and other documents.

There are, however, a fair number of companies, and some rather large, where the distributor is not a member of the NASD, and, therefore, this self-policing arrangement does not apply. In those cases, of course, the Commission undertakes the entire process of review and examination of the materials.

I have a document here which was published by the NASD which contains the statement of policy, the interpretations they have issued, various charts and tables which have been published from time to time. I think it is a rather full document on this particular subject. If the committee wishes, I would be glad to introduce it for the record.

Mr. MACK. We would be glad to have it in our file. If it is appropriate, we will include it in the record.

Then do you have policing activity in this area where the broker-dealer is a member of the NASD?

Mr. COHEN. With respect to investment company literature?

Mr. MACK. Yes.

Mr. COHEN. Yes, we do. Our authority is not diminished by the fact that NASD is in the picture. But with respect to literature particularly, the NASD has undertaken, as a cooperative venture with the Commission, self-policing in this area in the first instance. However, this does not in anyway impair the responsibility or the authority of the Commission.

Mr. MACK. In a self-policing activity, what action does the NASD take?

Mr. COHEN. Normally, when the literature comes to that organization, it is reviewed. They have a staff that is concerned almost solely with the problem of reviewing this sales literature. If to those people there is some question under the statement of policy, they immediately indicate that the literature may not be used. Occasionally there is a suggestion that the matter be taken up with the staff of the Commission, and that is done. But the main activity is prophylactic, by preventing the use of misleading literature.

Where improper literature has been used, nevertheless, and despite these provisions of the NASD rules, that organization undertakes disciplinary action and has in many instances.

Mr. MACK. By suspension?

Mr. COHEN. By suspension, by fine, or by other sanction appropriate.

Mr. MACK. Mr. Cary, I believe you referred to this matter, and it has received some publicity in the past. That has to do with the pricing of many new issues of over-the-counter securities and the fact that before the day is over, many of these new offerings have more than doubled the price at which they were offered.

In your testimony, you went on to say:

This raises questions as to whether there are forms of manipulation in that kind of a deal. This has taken place with a number of so-called hot issues today so as to be of particular alarm to us.

Mr. LOOMIS said:

There are various practices whereby this can be artificially stimulated.

Could you tell us something about what is going on with these new issues in the over-the-counter market?

Mr. CARY. I would like to start it off and then I would like to turn to Mr. Loomis for greater detail in this area.

There have been in the past year, at least to my knowledge, a number of stock issues which have come out and moved up rapidly, indeed, on the very same day or immediately thereafter. As you say, they are referred to in the street as hot issues.

Now, as to what is underlying them, this is an area in which we believe we should make further study, if and when we obtain this appropriation. There are evidences in some instances, as Mr. Loomis has indicated, of manipulation, and in other cases there may be a possibility or, indeed, more than possibility, a likelihood, that the parties originally issuing the securities held a very substantial amount off the market in order to have a relatively thin market which would move up rapidly immediately upon the issue.

Those are two of the factors in the situation. I think perhaps Mr. Loomis could fill in other points I have not discussed.

Mr. MACK. That certainly would be a means of manipulating the market.

Mr. CARY. Very definitely. It is an aspect of manipulation, holding off great chunks of stock from the market at the time of issue. We have already had a release on this point, and I think Mr. Loomis might want to mention that to you.

Mr. MACK. Mr. Loomis, I am particularly interested in what you referred to as artificial stimulation.

Mr. LOOMIS. The device to which the chairman referred is one of these artificial devices, artificial influences, that I had in mind. Typically, these hot issue situations, as the chairman identified them, are companies which have never been in the public markets before and for which there is, therefore, no established market price.

They come to market for the first time, quite frequently in the last year or so they have been rather glamorous sounding, companies with "tronics" in their name somewhere. The public has been much interested in this type of investment and there has been a great demand for them.

In addition, the supply is generally small in the market after the offering is made. Most of the investors who acquire one of these issues do not immediately turn around and resell it, so there is not very much available for those who want to buy it.

This unbalance of supply and demand, in itself, causes a rise in the price. The device which the chairman referred to of putting some of the stock away in the accounts of the firm or its officers or the underwriter, or its partners, or others, just increases and accentuates that unbalance between supply and demand, and intensifies the tendency for the price to rise.

There are other devices, such as giving part of the stock to a broker-dealer upon condition that he will commence trading it at rising prices, and telling investors that they can have some if they will buy some more in the after-market, thus intensifying the demand for these issues.

After a study that we made, the Commission issued a release on October 23, 1959, Securities Act Release No. 4150, which discussed some of these practices and pointed out the manner in which they violated various provisions of the statute. We have a copy available for you if you would wish it.

Following that, the NASD, which had always taken an interest in this hot issue problem, or at least had done so for 10 or 12 years, undertook a restudy of their rules in the matter in consultation with the staff of the Commission, and in May of 1960 came out with a revision of their so-called free-riding interpretation which deals with this practice of withholding portions of the issue in accounts of friendly accounts or inside accounts, and much tightened their rules so that any withholding, unless the amounts are insubstantial, and not disproportionate, is now prohibited by the NASD.

I understand they have filed a large number of complaints against members, charging them with withholding portions of the issue. Fifty or so in one district, as I understand it, have been filed in recent months, disciplinary proceedings against members.

We also have some broker-dealer proceedings pending at the present time in which we charge that the market was artificially influenced by this practice. We are in hopes that the cooperative effort and work of the Commission and the association has cut down on this practice.

We have also found one or two plain manipulations in this field which we are readying for the Department of Justice.

I am told that the hot issues have not been quite so hot in the last couple of weeks, but that, in essence, has been the problem that we have been wrestling with.

Mr. MACK. You do not rely on the NASD for policing in this area, do you?

Mr. LOOMIS. No, sir. We also watch for it in broker-dealer inspections and investigations, but the NASD can be very helpful. We retain, as in the field Mr. Cohen referred to, our responsibility and jurisdiction.

Mr. MACK. I will have to interrupt the proceedings now because we have to answer a quorum call.

I might say, Mr. Chairman, that I think we can wind up our activities here in about 10 or 15 minutes after I return. But at least two members of the committee asked me or requested that I keep you here until they returned, for further questioning. I would like you to wait a few minutes after the recess, if you do not mind.

Mr. CARY. I will be glad to, sir.

Mr. MACK. The committee will stand in recess for about 15 minutes. (A short recess was taken.)

Mr. MACK. The subcommittee will be in order.

We now have a quorum present.

Mr. Cary, over the years the Securities and Exchange Commission has mentioned that they had difficulty in auditing all the brokers and dealers that were registered with them. I presume that you are still having that same problem, that is, in regard to a sufficient number of auditors. Is that correct?

Mr. CARY. Yes, sir. I would like to ask Mr. Loomis to enlarge on that.

Mr. LOOMIS. Yes, sir; we still have the same problem. I think we have succeeded in improving our coverage somewhat in recent years. The number of inspections of broker-dealers made by the Commission has increased from—it has been increasing fairly steadily—from 820 in 1955 to 1,200 in 1957, to 1,499, approximately 1,500 in 1960, and we hope to do about 1,500 in this current fiscal year. The number of broker-dealers has also been increasing somewhat over the same period, so we have difficulty in gaining, but we have been for the last few years working on a 3-year cycle, or sometimes a little less. We had hoped to be below that except for the increase in the number of broker-dealers.

I might mention the fact that our inspections are not technically an audit in the sense a certified public accountant does an audit. The purpose of our inspections is designed to determine whether the broker-dealer is complying with all of the requirements of the statutes. In addition to our inspections we have a rule requiring broker-dealers to file an annual financial report with the Commission. That rule was revised a few years ago to require substantially all of the broker-dealers to have that report certified by an independent public accountant.

So, in addition to our inspections of about a third of the population in the broker-dealer field, we get an audited financial statement once a year from substantially all of them.

Mr. MACK. Do you have an opportunity to check the audit that you receive once a year?

Mr. LOOMIS. The financial statement is examined by our accountants to make sure that it is in order and in conformity with the rules, and nothing about it suggests anything suspicious. We don't have the manpower to go back and check the accountant's work unless something looks wrong.

Mr. MACK. But you do inspect all of them?

Mr. LOOMIS. We get this audit from all of them, and we inspect now approximately 1,500 a year. That is an increase of over a third in the last few years.

Mr. MACK. With reference to the financial statement or audit that is submitted to you, the personnel in your office will check all of these statements?

Mr. LOOMIS. It is really checked twice. It is examined first by an accountant in the regional office where the broker-dealer is located, who is generally familiar with that particular business, and then we make another spot check in our office here in Washington, of the audited financial statement.

Mr. MACK. Then your inspection and audit of broker-dealers is more of an inspection than an audit?

Mr. LOOMIS. Our inspection by our inspectors is really an inspection rather than an audit in the technical sense of the term.

Mr. MACK. How long does it take you to get around to all of the broker-dealers with your inspection and audit?

Mr. LOOMIS. As I say, there is an audit every year by an accountant. As far as our inspectors are concerned, we are working toward and working now on an essentially 3-year cycle, so that on the average we would get around to everybody once every 3 years. It doesn't work out that way, because some of them we have to go into more often because they present a problem. Others, therefore, we have to let go longer. But the average is every 3 years.

Mr. MACK. What would be the problem? Would that be a violation?

Mr. LOOMIS. Well, there would be technical violations, or the firm's capital position would be close to the line. He would have just enough money. Or he would keep his books and records not very well, just well enough to get by or otherwise we would feel that he would require a little closer scrutiny than some other people.

Mr. MACK. Would it be safe to say that you put some of them on probation?

Mr. LOOMIS. In some instances something like that is done by the regional administrator. He may make them file a financial statement once a month, and in each case where there are violations, even technical ones, discovered in an inspection, we write a letter to the broker-dealer advising him of these and telling him that we expect him to correct them.

When we go back, if we find he hasn't done so, he may be in some trouble.

Mr. MACK. What help do you get from the National Association of Securities Dealers? Do they provide a similar inspection?

Mr. LOOMIS. They inspect their members. The primary purpose of their inspection is to make sure that the member is complying with the rules of the association, but they also look for violations of our statutes, and particularly for capital violations. If they find one, they inform us. We don't rely on their inspections in the sense of leaving their members to them. We also inspect their members, but we attempt to coordinate the work to the extent that we don't both arrive at the same time, or too closely together. We do, of course, get assistance from them in the sense that they are covering some of the people, too.

Mr. MACK. Then you have some cooperation from them in your own inspections.

Mr. LOOMIS. Yes, we do. We have what is known as a cooperative inspection program which is primarily designed to prevent undue duplication, and to prevent everybody's inspectors arriving at the same time.

Mr. MACK. Under your cooperative program, do you rely on them to do some of your work?

Mr. LOOMIS. No, not in essence. We think that their inspections are valuable, but we don't really think that it relieves us of our obligation to inspect their members as often as we can.

Mr. MACK. Mr. Keith, did you have any questions that you wanted to ask?

Mr. KEITH. I thought I had read something in this morning's Wall Street Journal concerning some reports that were available to the industry which might have shed some light on the problems that we are facing. They hadn't been particularly concerned with this information that was available. I wondered if there was any tie-in between that and the National Association of Securities Dealers. I have just picked up the Wall Street Journal to refresh my mind on that. Can you enlighten me?

Mr. CARY. Congressman Keith, I am familiar with the article to which you refer. I have not read it in full, that is, in detail. It may be that there is something involving the National Association of Securities Dealers there. I thought the principal thrust related itself to one stock exchange, and most specifically our private investigation of that exchange and what action that exchange was taking at the present time in the light of or, shall we say, in anticipation of our investigation. I don't recall that the discussion in the Wall Street Journal article of today bore on the NASD. It may be another article. But if you are referring to the one on the right-hand front page, I think I have described it more or less correctly. I might ask Mr. Loomis or Mr. Cohen to correct me if I have not.

Mr. LOOMIS. I have read the article in question, and I think it is accurate that there is very little reference to the National Association of Securities Dealers, which operates only in over-the-counter trading, while this article seems to be concerned with exchange trading.

Mr. KEITH. Are you satisfied that the National Association of Securities Dealers are by and large doing a good job of regulating their membership?

Mr. CARY. I have been here so briefly I would like to ask Mr. Loomis to reply to that.

Mr. LOOMIS. Well, I think that they work hard at it, and I have a great deal of respect for the organization. They have a very difficult job. As has been said of us sometimes, it could perhaps be improved. But I think they are doing the very best they can.

Mr. CARY. Of course, the purpose of this study, itself, is to see wherein there may be improvements, both from our standpoint and from their own standpoint. Therefore, it would be hard for us to make a complete generalization when, indeed, one of the functions of the study would be to, you might say, provide some testing.

Mr. KEITH. Thank you, Mr. Chairman.

Mr. MACK. Mr. Chairman, you indicated you have an investigation and study into the American Stock Exchange.

Mr. CARY. Of the rules and practices of the American Stock Exchange relating primarily to specialists. That is the general purport of the study; yes, sir.

Mr. MACK. Was that initiated because of an apparent breakdown of the self-regulation in the exchanges?

Mr. CARY. Well, of course, we are right now in the private investigation stage, and that investigation primarily stems from the case which was adverted to earlier this morning. The question we have to ask is whether or not present rules of that exchange are adequate, and/or whether or not though adequate they were adequately enforced.

I will say, just to demonstrate the shadings, we might say, that since our private investigation has been instituted, there have been several new rules promulgated by the American Stock Exchange relating to this area, which may indicate that they, themselves, would feel that certain activities of specialists require more attention.

Mr. MACK. Your investigation also is for the purpose of determining whether rules are being violated at the present time?

Mr. CARY. That is correct, whether the rules are adequate and whether the present rules, if adequate, are nevertheless being violated.

Mr. MACK. Is there any reason for not going into other exchanges to make a similar study?

Mr. CARY. Well, I will put it this way: I would say that we have a case basis for an investigation, a private investigation, of the rules and regulations relating to specialists on the American Stock Exchange. We do not at this time have a similar case basis in others. And the rules of some of the other exchanges are different than those on the American Stock Exchange. Therefore, it is our thought that with that concrete basis as a start, we ought to limit this investigation to the American Stock Exchange. It may be that, if House Joint Resolution 438 is enacted and after this private investigation has proceeded, one will want to determine on a comparable basis what the other exchanges are doing.

Mr. MACK. Then you would limit to this one investigation of this one exchange at this time until at least you completed your investigation?

Mr. CARY. Until we get well along in the one.

Mr. MACK. I noted on page 8 of your statement, and I think this will be my last question, you state:

We note that the issuers having securities registered on the National Securities Exchange are required to file with the Commission monthly, semiannual, and annual reports essentially detailing the material events which have occurred during the reporting period, including financial data, mergers, and transactions with insiders.

Would these reports today require information concerning substantial sales to various corporations, where a director has a substantial interest?

Mr. CARY. May I ask whether your reference is to sales and purchases of shares in a corporation?

Mr. MACK. I am not talking about sales, but purchasers from companies owned by directors of the corporation.

Mr. CARY. Yes. In other words, not of shares but of products or what have you from and to the corporation. The answer is, in general, yes. We have disclosure requirements in several areas: first, in respect of new registrations under the Securities Act of 1933; second, in respect of filing reports under the Securities Exchange Act of 1934 by listed corporations; finally another group of corporations, which, having once registered under the 1933 act with respect to a new issue, are required to file reports if, generally speaking, their securities, at the time of registration, exceed \$2 million.

In all of those three areas there must be reporting of transactions on the part of insiders, which include directors, officers, and major shareholders. Therefore, if, for example, these parties are making a substantial sale to the corporation or purchase from the corporation, where a material transaction is involved, it must be reported.

Mr. MACK. Do you have any authority today to deal with these conflict-of-interest cases that have been occurring, especially in recent months?

Mr. CARY. On the general conflict-of-interest question, I suppose if one can generalize, we are referring to a number of recent cases which have been reported in the press. It can be said that, in a number of filings that come through the Commission, for example, under the Securities Act of 1933, there are disclosures of some transactions between the director or officer on the one hand and the corporation on the other. Perhaps in some instances that disclosure is inadequate. We attempt to force it to be adequate. In some instances, of course, particularly when you are dealing with a large corporation, it may not be material in terms of the investor. That is, it may be small in amount, although perhaps great in principle. In some of those instances, I can conceive of the fact that a relatively minor transaction might not be reported because it was not material.

Generalizing with respect to conflict-of-interest transactions, first of all, if they are material, they must be reported. You would have a failure of disclosure, in other words a violation of the registration requirements, if they were not reported, or if they were inadequately reported. Of course, the argument frequently will be made that a particular transaction is not material enough to be reported.

I do think that our principal function at the moment in the field of conflict of interest is in bringing insider transactions to the public attention through the disclosure requirements. We have other provisions of our acts which touch upon this subject, but they are more narrow in scope than the one to which I think you have had reference.

We had, for instance, 16(b), dealing with directors and officers purchasing and selling securities on a short-swing basis. We have section 10(b), dealing with the general failure of disclosure when insiders are either purchasing or selling securities. We also have much broader supervisory provisions, I would say, under the Investment Company Act, but I am relating myself in this area to the broad disclosure area rather than the Investment Company Act alone.

Mr. MACK. Then you have authority to deal with this problem only primarily where they fail to comply with your disclosure regulations?

Mr. CARY. That is correct. And it would only cover, of course, that group of companies which register new issues under the Securities Act of 1933, or listed companies under the Securities Exchange Act of 1934.

Mr. MACK. You require these reports from all of the corporations who are listed on the exchanges?

Mr. CARY. All the corporations listed on the exchanges; correct.

Mr. MACK. And you require similar reports from all those that have securities of a class aggregating more than \$2 million?

Mr. CARY. That is correct, sir, which have issued securities under the registration requirements of the 1933 act.

Mr. MACK. In your statement, further, you say:

A large but unknown number of issues in whose securities there is a substantial public interest are not subject to these reporting requirements.

Mr. CARY. That is correct, sir. That is, that whole group, including some very large companies, indeed, which are not listed on any exchange, which have not issued any securities in recent times, so that

they are not under section 15(d), as I recall, of the 1934 act, and which, therefore, are free of any jurisdiction of the Securities and Exchange Commission.

Mr. MACK. These other corporations would come under the National Association of Securities Dealers, would they not?

Mr. CARY. Not as companies. You see, the NASD really has its jurisdiction exclusively with respect to brokers and dealers and not with respect to the companies or issuers themselves. As a consequence, I suppose the answer would be "no" to you, except that the broker and dealer might be relating himself to a particular security of a company.

Mr. MACK. Then these companies would not have to make reports to anyone?

Mr. CARY. That is correct, unless there might be a State law requirement, if it was an insurance company, pursuant to an insurance law of the State.

Mr. MACK. Mr. Chairman, I want to thank you very much for your appearance today. You have been very patient. And I want to thank your staff also.

Mr. CARY. We appreciate the opportunity to appear, Mr. Chairman. Thank you.

Mr. MACK. The committee will stand adjourned until 9:45 tomorrow morning.

(Whereupon, at 4:35 p.m., the subcommittee recessed, to reconvene at 9:45 a.m. Wednesday, June 28, 1961.)

## SECURITIES MARKETS INVESTIGATION

WEDNESDAY, JUNE 28, 1961

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCE AND FINANCE OF THE  
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room 1334, House Office Building, Hon. Peter F. Mack (chairman of the subcommittee) presiding.

Mr. MACK. The committee will come to order.

We are continuing hearings this morning on House Joint Resolution 438.

We have with us this morning the chairman of the board of governors of the National Association of Securities Dealers, Inc., Mr. William H. Claffin.

The association has membership made up of brokers and dealers who constitute participation in the over-the-counter market. This committee has been particularly concerned about attempted rigging and/or manipulation of the market and many people have indicated that the problem exists especially in the over-the-counter market.

I would say that in view of recent events that it does not appear that they have a monopoly in this area, but it is a matter with which this committee has been concerned for some time. We are especially happy and very pleased this morning to have the chairman of the board of governors of the National Association of Securities Dealers.

Mr. Claffin, we will be happy to have your testimony at this time.

**STATEMENT OF WILLIAM H. CLAFLIN III, CHAIRMAN, BOARD OF GOVERNORS, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.; ACCOMPANIED BY SAMUEL S. WHITTEMORE, MEMBER OF BOARD OF GOVERNORS AND CHAIRMAN OF THE LEGISLATION COMMITTEE; DONALD H. BURNS, ASSISTANT TO THE EXECUTIVE DIRECTOR; AND MARC A. WHITE, COUNSEL TO THE ASSOCIATION**

Mr. CLAFLIN. Thank you, Mr. Mack. I want to express my deep appreciation for being permitted to come here today and to say, indeed, it is a very rewarding experience personally to participate and I hope we can be of some assistance and make some contribution to your committee.

Mr. Chairman and members of the subcommittee, I am William H. Claffin III, of Boston, Mass., chairman of the board of governors of the National Association of Securities Dealers, Inc.

I am accompanied today by Samuel S. Whittemore, Spokane, Wash., a member of the board of governors, and chairman of the legislation committee of the association. Also with me are Donald H. Burns, assistant to the executive director, and Marc A. White, counsel to the association.

We regret that Mr. Wallace H. Fulton, executive director of the association, is unable to be with us because of a recent illness.

We are here to discuss House Joint Resolution No. 438, which would amend section 19 of the Securities Exchange Act of 1934 by adding a new subsection under which the Securities and Exchange Commission would be authorized and directed to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including the rules for disciplining members of these organizations for conduct inconsistent with just and equitable principles of trade.

The association is in favor of the resolution and the amendment to section 19 of the Securities Exchange Act of 1934. We note that the proposed amendment authorizes the Commission to make a study and investigation, and we wish to point out that we believe a study of the rules of the various exchanges and the association may well be beneficial in the light of the growth and increased activity in the securities markets and the fact that in the past 25 years there has not been time, nor available funds and personnel, for a concentrated review of the operation of these organizations and their procedures.

As to that part of the resolution which relates to the association, we question whether this appropriation would be justified merely to investigate the association's rules, or the association's enforcement procedures. We cite the following reasons:

The National Association of Securities Dealers, Inc., is the only organization in the country registered pursuant to section 15A of the Securities Exchange Act of 1934. The principal work of the association is the continuous examination and investigation of members to see that our rules, certain rules and regulations of the Securities and Exchange Commission, and certain regulations of the Board of Governors of the Federal Reserve System are being complied with by our members.

The association's rules of fair practice, adopted in compliance with section 15A of the Securities Exchange Act of 1934, constitute a code of ethics which in many areas goes beyond statutes or general rules of law in the securities field. They are directed to the public interest as well as the welfare of the securities business, and are designed to promote within our industry high standards of commercial honor and just and equitable principles of trade.

The association has previously furnished the Subcommittee on Legislative Oversight of the Interstate and Foreign Commerce Committee a history of the association and its activities from formation through the year 1958. This history was the subject of a subcommittee publication in 1959.

This publication traces the history of efforts at self-regulation by the industry from 1934 to the passage of the Maloney Act amendment in 1938 under which act the National Association of Securities Dealers was established.

As the aforementioned reprint indicates, the association performs many functions in an effort to carry out the congressional intent as expressed in the Maloney Act, but its main function is that of self-regulation of the membership by constant enforcement of its rules and certain of the rules and regulations of both the Securities and Exchange Commission and the Federal Reserve Board.

This enforcement results in complaints, disciplinary proceedings, and decisions imposing penalties of expulsion, suspension, fines, or censure. These decisions are the work of the association's 13 regional districts or so-called district business conduct committees. They are reviewed by the board of governors of the association and in turn forwarded to the Securities and Exchange Commission for their review.

In instances where a member or a registered representative feels aggrieved at a decision of the association and has exhausted his remedies within the association, he may appeal to the Securities and Exchange Commission. The Commission may, by its own action, call up the decisions for review. Of course, any person aggrieved by a Commission decision may appeal to the Federal court of appeals.

In the 3 years since the information was compiled for the subcommittee reprint, 23 cases have been appealed to the Securities and Exchange Commission. Thus, the Commission has had occasion to consider specific cases involving most of our rules and through the hearing of these cases is continuously reviewing the nature and scope of our examinations, disciplinary actions, bylaws, rules, and interpretations.

In addition to the continuous review implicit in the disciplinary area, it should be noted that the association has never put into effect a rule, interpretation, or policy until the Commission has considered the matter and determined that it will not disapprove. Any proposed changes in these would, of course, be subject to the same procedures.

In order not to remain static during the growth of the business and to meet problems and new techniques, we consult on a continuous basis with the staff of the Commission and the Commission itself. Our aims are similar: the protection of investors through integrity in our business. By achieving this, the public interest is served.

We are all aware of the great interest in securities which has marked recent months. Nor can we overlook the fact that this has been a cyclical development since the end of World War II. Statistics indicate the growth of the business itself in this period.

In 1946, the association had 2,514 member firms; in 1956 it had 3,634; and as of May 30, 1961, we had 4,586. In 1946, members had 849 branch offices; in 1956 there were 2,548; and as of May 30, 1961 there were 4,373. In 1946, 23,374 representatives were registered with the association; in 1956 we had 48,566; in May 1961 we had 93,351 registered representatives.

This rapid and constant growth has caused the association to conduct numerous studies of its own. In the last few years we have given consideration to and have had almost continuous discussions with the Division of Trading and Exchanges of the Commission relating to the improvement and modernization of our rules. Prominent in these discussions have been:

1. Improving the admission standards required of registered representatives and the adoption of a more searching and difficult examination which will require a far greater knowledge of the securities business prior to admittance.

2. Changes in the rules to provide increased monetary penalties.
3. Possibility of broadening areas of disqualification of individuals entering the business.
4. Amending and changing our methods of enforcement of the association's policy on "free-riding and withholding," which is designed to insure that those new issues which command a premium at the time of offering are sold to the public and not to insiders or used for commercial advantage.
5. Modernization of the association's 5-percent policy, which relates to the fairness of markups in dealings with customers.

We have completed some of these projects. We have also taken up many minor matters which relate to streamlining procedures when the times have indicated the necessity for change. These efforts serve to keep us well aware of the need for continuous review of problems and solutions.

For these reasons we do not believe the expenditure of money as proposed would be necessary solely to determine the adequacy or enforcement of our rules. We hope that a study of the rules of the association and those of the exchanges on an overall basis can be found to be helpful, and for this reason we are in favor of the resolution.

We assume that Congress would intend that this study go beyond the mere question of adequacy of current rules and will include consideration of present-day problems in the securities markets and those which can be envisioned in the future.

There is one other area in our business where we are studying the effects of rapid growth. Assets of mutual funds have recently passed the \$20 billion mark, and this expansion of the investment trust business has caused us to renew the emphasis on our responsibilities and activities in this field.

Much is yet to be learned about the role of variable annuities and real estate investment trusts in the securities field. What effect will electronic equipment for handling quotations and bookkeeping have on the operation of the business and the customary methods of marketing securities, and how will this affect the association's inspection of our members?

It is to all of these areas and those which may be inherent in the operation of the exchanges that we hope the study will be directed.

Our industry would not feel that I was fulfilling my trust if I did not emphasize the serious state of the present backlog of new issues waiting to be processed by the Securities and Exchange Commission. The long delays resulted from this condition dangerously impair the flow of new capital to industry.

Companies that have more immediate needs for capital are forced to find other ways of raising money, and these often are not to the best interests of the company or its public stockholders. We sincerely urge that every possible aid be given to the Commission to solve this problem and, if this study is instituted, to assure that the workload will not fall on present personnel and tend to aggravate this already serious condition.

Should you determine to proceed, we are ready and willing to cooperate in every way and are hopeful that this study will prove advantageous to the public and our industry.

On behalf of the National Association of Securities Dealers, Inc., I want to thank this committee for the opportunity afforded us to comment on House Joint Resolution No. 438.

If you will permit me, Mr. Mack, since we prepared this statement, we have had the opportunity to go through the very interesting testimony of yesterday, and I would like to add a couple of items that occurred to us or were brought to mind by that testimony.

Mr. MACK. You may proceed.

Mr. CLAFLIN. We were pleased to see in Mr. Cary's remarks that he sees a need for studying the activities of broker-dealers who are not members of any association. Our experience also indicates a need for this inclusion and we would like to heartily endorse this.

I am sure that from yesterday's discussion the problem of part-time salesmen will come up and if we can save time by commenting on it here, I would like to do so.

We have had several committees study this problem. To date we have had none of these committees find any justification for the position that the number of hours that a man works is the criterion as to his ability and value to the industry.

We continuously come up with the conclusion that the proper approach to this problem is one through further education, better training of personnel, and we are currently attacking the problem through the means of a more demanding and thorough examination. We feel that if firms will improve their educational programs, train these men better, that it will tend to solve this problem.

We also, from the point of view of the industry, would like to say that as far as the problem of growth goes, that we see both sides of this growth picture, one, as the industry increases in size and the public has greater demands for our facilities, the standard of people whom we are able to attract into the industry is raised. I am sure all our firms currently are finding a much higher caliber of man willing to come into the securities industry than was true a few years ago. This growth also attracts or makes our industry more attractive, to the undesirable elements which the NASD is well aware and I am sure the SEC is, and we are both working to the best of our abilities on that phase.

There was emphasis placed yesterday on the lack of information in the over-the-counter market. This is very correct and a problem that has been with us for a good many years, and it is still with us. It is one we are working on.

Our present approach is an attempt to form a clearing corporation which would clear securities for our members and via this route be able to assemble figures on volumes, on the range of prices during a day, change from the previous day, and so forth. I think if our attempt here is successful that it may well help to fill this void.

I and my associates are here to answer any questions that you would like to ask of us and I sincerely hope we will be able to be of assistance.

Thank you, Mr. Mack.

Mr. MACK. Now, if you established this clearing corporation that you suggested, would this not be done by amendment to your rules?

Mr. CLAFLIN. Our present thinking on that, Mr. Mack, is that we will be the promoters. We have the membership, and we feel that probably we would not end up in the picture. We would get

it started, encourage people to work on it, develop it, set up a separate corporation, and have the membership of the clearing corporation itself be the driving force and the owners. In other words, we are the promoters of a good thing rather than trying to establish a clearing corporation under our own association.

Mr. MACK. You would leave that up to your members, would you not?

Mr. CLAFLIN. As soon as we had it well on its feet, we would withdraw.

Mr. MACK. The members would operate the corporation?

Mr. CLAFLIN. Yes, sir; the members would operate it. This, of course, is in the study stage and we may be advised by the SEC that they feel we should stay in it or other suggestions may be made, but that is the way we are aimed at the moment.

Mr. MACK. You mentioned that your association is the only association operating today, is that correct?

Mr. CLAFLIN. Yes, sir; the only registered association; that is right.

Mr. MACK. And the members of your association are dealers in securities?

Mr. CLAFLIN. That is right.

Mr. MACK. Then your association includes practically all of the dealers of the country, is that correct?

Mr. CLAFLIN. I would judge from what we can see that there is somewhat in the neighborhood of 5,400 in the country of which approximately 4,600 are ours. I think the testimony yesterday covered that.

Mr. WHITE. In the statement, Mr. Claffin gave the figure of 4,586 as of May 1961, and I think Chairman Cary, yesterday, gave the figure, but I believe it is around 5,400 broker-dealers registered under the Securities and Exchange Act of 1954.

Mr. MACK. The SEC relies on your organization to do most of the policing in the over-the-counter market.

Mr. CLAFLIN. Under our rules; yes, sir.

Mr. MACK. It seems to me you rely quite heavily on your individual members to do a lot of the policing that needs to be done, is that correct?

Mr. CLAFLIN. There are two real approaches. One is to establish standards of high conduct that they can live up to and the other is a policing phase, which is like, or fairly similar to what the SEC does in conducting examinations of our membership to see that they are complying with the rules and regulations of our association, so we give them the standards and then we inspect them to see that they are living up to the standards.

Mr. MACK. Are those standards your rules?

Mr. CLAFLIN. Those are our rules, bylaws, and our interpretations of the rules.

Mr. MACK. If they did not live up to these standards, they would be subject to disciplinary action?

Mr. CLAFLIN. That is correct.

Mr. MACK. How many employees do you have in the enforcing area?

Mr. BURNS. There are approximately 30 examiners (and 3 in training) on the force throughout the country in the regional offices and also a few working out of the executive office in Washington.

Mr. MACK. That is 30 examiners who would be investigators?

Mr. BURNS. That is correct.

(The following additional information with respect to examiners was later submitted for the record:)

*Summary of examiners*

District secretaries who make examinations.....	11
Examiners in district offices.....	15
Examiners working out of executive office.....	6
Executive office examiners recently employed who are now training.....	4
Examiner in New York on 6 months' leave of absence.....	1
Vacancies (5 in New York, 2 in Chicago, and 1 in Washington, D.C.).....	8
<b>Total.....</b>	<b>45</b>

Mr. MACK. Does this not seem to be an inadequate force when you have such a tremendous number of dealers and registered representatives?

Mr. CLAFLIN. We have a similar problem to that which I assume the SEC has and that is finding qualified personnel. In our table of organization, we have authorization for about 10 more men which we are constantly seeking out. Like many organizations in this field, there is a dearth of personnel and a high demand in security houses and the like for personnel such as ours. We have lost about four of our finest men to the securities industry itself over the last year or so.

Mr. MACK. You have 4,586 dealers who are members of your association. It would seem to me that with all of these representatives it would be a tremendous load for you to carry with only 30 investigators.

Mr. CLAFLIN. I certainly have personally an enormous admiration for how hard our staff works.

I think reference to our percent of members examined would be helpful, Mr. Burns.

Mr. MACK. May I ask first if you make routine examinations of all of the members of our association?

Mr. CLAFLIN. We do. Our goal is the same as the SEC's goal of a 3-year cycle, doing a third of our members each year.

We are broken down into 13 districts. Each district handles their own examination program within their district so that each district obviously varies. Some are over the goal and some are underneath the goal.

Would you like our last year's record on examinations and percentage thereof?

(The information referred to follows:)

*Examinations for 1960-61*

Year	Main office		Branch office	
	Number	Percent of normal	Number	Percent of normal
1960.....	1,497	33.5	516	12.2
1961 (Jan. 1 to June 30).....	758	16.4	216	4.9

Mr. MACK. If you have 30 representatives, you would have difficulty making it every 3 years, would you not?

Mr. CLAFLIN. It is a question of how many problems you have.

Mr. MACK. With some of them, when you ran into a problem, you would spend more time in one location plus the fact that I presume you would find situations existing similar to the Securities and Exchange Commission, and that is you would have to have more frequent investigations of certain members of your association.

Mr. CLAFLIN. There are obviously bad boys whom we are inspecting frequently or we go back to find out if they have learned their lesson, which is really a second phase of our enforcement program which is policing the bad boys as well as our routine investigation of members.

Mr. MACK. Do you feel that your rules are sufficient to deal with the violators?

Mr. CLAFLIN. We feel we keep our rules in a state of flow, if that is the proper adjective. As we find problems that are new or coming up that we have not met before, we try to either build a rule or interpretation that will give us the authority or the ability to solve that problem, or we rewrite an existing interpretation or rule to try to fill in the niche. Obviously new problems and new ways of getting around existing regulations are being thought up all the time and we have to keep on our feet to meet the changing times.

Mr. MACK. In your annual report of 1960 you referred to the fact that 348 formal complaints were filed with the association during that year and the District Business Conduct Committees of the board expelled 36 representatives, suspended 16 members and 13 registered representatives, fined 189 members and 44 representatives, censured 152 members and 36 representatives. Your report mentions that 68 cases were appealed or called up for review by the board of governors in 1960 where you had only 1 case 5 years ago.

The number of cases that you have indicates that your 30 investigators were quite busy during that period of time.

Mr. CLAFLIN. They were.

Mr. MACK. It also confirms my feeling that, if you had additional investigators they might have found other instances where you had violations.

Mr. CLAFLIN. I am sure they would and we are diligently seeking additional personnel to add to our force to meet that void.

Mr. MACK. I asked the Chairman of the Commission yesterday the reason for the increased number of violations and I would like to have your opinion today as to why you had 68 cases this year whereas you only had 1 case 5 years ago which were appealed to the Board?

Mr. CLAFLIN. As I was not on the Board 5 years ago, I think Mr. Burns can give you the history better than I can.

Mr. WHITE. I think the history of the statistics of the association will indicate that each year since its formation the association has picked up its activity in the disciplinary area. I think you can also trace the growth with the size of the budget it had available to supervise and inspect to see that its rules were enforced.

In the last 4 years, in the period during which I have been counsel of the association, I have seen this growth and every year we have more examiners and as a result more complaints and more actions before the board of governors and I think that it is coincidental with the growth of the association's activities as well as the growth in the business.

Mr. MACK. Can you tell us how you deal with members of your association. How is the disciplinary action taken with the members of your association?

Mr. CLAFLIN. I think our counsel can probably answer that.

Mr. WHITE. The public has a right to file a complaint in any one of our district offices. If they cite one of our rules or cite a general area of complaint that would fall under our rules, we must accept that complaint and the district business conduct committees in the 13 districts throughout the United States must act upon it.

I do not know exactly what percentage of our complaints arise from public complaints, but it would be considerably less than complaints that result from our own examinations. There, an examiner brings his report into this District Business Conduct Committee, they file a complaint, then the respondent is offered an opportunity to be heard and a decision is rendered by his District Business Conduct Committee. If the respondent disagrees, he can appeal to the Board of Governors, or if the Board of Governors feel a mistake was made or the penalty was wrong at the district level, they can call for a review. Then the parties can appeal to the Securities and Exchange Commission and beyond that to the Federal courts of appeals.

Mr. MACK. These same investigators would have the responsibility for exploring or investigating complaints from the public as well as making routine inspections, is that correct?

Mr. WHITE. That is correct.

Mr. MACK. And the action is reviewed or taken actually by your District Business Conduct Committee, is that correct?

Mr. WHITE. That is right, and they are members of the business who serve pursuant to the bylaws.

Mr. MACK. These actions can be reviewed by the Board of Governors and then appealed to the Securities and Exchange Commission?

Mr. WHITE. That is correct.

Mr. MACK. Does the Commission have any jurisdiction over you or authority over you to force you to take certain disciplinary actions?

Mr. WHITE. They certainly have residual powers over us by virtue of the fact that the association is registered under a section of the Securities and Exchange Act of 1934 that confers review powers. I think in Mr. Loomis' testimony he indicated yesterday that we attempt to cooperate in this field. For example when we find a net capital violation which is a violation of a Commission rule, we immediately notify the Office of the Division of Trading and Exchange of the Commission and conversely rather than proceed on their own when a violation of one of our rules comes to their attention, they will refer the matter to us. For example, if they find a violation of our free-riding policy they would refer the matter to us and we do refer matters to them which we feel are exclusively within their jurisdiction because of an exclusive rule of the Commission which may be involved.

Mr. MACK. They have no direct means of compelling you to take disciplinary action?

Mr. WHITE. I do not think they would have to compel us. If it were in our area we would do something about it.

Mr. CLAFLIN. I think there is an additional order to that, Mr. Mack. The SEC has the right to revoke our registration if they

feel that we are not properly carrying out our duties, so from that point of view there is a watchdog clause on this.

Mr. MACK. It is very unlikely. It would have to be a serious offense before the SEC would do that.

Mr. CLAFLIN. That is right, but we are well aware of that relationship and correspondingly, if they express the opinion that we should do something, there would certainly have to be very compelling reasons not to do it.

Mr. MACK. Your association has cooperated with the Securities and Exchange Commission?

Mr. CLAFLIN. That is right.

Mr. MACK. What is the extent of your jurisdiction in the matter of disciplining your members? That is, does it pertain solely to their conduct in connection with their activities as dealers or does a member's conduct and his activities as a broker or in other fields such as manager, sponsor or adviser to an investment company bear upon his conduct within the disciplinary jurisdiction of your association?

Mr. CLAFLIN. There are several phases to that question. Perhaps the easiest one to start with is the investment trust industry. The wholesalers of investment trusts, the division of that field, are members of our association, but the managers of the funds are not. As was brought out yesterday, most funds are organized on the basis of having a management contract with the people who run the fund.

On the other side of the chart, we have the wholesaler group who sell the fund. There may be exceptions, but it is practically the rule that these two organizations are not one. The wholesaler is our member. Their wholesaling procedures, advertising and actions in general are subject to our rules, but the managers are not members of our association and we have no jurisdiction over them.

Mr. MACK. They could be members, could they not, in some instances?

Mr. CLAFLIN. Thinking from their point of view, there is no purpose.

Mr. MACK. Would you say all management companies are not members of your association? Would you say no management company is a member of your association?

Mr. CLAFLIN. There may be one or two funds which are organized differently from the normal pattern where it is all one ball of wax, but so far as the industry is concerned, it is not our problem. We cannot reach them on the handling of their portfolios.

Mr. WHITE. To be a member, they have to be a registered broker-dealer and whatever organization or group applies, has to fit the definition of a broker-dealer.

Mr. MACK. You have some broker-dealers, do you not, who are also associated with the management firms?

Mr. CLAFLIN. Are you thinking of people such as Lehman?

Mr. MACK. I am asking the question generally. I am not referring to any one firm.

Mr. CLAFLIN. Normally investment firms that start investment trusts would set up a corporation to do that and there might be commingling of personnel, but it would be a separate structure and one that is not a member of the NASD.

Mr. MACK. It would be interesting to know what disciplinary action you can take in cases of that kind?

Mr. CLAFLIN. Where there is mismanagement of portfolios?

Mr. MACK. Yes.

Mr. CLAFLIN. We have no jurisdiction, and I do not believe there is any action that we could take.

Mr. MACK. What if the individual also happened to be a member of your association? Are you powerless to expell him for something that he has done in this management area?

Mr. WHITE. The basic rule of ours, the first section of article 3 of "Fair Practice" says that—

a member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Theoretically, you can invoke that rule where you find unethical conduct and we have done it and we have many interpretations under that specific rule.

As the chairman pointed out, where we have found abuses in the industry, we have adopted interpretations under that section. This particular question you raise has not come up, and, of course, the Board has not considered it.

Mr. CLAFLIN. Whether we could take Section 1 of Article 3 and give a broad interpretation which reads, a member in the conduct of his business shall observe high standards of commercial honor and just and equitable principles of trade, just as a personal opinion, I would think that would be stretching "in the conduct of his business" to get at other businesses that he was in, but it might be possible. I am afraid perhaps we are not the association to tackle the policing of the management of funds.

Mr. MACK. I am talking about how effective your disciplining is within your own organization. It would seem to me that this is an area that should be appropriately dealt with by your organization. In other words, if a man has two business operations, one as a dealer and a member of your association who abides by your rules and regulations, but then on the other hand, is involved in an illegal activity in another business operation, it seems to me that if it is a related area, your organization should be able to take disciplinary action.

Mr. CLAFLIN. It is a very interesting point and we will explore it and see if we can do something about it.

Mr. HEMPHILL. I do not want to discuss the *Re* case here, but I would like to know what your organization has done and what plans your organization has made for future policing in view of the facts which came to light in the *Re* case.

Mr. CLAFLIN. That is an American Stock Exchange problem. I think I would be correct in saying they are not a member of our organization so we would have no jurisdiction. It is out of my area.

Mr. HEMPHILL. You do not have specialists in your organization?

Mr. CLAFLIN. They would be members of the American Stock Exchange but in most cases specialists are not registered with us because they do not do business with the public. They serve a function within the exchange itself but are not dealing with the public.

Mr. HEMPHILL. But your organization does include people who are engaged in the investment fund business?

Mr. CLAFLIN. In the distribution of investment shares, that is correct.

Mr. HEMPHILL. I asked questions yesterday of the Chairman of the Commission relative to investment fund uses. As an example, if a woman bought some stock in mutual funds from perhaps her husband's best friend, what protection does she have in the securities field today? The ordinary person down in some part of the country who does not know anything about stocks, bonds, securities, has no conception of the market or the real value. What protection does such a person have today?

Mr. CLAFLIN. I am assuming in this case that particularly the investment trust was not a proper investment for her to make and what protection does she have against making an improper investment. Is that the question?

Mr. HEMPHILL. Against being defrauded, investing in a fund that is not sound or one that has misrepresented itself, things of that nature?

Mr. CLAFLIN. There is what we call section 2 of our "Rules of Fair Practice," which requires that in recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such a customer upon the basis of the facts, if any disclosed by such customer, as to his other security holdings, financial needs, and so on.

There have been some very heartening decisions by the Securities and Exchange Commission which have helped us and that is an area where we would tackle that type of problem, which is one of misrepresentation. In other words, if it were not proper for the widow to buy that security, it would be a violation of our section 2.

Mr. HEMPHILL. This would go on down to the actual salesman who made the sale to the customer?

Mr. CLAFLIN. All registered representatives of our organization are subject to the rules and regulations and disciplinary actions under our rules and regulations.

Mr. HEMPHILL. Suppose some member of your organization hires or associates someone who is not associated with your organization; would you have responsibility for what that member did?

Mr. CLAFLIN. The member is responsible to register his sales personnel with us. He would be in violation. Were we to expel or suspend that member, the unregistered salesman probably would be named as a cause of that and thereby have the same effect of removing him from the industry.

Mr. HEMPHILL. The difficulty that purposes to me is the fact that the customer who is making the purchase has no knowledge particularly of what your organization is trying to do or what the American Stock Exchange or anyone else is trying to do. They would not have any knowledge of the expulsion. There is the fact that they happen to read the financial page of the paper which they just happen to see what their investment fund is doing that day, and some people just read the funny paper and the sports page in these days and times, and if we are not going to give some measure of protection by this legislation to the customer down the line, I think we are window dressing and not getting to the real heart of the problem. It seems to me we have passed legislation where the public thinks they are protected and they are not.

Mr. CLAFLIN. This widow in question has the right to bring her case, should she lose money through the investment, before the NASD, who would proceed in the same manner as if they instituted the proceedings.

Mr. HEMPHILL. The only way she could possibly get her money back if she lost it would be to bring a case of fraud and deceit.

Mr. CLAFLIN. That is correct.

Mr. HEMPHILL. By that time the bird who made the sale has flown the coop because that sort of individual is usually not responsible.

Mr. CLAFLIN. I think in cases of fraud that the proper place for such actions would be the courts of law. Our association is set up to promote high standards in our industry and it is really an ethical association. I do not think Congress would ever want to give us policing powers to the extent that we would be enforcing law or get into that phase of law.

Mr. HEMPHILL. I am happy that you have an organization and I am delighted that you come down here and help us, because you are the people who know the trade best, in my judgment. What we in Congress have to do is look to you people for the guidance in this very technical field.

We say a person can go in the courts in the case of a fraud. However, there may be psychological problems. Perhaps a person might not want to go into court because he would not want to admit he had been a sucker, and in the second instance, sometimes the law is slow, and sometimes it is embarrassing to the person concerned.

Our position is that of representative of the people and we have no other authority. We just represent the customer or, if we have a broker or security dealer, he is represented, too, so we have the dual obligation, but it seems to me that the customer or purchaser is the person who needs the most protection. Would you agree with that?

Mr. CLAFLIN. We are certainly very anxious to give them all the protection we can. Our approach to it is to try to weed out all of the bad apples in the barrel as far as we can spot them and get them out of our industry and set standards for our salesmen and registered representative personnel to live up to which would prevent this type of thing from happening.

Mr. GLENN. I believe you stated that not all security dealers belong to your association; is that so?

Mr. CLAFLIN. That is correct.

Mr. GLENN. Then what is the attraction or inducement for security dealers to belong to your association?

Mr. CLAFLIN. It is really a question of what they do. For instance, in the *Re* case, they are performing a function that does not deal with the public, so there would be no purpose for organizations like theirs being members of our organization. They are policed by the exchange that they work in.

There are also a number of salesmen who sell a particular fund, the wholesaler of which is not a member of ours. Therefore, our requirement of not dealing with a nonmember is of no consequence. So there is a big group there which do not belong to us because they are selling in essence one security which is issued by a nonmember.

Mr. MACK. You are referring to those companies that distribute and sell their own funds exclusively?

Mr. CLAFLIN. Their own funds, yes. Perhaps Mr. White can clarify that.

Mr. WHITE. The distributor of the fund is our member. There are various funds distributed by nonmembers and normally they are dis-

tributed by their own distributing sales force, some of the very large ones. There are various other broker-dealers who perhaps operate on an intrastate basis or by the nature of their business see no advantage to belonging to the association.

That would make up the difference between the number of our members and the number of registered broker-dealers.

Mr. GLENN. My question is what is the attraction to induce people to become members of your organization?

Mr. CLAFLIN. Section 25A reads:

No member shall deal with any nonmember broker-dealer except at the same prices for the same commissions or fees, and on the same terms and conditions, as are by such member accorded to the general public.

You can see in the primary distribution of securities you would have to belong to the NASD to participate in any primary offering.

If an investment trust is offering funds by prospectus which is the primary offering, and they are members of the NASD, no dealer can receive that concession unless he is also a member. Does that help?

Mr. GLENN. To some extent, but I am still a little vague as to why anyone would want to join an association voluntarily for the purposes of having himself policed, which is what you do.

Mr. CLAFLIN. If they are really doing business with the public and doing business with other broker-dealers who are members, they more or less have to be today to receive concessions. Many things are sold less a discount to a broker-dealer, which is his profit in the transaction. Without being a member of the NASD they are not eligible to receive that discount. They cannot be put in a wholesale position, so to speak.

Mr. GLENN. Why are they not eligible to receive that discount if they are not members?

Mr. CLAFLIN. Because it is violation of our section 25A.

Mr. GLENN. If they are not members, then it would not affect them.

Mr. CLAFLIN. If a member of the NASD is the distributor, then the nonmember cannot participate in any way other than as if he was a member of the public.

Mr. GLENN. In that situation, then, would you fine the distributor for dealing with a nonmember?

Mr. CLAFLIN. Yes, sir.

Mr. GLENN. That is under your rules and regulations?

Mr. CLAFLIN. That is right. We would police our member because he did business with a nonmember. We would have no jurisdiction over the nonmember. We have numerous cases on that, but mostly through inadvertence.

Mr. GLENN. Has it gone any further than that, say to the Securities and Exchange Commission for their approval or disapproval?

Mr. CLAFLIN. For appeal?

Mr. GLENN. Yes.

Mr. WHITE. That particular issue has not, but the rule which the Chairman of the Board was citing is section 25 of article III of our rules of fair practice.

When the association was formed and adopted these rules of fair practice, the Commission reviewed the rules and rendered the decision in which they did not disapprove of the rules.

The basic point you make goes to the advantage to joining the association, which was considered by Congress when it adopted the Maloney Act, and the advantage would be that the members must treat nonmembers as members of the public and would not give them a discount or concession; hence the advantage of joining the association.

Mr. CLAFLIN. Without section 25A we would not have any members.

Mr. GLENN. On these dealers who are not members, but make application to get in your association, what test do you apply on their applications?

Mr. BURNS. If there are no existing statutory bars which would prevent membership, we are required to accept them as members.

Mr. GLENN. Are there any you have ever turned down?

Mr. BURNS. There have been.

Mr. GLENN. For what reason?

Mr. BURNS. Because there has been an existing statutory bar.

Mr. GLENN. What are these?

Mr. WHITE. They are set forth in our bylaws or in the Securities and Exchange Act of 1934. It is a similar phrasing of disqualification. Our disqualification set forth in our bylaws relate to an officer-partner who has been the cause of an expulsion or revocation by the Commission who has been named in any way in one of those serious disciplinary matters or who has been convicted of a felony in the past 10 years involving conversion, embezzlement, or similar crimes arising out of the use of securities or funds, so if a person falls into any one of those categories set forth in our bylaws, he is not eligible for membership.

In addition, he must be transacting a securities business in the United States and/or under State law so that he is a qualified, registered broker-dealer prior to his admittance into membership and the association must admit him unless he specifically has a bar created by our bylaws.

Mr. GLENN. If he meets these requirements, then you have no other recourse than to admit him?

Mr. CLAFLIN. Yes, sir.

Mr. MACK. Can you expel him for the same reason?

Mr. CLAFLIN. Do you mean if there had been a statutory bar which had not been disclosed?

Mr. MACK. Do you use the same standard for expelling or revocation?

Mr. CLAFLIN. That is correct.

Mr. WHITE. There is a provision if anything develops after his membership, if one of these bars came into being as a result of his membership, we start membership continuance proceedings. He can argue it out at a proceeding, but if the bar existed, his membership would be canceled.

Mr. MACK. Have you ever expelled anyone for that reason?

Mr. WHITE. Yes.

Mr. GLENN. On page 5 you state you have had five projects under discussion the last few years and you say you have completed some of these projects. Which of those have you completed?

Mr. CLAFLIN. In No. 1, we are in the final stages of completing this examination. We have about 400 questions which we are now field

testing. The SEC has agreed to our making a stiffer examination, being able to use multiple-choice type questions and not having to disclose the examination prior to giving it, all of which makes for a much stronger admissions standard.

You could say that almost as far as our progress has permitted us to do it, we are in agreement there.

The changes in the rules to provide increased monetary penalties went in last June or July, which was an increase from \$500 to \$1,000 for one violation.

No. 3 is something which has been discussed numerous times and we are constantly working on it and we hope we will get some concrete results, but I would say at the moment we had not arrived on No. 3.

With regard to free riding and withholding, our new policy went into effect in April of 1960 and also our method of enforcing that is now in effect.

Also, this "modernization" as it is termed, of our 5-percent policy went into effect about a year and a quarter ago, without checking the dates, but it is in effect today, and it has not been disapproved by the Securities and Exchange Commission and it is in our manual today for our members to live up to.

Mr. GLENN. That is all, Mr. Chairman.

Mr. KEITH. I have no questions, but I would like to compliment the witness inasmuch as he comes from my home State of Massachusetts. He has done a fine job.

Mr. CURTIN. Mr. Claffin, I notice in your statement you say there is considerable time lost between the time that applications for new securities are filed with the SEC and before they approve them. What is the average lost time?

Mr. CLAFLIN. That is a question I am sure I am out of my bailiwick on. I am only one dealer who sees a few cases going in, but I think the average is up around 45 or 50 days. It actually varies tremendously with the type of problem that is before the SEC. Obviously, if it is something that had been there recently, such as a recent prospectus, and it is just a question of updating and reviewing, there is not much time involved, but with some new company that is complicated and where there is a great deal of detail to be worked over and there are new problems, then quite some time is required.

It varies in each case, but instead of being the 20 days that you could more or less count on in the old days, now it may run 45 or 50 days and you do not know when you are going to get your clearance.

Mr. CURTIN. What do you think the solution to this would be, more personnel with the SEC?

Mr. CLAFLIN. I am sure the question could be more intelligently answered by the SEC, but I would just assume if they had the adequate personnel they could process the increased volume of prospectuses in the old traditional 20-day period. I assume that it is personnel. I, of course, am not associated with the SEC.

Mr. CURTIN. You say that you now have 93,351 representatives in your association.

Mr. CLAFLIN. Yes, sir.

Mr. CURTIN. How many of those are working part time?

Mr. CLAFLIN. We have a study on that. It is about 22,500 or nearly 30 percent of the 93,351 so far. That was the last count. Those are part time.

Mr. CURTIN. Are these new representatives, or salesmen, given any course of training before they are turned loose on the public?

Mr. CLAFLIN. That, of course, varies with each individual firm, of which we have some 4,600. Each one obviously trains his own registered representatives. They have to, according to our rules, either have been in the securities business 1 year or take our exam.

Mr. CURTIN. You do give an examination?

Mr. CLAFLIN. Yes, sir; and that is why we have been so anxious to tighten up our exam procedures and make it tougher and more difficult to pass and require greater knowledge.

Mr. CURTIN. That is all, Mr. Chairman. Thank you.

Mr. MACK. Your association is run by the board of governors?

Mr. CLAFLIN. That is correct.

Mr. MACK. As a member of the board of governors, you serve without compensation?

Mr. CLAFLIN. That is correct.

Mr. MACK. Thank you very much.

We have an executive session scheduled for this hour and, if convenient, we would like for you to return at 1:30.

Mr. CLAFLIN. We would be very pleased to.

Mr. MACK. The committee will stand in recess until 1:30.

(Whereupon, at 11 a.m. the subcommittee recessed, to reconvene at 1:30 p.m. the same day.)

AFTER RECESS

(The subcommittee reconvened at 1:45 p.m., Hon. Peter F. Mack, chairman of the subcommittee, presiding.)

Mr. MACK. The subcommittee will come to order, please.

When we adjourned at noon I had just inquired about your association with the National Association of Securities Dealers. The board of governors are the ones who run the national association; is that not correct?

**STATEMENT OF WILLIAM H. CLAFLIN III, CHAIRMAN, BOARD OF GOVERNORS, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. (ACCOMPANIED BY SAMUEL S. WHITTEMORE, MEMBER, BOARD OF GOVERNORS, AND CHAIRMAN, LEGISLATION COMMITTEE; DONALD H. BURNS, ASSISTANT TO THE EXECUTIVE DIRECTOR; AND MARC A. WHITE, COUNSEL TO THE ASSOCIATION)—**

Resumed

Mr. CLAFLIN. That is correct. They are the policymaking board.

Mr. MACK. And I presume that the board of governors are elected by all of the member dealers; is that correct?

Mr. CLAFLIN. They come from each of the 13 districts. The number varies with the number of dealers in the districts and they are elected by the districts. They are proposed by a nominating committee in the usual manner.

Mr. MACK. Is this election at a convention or is it just the solicitation of votes from the members of the association?

Mr. BURNS. Annually, the district committee in the respective districts will appoint a nominating committee, composed of members who are not members of the district committee. That nominating commit-

tee will name a candidate for the office of the board of governors and also for any vacancies which may arise on the district committee. Those names are submitted to the full membership in that district, and if there is not an opposition slate within 20 days they are considered to be duly elected.

Mr. MACK. This committee has the same responsibility in the district that the board of governors has in the entire country?

Mr. BURNS. That is right, and they are elected in a similar manner.

Mr. MACK. In your financial statement, I notice that the amount of money you spent in 1960 for complaints and investigations, travel and transcripts, was \$109,000. Is that the entire amount that your organization spent for investigations concerning irregularities of violations of the rules of your organization?

Mr. WHITE. Mr. Chairman, in addition to that figure, you will notice under the heading "Income, finance and costs," a good portion of that total figure of \$112,000 would also go into this general area of administration of complaints, proceedings, and so forth.

In some cases we assess costs against the respondents; in other cases we absorb costs ourselves, depending upon the conclusion of the cases. But both of those figures or almost the total of the expense item and the income item would go into the area of complaints.

Mr. CLAFLIN. It should be pointed out that most of the investigations are done by the district offices. You will see a sum of \$430,000 there for the operation of those offices. The primary function of those is performing investigations of the nature you are speaking of.

Mr. MACK. Let's clear that up. Do you have separate appropriations for your district offices?

Mr. CLAFLIN. That is right. You see, the salaries of our 13 district secretaries and—

Mr. MACK. Then this financial statement does not accurately reflect the expenses of your association.

Mr. CLAFLIN. Well, the primary function of these district offices is making the investigations and inspections of our members, and they have a budget of their own.

Mr. MACK. Then you incorrectly answered the question I raised before, and that was whether this \$109,000 included all of the money that you spent for complaints and investigations.

Mr. WHITE. I think what I attempted to say, Mr. Chairman, was that items of out-of-pocket expenses in connection with those, such as transcripts, moving our examiners as witnesses, those items were in there, but in each district we have a district secretary and he is the principal authority in that district for making examinations, coordinating this complaint procedure for the volunteer businessmen who sit on the committees. So that 90 percent of his duties are in the complaint area.

Mr. MACK. Then what we should do is add the expenses of the district offices to the complaints and investigating figure, including the travel and transcripts, to get the amount of money that has been spent in 1960?

Mr. CLAFLIN. That would be fairly close; yes, sir.

(Mr. Claffin later submitted the following additional information:)

Approximately \$1,028,000 of expenses for the fiscal year ended September 30, 1960, were incurred in connection with complaints and investigations and enforcement of the rules of fair practice. This amount represents allocations of

salaries and other expenses determined on the basis of estimates of time and expenses devoted to investigations and enforcement of the rules of fair practice. The balance of expenses for the fiscal year (\$604,560) includes for the most part, printing and distributing the association's manual and other publications and notices, administration of the qualification examination for new registered representatives and all other general administrative expenses.

Mr. MACK. And that is for the year ending September 30, 1960.

Mr. CLAFLIN. Yes, sir.

Mr. MACK. Then your fines and costs as a result of these investigations came to \$112,000?

Mr. CLAFLIN. That is right.

Mr. MACK. Mr. Curtin.

Mr. CURTIN. I have just an additional question or two, Mr. Chairman.

Mr. Clafin, the problem that has intrigued me for a long time is these over-the-counter transactions. As I understand it, stocks on the exchanges when sold, are sort of in the form of an auction. But when a sale is made over the counter, one purchaser can place an order for a particular security and pay one price and someone else can get in touch with his broker and buy the same security at exactly the same moment for a point or two above or below what the first purchaser would pay; is that correct?

Mr. CLAFLIN. One is a buy order and the other is a sell order?

Mr. CURTIN. No. Suppose I wanted to buy stock X, and I called my broker and said I wanted to buy it and he said it was 65, and I bought it at 65. But at the identical moment, some other person wanting to buy stock X called his broker and might have to pay 66 or 64; is that correct? Could that happen in over-the-counter transactions?

Mr. CLAFLIN. It is a two-way market in the over-the-counter market. There are firms, brokerage offices, that make markets. So in attempting to execute an order, he would go to a house that made a market in this stock. He would give you a market, say, of 64 to 65. You might try another two or three firms that make markets and find some bidding  $63\frac{1}{2}$ - $64\frac{1}{2}$ , making slightly different markets.

One of your functions in executing that order for your customer is to seek out the best market, and then execute to his best advantage. So if you found the best offering as  $64\frac{1}{2}$ , you would go back to that broker and buy, say, 100 shares at  $64\frac{1}{2}$ .

Somebody on the west coast might be doing the same thing, and might go into four or five houses, and could find slightly different conditions out there, and might buy slightly cheaper or might buy at slightly more expense, because they might be dealing with different firms.

Mr. CURTIN. So it would be possible for the same stock to be sold at different prices in different sections, or even in the same section, to different purchasers, in an over-the-counter deal?

Mr. CLAFLIN. Yes, it is possible, but because of the national nature of most of these markets, made by big wire houses, mainly, the market often is emanating from New York, even if the order is on the west coast or down in Florida or in Boston. So they are making the same market all over the country.

Mr. CURTIN. Is that same divergence possible on the exchange?

Mr. CLAFLIN. It is possible what you say, that someone could pay a different price on the west coast than they do on the east coast at one particular time.

Mr. CURTIN. Did you say it is possible?

Mr. CLAFLIN. On the exchanges?

Mr. CURTIN. It is possible on the exchanges?

Mr. CLAFLIN. Well, on the exchange you match orders, so to speak, and it is not a quoted market but it is an actual bid-and-asked between brokers who are representing customers with the specialist having a function in there of trying to improve that market where possible and executing orders for other brokers; in other words, handling them on the post.

Theoretically, you would end up with only one seller. If United States Steel sells at 82, and 100 shares are sold, there is only one fellow who sold 100 shares at 82. The west coast order may come in, a similar buy order, say, and he may pay one-eighth more or he may pay the same price. He may have to wait until an order on the other side of the market comes in and the two of them get together and agree on a price.

Mr. CURTIN. Do you think that something should be done to make the price more even on over-the-counter transactions, or don't you think that is necessary?

Mr. CLAFLIN. I am not too sure of what you could do to make it even. Very often, you take some of these firms making very big markets, their markets may be 1,000, 2,000, 3,000 shares on a market that is 16 to a quarter, and if they are making the best market, a fellow from California can come in and buy 100 shares at a quarter and a fellow from Boston come in and buy 100 shares at a quarter and it will not budge the market a bit. It will stay right there.

Mr. CURTIN. Does your association do anything toward stabilizing these markets in any way?

Mr. CLAFLIN. Well, as far as stabilizing the markets goes, I would say we do not. The markets really move because of the—

Mr. CURTIN. Supply and demand?

Mr. CLAFLIN. Or more buy orders than sell orders will move it up and more sell orders than buy orders will move it down, because actually the brokers are positioning the other side of the customer's order. Once he has bought 400 or 500 shares at a price, he wants to pull down and he is not quite so anxious to buy any more stock at that price, so that tends to move the prices down.

As that is the flow involved in this picture, I do not know if you tried to regulate it whether you might not do more damage to the market than good. I may have just served to confuse you. Have I?

Mr. MACK. I was wondering if you people are doing anything in regard to quotations which would accurately reflect the sales of the various stocks.

Mr. CLAFLIN. Our quotations are not quotations of sales similar to what you have on the New York Stock Exchange or the American Exchange, or the exchanges in general. There they are publishing actual prices. The "close" is the actual last sale made on that particular exchange.

We have no mechanism for knowing whether somebody bought or sold 100 shares in Texas or Colorado or what the last sale was. There is no central point at which this is assembled. So our service comes

from assembling quotations as of a specified time, and we work on the basis of assembling actual bids on the securities and publishing them with what is loosely called a balloon, I think is the term, on the offering side. But we are working our quotes off of the bid side of the market.

Mr. HEMPHILL. Could I ask a question at that point?

Is it possible today on your existing laws and regulations for a group of stockholders to get together and indicate such a strong demand for a certain stock that they could run it up out of its proportionate value, line it up in large quantities?

Mr. CLAFLIN. If the question is, Is it possible to manipulate securities, the answer is obviously "Yes." The normal over-the-counter market is not made up of broker-dealers buying for their own accounts, so to speak, in the market. The impetus is coming from the public.

A public order comes in to either buy or sell and it affects the over-the-counter market. Dealers trade amongst themselves to cover their positions, obviously. If they get too much stock that they have purchased, they may want to pass it off to two or three other brokers who haven't got as much as they would like, so there is that interchange.

But normally, what you are speaking of is not a normal operation in the over-the-counter market of four or five brokers getting together and saying, "This stock looks too cheap. Let's move it up."

Mr. HEMPHILL. Wouldn't demand for it have a natural tendency to move it up, if there was a great demand?

Mr. CLAFLIN. That is right, but the demand in normal operation would come from members of the public.

Mr. HEMPHILL. Because actually the price which is quoted, the price which is paid, all of it depends on one item: confidence, does it not basically?

Mr. CLAFLIN. The price depends on confidence?

Mr. HEMPHILL. On the confidence that the purchasers in general have in that particular stock.

Mr. CLAFLIN. That is right; yes.

Mr. HEMPHILL. And, of course, the corporate background of the stock. What I was thinking was if four or five brokerage houses got together and decided that they wanted to run up the price of some particular stock, I do not see anything to keep them from doing it if they wanted to go into the market to make the demand. It is perfectly legitimate, is it not?

Mr. WHITE. If your question is directed to manipulation where we can find that they have created a public demand by high-pressure tactics of selling and they, in turn, dominate the market, control the market themselves, we put people like that out of business. We have last year and the year before. If we can show they really dominate the market and their selling techniques are designed to artificially raise this price, and there is no reason for it, we have held that is manipulation under our rules and quite often we invoke the 5 percent policy we have because they are using as a base a cost that we quarrel with.

A lot of those cases have eventuated in expulsions, which are a matter of public record.

Mr. HEMPHILL. Suppose he is not a member of your association. Can you still put him out of business?

Mr. WHITE. We have no jurisdiction over him. The Securities and Exchange Commission has cases under their antimanipulation rules similar to that, and they revoke the registration of the broker-dealer.

Mr. HEMPHILL. But unless someone gave away a confidence, if the agreement was in confidence among the—I don't want to say conspirators, as I do not like to type people with names, but if there was some sort of conspiracy to create the demand, 9 times out of 10 unless somebody talked on the thing you would not know it, would you, or would you know it by the demand?

Mr. WHITE. If it were a very subtle arrangement, it would probably be difficult to uncover. But if it were accompanied by what we term "boilershop" or "buckethouse" technique, that in itself would give you an indication to look into it and you would probably then discover it.

Mr. HEMPHILL. And then you could kick them out of your association?

Mr. WHITE. Yes.

Mr. HEMPHILL. But you cannot put them out of the business in the sense that you would keep them from doing more business. That is up to the SEC.

Mr. WHITE. That is right.

Mr. HEMPHILL. Thank you.

Mr. MACK. Reference has been made to a statement of policy worked out by your association covering the distribution of investment company shares. Your report last year indicated that there were some 8,200 pieces of literature reviewed, and 5,200 required some sort of corrective action. Just how effective is that statement of policy?

M. CLAFLIN. Is the question as to whether we think the statement of policy is effective or whether our enforcement of it is effective, or both?

Mr. MACK. It would seem to me that if you had an effective statement of policy, wasn't the statement of policy issued for the purpose of maintaining some minimum standards for information in this literature?

Mr. WHITE. The statement of policy, which is in our manual and administered by us for our members, was adopted by the SEC as a guide to people preparing sales literature in the area of investment trusts. They are supposed to conform to that. I would think it has been very effective.

The indication of the number of comments we have had to make on material submitted to us, I think, just indicates the difficulty people have with the English language. The rules require them to file the literature they use with us 3 days after its use, but as a practical matter they file the material they propose to use prior to its being used. Then our investment company committee in our national office reviews that material to see whether it conforms to the statement. Then if it does not, they write them or telephone them and suggest ways that they can amend the literature or the statements they have made to conform.

Generally—in fact our experience has indicated that they just amend it to conform to our comments. If they should use it without conforming, or what have you, we have taken disciplinary action and we have also, when we found out they used something which they have

not submitted and we naturally have not had a chance to review it, and we found out about it, we have made them withdraw it and destroy it.

Mr. MACK. Your statement of policy would permit them to use the literature for 3 days?

Mr. WHITE. That is correct. But as a practical matter, they run it through our office as a preventive measure.

Mr. MACK. Then would you say that all of the literature being used has conformed with your statement of policy?

Mr. WHITE. I would say that the literature used by our members, by and large, complies, because we have various, from time to time, disciplinary cases involving a violation of this, but they are not among the most frequent of the violations we find.

One of the specific items every examiner looks for is for a file on literature dealing with mutual funds. So I would not say that the incidence of violation is high, which would indicate that the compliance is high. I think the reason it is high is because they submit the material in advance.

Mr. MACK. Do you have any information concerning the amount of literature used which did not comply with your standards, with your statement of policy?

Mr. WHITE. Our complaint statistics, if broken down, which we could do, would indicate the number of complaints which contained an item of violation of the statement of policy. As I say, out of, say, 300 complaints, for example, I do not think we would have 10 that would involve this violation.

I think the general impression we get is that there is compliance with it. I think that the statistics on the complaints would show that, and the examinations, because our examinations have a specific item in them that our examiners must check, that he has reviewed the literature and whether or not he has found violations.

Mr. MACK. What type of procedure do you have for reviewing this literature?

Mr. WHITE. Well, we have a staff in our Washington office composed of the secretary of this committee and two assistant secretaries, as well as other clerical help who review all the material. Generally it is submitted annually by these distributors of funds. It is material that they use for a period of time without making changes.

Those individuals go over every piece of literature. Of course, they get acquainted with the company and their methods of sales and the kinds of charts they want to use, and that sort of thing.

Mr. MACK. It seems to me that if your statement of policy is effective there would be no need for all of this corrective action. In three-fourths of the cases you seem to need corrective action. Therefore, it would seem to me that they do not understand or do not care to adhere to the statement.

Mr. CLAFLIN. A great many of these 5,200 items that they mention here are extremely minor, often just phraseologies, "Don't use the word 'within,' use 'in,' because it might possibly mislead somebody."

Actually, there is a phrase called "nitpicking." You might call it that. But they want to be sure that they are not misleading anyone. If we see anything, even the slightest thing, we send it back, because a member usually does not care if we change it or not, as long as it is in compliance. So these are not major errors that we find. Many of them are very minor.

Mr. MACK. You have established a 5-percent markup policy, which has been discussed here today.

Mr. CLAFLIN. I am sorry?

Mr. MACK. The National Association of Securities Dealers has established, I understand, a 5-percent markup policy.

Mr. CLAFLIN. That has been in effect for a good many years, since 1943. It has been rewritten also several times, the most recent one being December 15, 1960. I may have mislead you by giving the inference that we had just put this into effect.

What I meant was that it had been reviewed, modernized, changed, so that it met the modern times.

Mr. MACK. It has been officially adopted by your association; isn't that correct?

Mr. CLAFLIN. Yes, since 1943, and actually in concept it has not been changed materially.

Mr. MACK. You exert some effort in encouraging your members to live up to this policy; is that right?

Mr. CLAFLIN. It is one of the major things that we look for in our examinations. In fact, we have a normal procedure which would be to take off a list of principal transactions, normally consecutive, and actually compute the percentage markup on those trades. That is the way we would review it.

Mr. MACK. Does this policy apply to the investment company or investment trust?

Mr. CLAFLIN. It does not apply to, generally speaking, primary market operations which are subject to prospectus. The investment trusts, of course, are all offered by prospectus only, which is filed with the SEC, and the markups are disclosed in that prospectus available to the public. We do not police prospectuses.

Mr. MACK. Then it is over 5 percent in those cases?

Mr. CLAFLIN. In the investment trust field their charge normally is in excess of 5 percent.

Mr. MACK. Why is there a greater charge for the mutuals than for your other business?

Mr. CLAFLIN. I would like to have the investment trust field answer that question as I am again talking on someone else's industry. I think one of the theories in back of it is that the size purchase in an investment trust is apt to be smaller than in an over-the-counter transaction or an individual security transaction.

There is also the promotional effort that they put into selling their trusts, which may or may not be a legitimate item, to consider I mean. Also, there is the normal structure of a wholesaler as well as a retailer. That is an expensive item that has to be supported.

Mr. MACK. Have you instituted a similar policy in regard to these trusts and mutuals?

Mr. CLAFLIN. Do we have any authority?

Mr. MACK. Would you have the authority to institute a similar policy in regard to the investment trusts?

Mr. CLAFLIN. Well, we have no authority over the markup or charge made on securities that are offered by prospectus. That is in the realm of the SEC, I believe.

Mr. WHITE. And it is my understanding that the Investment Company Act contains a maximum of 9 percent as to contractual plans.

This has tended to hold sales charges on regular purchases to something below that figure,  $7\frac{1}{2}$  to  $8\frac{3}{4}$  percent. I think that there would have to be a change in the law or certainly a concerted effort acceptable to the Securities and Exchange Commission before that area could be looked into.

Mr. MACK. I understand that that is the case, that there is a maximum of 9 percent in the law, and that in the case of the investment companies' mutual shares that they are, in most instances, right up to the line charging the 9 percent. I was concerned about this.

It seems to me that if a 5-percent markup is adequate in other areas, even in cases where they have a smaller investment or small investments, that these others might fall in the same category. Is that not true, that they are charging 9 percent?

Mr. CLAFLIN. I would say it ranged  $7\frac{1}{2}$  to  $8\frac{3}{4}$  percent.

Mr. MACK. I noticed that you have been concerned about the dealer misuse of customers' funds, and I think you have recently issued a revised interpretation seeking to prevent the misuse of customers' funds where dealers have been paid by customers but delay forwarding payment to the underwriters. If that is true, what need was there for this interpretation?

Mr. CLAFLIN. I think what you are referring to is what we call our prompt-payment rule, which we put out because we found that dealers were slow in forwarding funds from the retailer, retailing dealer, to the wholesale dealer. There were occasions where this delay we felt was unnecessary and possibly the use of the customers' funds unwarranted.

We put this out to alert and warn the members that we would police this, and that they had an obligation to forward these funds promptly.

Mr. MACK. Have you been successful in dealing with this problem?

Mr. CLAFLIN. We had certain people in mind when we rewrote this that were, we thought, cheating a little, or however you want to call it, and our investigations, as we go back to these people, would indicate that they have taken the warning to heart.

Mr. MACK. As a matter of fact, isn't this rather extensive in your business?

Mr. CLAFLIN. Wasn't it an extensive practice?

Mr. MACK. Yes.

Mr. CLAFLIN. I think there may have been a certain amount of sloppy bookkeeping and slowness in processing this. I think the intentional use or delay of funds which the firm in question would be able to use on the way through, if you want to put it that way, there was not too much of that, but there was some, and it also served to improve the prompt payment of some of our more slow-accounting members. That I know of, we haven't a case in front of us at the moment on that.

Mr. MACK. Recently you sent a letter to your members concerning the \$1,400 million in fails. That seems to be a tremendous amount of money involved. What is the meaning or significance of this?

Mr. CLAFLIN. Well, actually your fail position is an index of the volume of business and also how current you are in staying up, or your back office is, in staying up with the activity. When you get periods of excess activity, such as we have had in the first part of this

year, it puts an extreme burden on your back office personnel to keep up with that activity.

We believe from our investigations and questionnaires and so forth that the industry has fallen behind in its daily work, which is reflected in this increase in the fail figure that you speak of. What we were doing about it was in essence calling it to the attention of all these broker-dealers so that they would put additional emphasis on it, be cognizant of it.

Also, we strongly urged the closing on the day before Memorial Day, to use that day to spend a day catching up on the back work. These situations usually get ironed out, as we have seen in recent days. The activity has been dropping off here and the volume has gone down, which should correct this situation that we were looking at in this high fail period. Also, we go back to the clearing house approach which we feel if we had it in existence would have been able to cut down this problem materially.

Mr. MACK. You have had a lot of difficulty in recent months or years with hot issues. People have had quite a lot to say about that. What have you done in these cases, for instance where the price by the underwriter is \$5 and they increased to \$10 or \$20 by the time the first day is over?

Mr. CLAFLIN. Our approach to this free riding and withholding problem is by our interpretation with respect to freeriding and withholding. It is quite a long interpretation, so I will not read it.

But the point of it is to make sure that securities are not withheld from the public and go to legitimate accounts with investment practice, and are not used for commercial bribery purposes; also, that the amounts that are placed in insider accounts are not disproportionate or substantial.

It is very complicated, but we police it, and it is the cause of a great many of our complaints, where we feel a member has placed too high a percentage of his allotment in the hands of insider accounts, where possibly he has retained part in his own firm account and has not offered it to the public, and also where allotments have been made to people in the buying department of institutions who do not have investment histories, and the like, with the member.

Mr. MACK. Do you investigate these cases on your own motion, or do you rely on routine inspections of the dealer?

Mr. CLAFLIN. We have two approaches to it. One is through our normal investigations that go on daily. The other is via the route of questionnaires which we send out on particular securities. These are authorized by the executive committee, selected from a list.

We do not send questionnaires out on all of them. It would be too burdensome. But we select them. And then, on the basis of the results of these questionnaires, which are designed to ask the questions as to what percentage was allotted to insiders and how many had investment histories—it is that type of questionnaire.

Mr. MACK. In effect, you are asking them in the questionnaire whether they are being good boys?

Mr. CLAFLIN. That is right.

Mr. MACK. And you are relying on their word to tell you whether they have manipulated or attempted to manipulate the stock?

Mr. CLAFLIN. It isn't quite that blatant because we do inspect these firms quite frequently. If we found that they did not answer one of these questionnaires correctly, I am not sure it would be automatic expulsion, but it would be very close to same.

Mr. MACK. Would you tell me how many cases you have under investigation at the present time, concerning manipulation or artificial stimulation in these instances?

Mr. WHITE. There are two areas you are discussing, one being the enforcement of our own interpretation. At the moment, in 1961, we have picked out 33 issues which have been the subject of questionnaires. We sent out 1,600 questionnaires to underwriters and selling groups in those 33 issues. Because there is a certain amount of disclosure of where these securities go in the first instance, we can check up on the surface accuracy of these questionnaires when they come in. There are some 35 questions on those. We ask not only ones which would point to a violation of our own interpretation, but which would point to other areas we might want to send an examiner out to look at.

(The following table was submitted for the record by Mr. White:)

*Total number of "hot issues" and questionnaires investigated for the period of 1956 through March 1961*

Year	Number of issues	Number of questionnaires sent
1956.....	3	817
1957.....	3	411
1958.....	10	1,890
1959.....	34	1,016
1960.....	50	1,872
1961.....	33	1,618
Total.....	133	7,624

Mr. WHITE. When we find that on the face of it there appears to be a violation of the interpretation, those questionnaires are referred to the district where the member's principal office is located. We have had in the past 2 years, I would say, a third of all of our disciplinary cases which have arisen in this area. As a result of that activity in 1960, we put into effect a revised interpretation which strengthens and buttons up a lot of loopholes, and we find up until this last batch of questionnaires which have gone out, that we think it has been of great help. On the manipulation end of it, we have had several cases which perhaps could be interpreted as manipulation, but instead we have found it a violation of the free-riding interpretation, rather than go into the manipulation aspect. However, we have inserted in our manual the Commission's staff study in that area. But we don't have any specific free-riding cases where we allege manipulation as such.

We have alleged a violation of our interpretation, because the securities either were withheld from the public or they were sold to other broker-dealers or sold to insiders who did not have investment histories to justify the purchase, or in amounts which were disproportionate or substantial.

Mr. MACK. There would be no question, though, about artificial stimulation being a manipulation of a stock?

Mr. WHITE. Do you mean artificial stimulation at the time of the offering or thereafter?

Mr. MACK. I would presume at the time of the offering.

Mr. WHITE. Certainly if we could prove that, we would take action on it, if not under the interpretation, then under the rules of fair practice.

Mr. MACK. At the same time, do you investigate tie-in sales, or is that more difficult to investigate?

Mr. CLAFLIN. Usually you have to be tipped on tie-in sales. In other words, you have to have somebody who tells you that it is tied in. So it is apt to come in from a complaint from a member of the public. But just going in and looking at the records, unless you have been warned, you would have quite a bit of difficulty picking it up in a routine examination. It is a hard thing to catch someone at.

Mr. MACK. What has been your experience with the tie-in sales? Have you had quite a few complaints or tips concerning the tie-in sales which you have investigated?

Mr. CLAFLIN. Actually, I don't know that we have a case on that.

Mr. WHITE. We have no case on it. My knowledge of it stems from conversations or the newspapers. By that I don't mean that it probably doesn't exist, but I have no personal knowledge of it.

Mr. MACK. The people in the industry generally are acquainted with the procedure involved, and it seems to be a practice in the industry, but I conclude that your investigations haven't been successful in proving a case.

Mr. WHITE. In that particular area, we do not have a case as yet.

Mr. MACK. Could I ask if your investigators in these cases—and we have referred to the hot issues—if the investigators would be out of your central office or do you generally rely on sending the information to your district office and turning the matter over to them?

Mr. WHITE. On that score, normally the district office would handle it. We have had various instances where we have found violations or any given violations, free riding or otherwise, in a particular area, and we will then supplement the staff in the district with examiners from the national office. While they are from this office, they are continually traveling around the country, and we move them from place to place as the need arises. So in that particular instance, if we had some information that it came out of our New York office or Washington office, which indicated some manipulation, we might send special individuals who were more competent in that area to another district.

Mr. MACK. What have you done about cases where the underwriter or the dealer has reserved blocks of stocks for favored customers?

Mr. CLAFLIN. For favorite customers or just reserved it and not offered it?

Mr. MACK. No; for favored customers, with the understanding that the price of the stock would increase and they could unload it at a very early date.

Mr. WHITE. At the present time, the interpretation covers that and they would not be able to withhold part of the public offering for placing with other broker-dealers or friends or insiders of other broker-dealers. That was one of the great areas we did not cover in the old interpretation.

The one in effect now specifically covers that. The Board looked upon that activity as unethical. Now the interpretation covers that. We specifically have covered the area even if it is disclosed. It still must meet the terms of the interpretation.

Mr. MACK. Then you amended your rules to cover this matter?

Mr. CLAFLIN. Our interpretation, yes.

Mr. MACK. What has been your experience with that? Does that not exist today? Do you have cases under investigation where this has been done?

Mr. CLAFLIN. Well, actually that became effective on April 1, 1960, so that a great many of the cases that we have been receiving in the last 6 or 8 months, of course, have been under the old interpretation. We are just now beginning to get cases arising from our new interpretation.

Mr. MACK. It has been in effect for a year?

Mr. CLAFLIN. I think in our examinations we are finding that this has closed many of these loopholes and stopped the practices.

Mr. WHITE. That is correct.

We saw a practice arising even when we put this interpretation into effect, where certain issuers were disclosing an arrangement to allot to insiders, and there was some understanding that this didn't cover it. The language of this covers that arrangement and we have so reaffirmed it, the Board has. So we saw that avenue and we have that covered.

I think that the situation so far is that the number of complaints is going to reduce principally because a lot of the members after reading this have decided they will not sell to insiders or other broker-dealers at all, which is a business decision of theirs. That is the indication we see. We haven't had enough experience with actual examinations yet to know whether the high number of these complaints is going to continue.

Mr. MACK. You probably wouldn't have a complaint if it was offered to a favored customer.

Mr. CLAFLIN. If this favored customer is a member of the public, our interpretation does not cover members of the public. What we are trying to cover is withholding, not offering, to members of the public, or using your stock for commercial bribery and other purposes of that nature, or keeping it yourself. But if it was sold to a member of the public who was not an insider, who was not connected with a financial institution, the sale would be considered all right.

Mr. MACK. Then you have no rule to prohibit any sales to favored customers?

Mr. CLAFLIN. That is correct, as long as they are members of the public.

Mr. MACK. And not insiders?

Mr. CLAFLIN. That is correct.

Mr. HEMPHILL. It occurs to me that you have to have some favored customers to keep up the business, wouldn't you? As a lawyer, if a fellow gives me all of his business, when he calls me on the telephone, I drop everything and attend to his business. I don't see anything unethical in having a favored customer. He is paying the same fee, I suppose, that everybody else is paying. There is no lack of ethics there as long as he is not being defrauded. He would probably have

you on the lookout for good things, would he not? I know if I was a favored customer, I would expect you to be looking out for me.

Mr. CLAFLIN. That is right, and although I haven't given it any thought, I would think superficially that a distribution that was in relation to the business done by a customer during the year would be perfectly sound. If a man is a little customer in your shop, you would probably give him a little allocation, and if a man was a big customer of yours, you would reflect that in your allocation.

Mr. HEMPHILL. If you had some bank stock that you got hold of and you knew John Doaks down the street was a good customer of yours and would like to have some, there is nothing wrong with phoning him and telling him "I have what you want." That keeps his business.

Mr. CLAFLIN. This is really aimed at where a broker-dealer withholds, either by putting in insider accounts or even just straight withholding in the firm account, to make an additional compensation in a new issue because he feels it is going up. He makes the profit instead of giving it to the customer. Or the other side of it, where you put it out to people whose business you hope you are going to influence.

Mr. HEMPHILL. The thing that concerns me is that you have to stay alive, and if you tie this thing up so tight you impede the national flow of business, you do the industry and public a great disservice. We do not want to do a great disservice to the public or to the industry either.

Mr. CLAFLIN. That is right. We have never looked at how they allocate it to the public. We want to see whether it is the public or whether it isn't. We feel a member going into an underwriting assumes an obligation to distribute those securities to members of the public, and that is what we try and determine as to whether he has done that or not.

Mr. HEMPHILL. As long as he serves the public, you have no quarrel with it?

Mr. CLAFLIN. We have no quarrel with it.

Mr. HEMPHILL. Thank you.

Mr. MACK. You investigate to determine whether he is withholding the securities from the market, do you not?

Mr. CLAFLIN. That is right.

Mr. MACK. And then if he distributes these securities to the public rather than keeping them for himself, his family, or colleagues, you would have no objection?

Mr. CLAFLIN. That is correct.

Mr. MACK. They could, of course, manipulate the price by withholding a security and then not taking the profit themselves but passing the profit around to some favored customer, is that correct?

Mr. CLAFLIN. You are speaking of a delayed sale at a later date?

Mr. MACK. Yes.

Mr. CLAFLIN. Yes, I can see that. You mean at the original offering price?

Mr. MACK. At the original offering price.

Mr. CLAFLIN. Yes, that is possible.

Mr. MACK. He would be doing that for the benefit of the favored customer.

Mr. CLAFLIN. We don't see much of that. Maybe you thought of a new way of doing it.

Mr. MACK. That wasn't the purpose of the question. In this field, I am not particularly impressed with the fact that they need new ideas.

Do you care to state your opinion on the imposition of additional safeguards regarding credit balances, related customers credit balances?

Mr. CLAFLIN. Is this segregation that you are speaking of, additional credit balances?

Mr. MACK. Well, safeguards to the customers credit balances, yes; to protect the credit balance of the customer.

Mr. CLAFLIN. I am afraid I haven't got the question quite straight. Is this in relation to margin accounts where there is excess equity in the account? Such as loaning of funds?

Mr. MACK. It is segregation of the funds, the credit balance, the balance of customers funds, or commingling of the funds.

Mr. CLAFLIN. I think most of that is stock exchange. I think you are in the area of the exchanges where they have their margin requirements and segregation of funds.

Mr. MACK. This came up in the legislative hearings a year ago, or 2 years ago. The Commission at one time opposed this. I just wanted today to see whether you had any views concerning it.

Mr. WHITE. I think, Mr. Chairman, I recall that it came up a year or so ago. I would certainly like to see what the Chairman then said so that I would see what our comments were. I don't recall. But I think we considered that a matter for the stock exchange and I think we commented on it, but I don't recall what our comment was. It is in the record of the meeting.

Mr. MACK. Then in regard to the margin requirements, do you have any views concerning the credit granted by various institutions, such as banks, in purchasing your securities?

Mr. CLAFLIN. Well, of course, banks are not in the same stream of policing, or whatever the proper term, but they are allowed to do things that we are not allowed to do. I am sure I am not qualified to discuss the Federal Reserve position on this, and whether they ought to be doing something they are not. As far as we are concerned, of course, we are not allowed to loan money on our over-the-counter securities anyway. It is a problem that really doesn't come up with us.

Mr. MACK. Presently there is no limitation on the amount of loans for securities purchased over the counter, is that correct?

Mr. CLAFLIN. Are you speaking of the banks or brokers?

Mr. MACK. No, the banks.

Mr. CLAFLIN. No, there is no limit that I know of.

Mr. MACK. In other words, it has to be listed securities. The limitation is on the listed securities?

Mr. BURNS. That is right.

Mr. HEMPHILL. It is my understanding, to air out the thing he is exploring, that most of the States have trust laws defining the purchase of stocks or bonds from trust funds to certain types. Isn't that so generally?

Mr. WHITE. That is for purchases by a trustee or fiduciary.

Mr. HEMPHILL. Yes.

Mr. BURNS. It is an accredited list, that is correct.

Mr. CLAFLIN. They have such things as accredited lists in certain States. They also have quite an elaborate theory they call the prudent man theory, in some States, which, if it goes up, you are prudent, and if it goes down, you are not.

Mr. HEMPHILL. As I understand it, and maybe I am incorrect, some years ago I came across the point where the national banks are limited, where they cannot loan money for the purchase of certain stocks, if they know that that is what the money is going to be used for. Is that correct?

Mr. CLAFLIN. Yes. I think you are in the listed security field and also in the bank regulation field, neither of which I feel qualified to comment on.

Mr. HEMPHILL. I was confused a little bit when you were talking about the banking, and what they could and could not purchase. I knew that under the national bank laws there are some limitations, and I think very properly so.

Mr. CLAFLIN. We very seldom see—if a customer takes securities from a brokerage house and goes over to a bank—what kind of a trade he can make with that bank. We are not usually let in on that, and very seldom are informed about it.

There is no reason they should tell us. We are usually not told. So our knowledge of what goes on on the other side of the street is very meager.

Mr. MACK. I was referring to the limitations placed upon stocks which are traded on the national exchange.

Mr. CLAFLIN. The margin requirements?

Mr. MACK. That is true. And I made mention of the fact that the stocks sold on the over-the-counter market were not subjected to the same limitations.

Mr. CLAFLIN. They are not permitted the same.

Mr. MACK. I don't think there is any question about that.

Mr. BURNS. Well, I think, sir, under the regulation U applicable to the banks, in lending on listed securities, there is a limitation as to what they can loan, and there is not insofar as over-the-counter securities are concerned.

Mr. MACK. That is the point I was trying to make, and I am afraid I was not able to get it across. My question was, Do you have any views concerning that matter?

Mr. CLAFLIN. Actually, we haven't considered it, as U does not come under our periphery. As far as the securities industry goes, we are not allowed to loan on the unlisted securities. We are allowed, I think it is 30 percent at the moment, on the listed securities. So from that point of view there is the same differentiation made between the two types of securities.

Mr. MACK. Mr. Cary, before the committee yesterday, called our attention to the fact, or the fact was included in the appendix he submitted with his statement, that there was an investigation conducted on the feasibility or advisability of completely segregating the functions of a dealer from those of a broker.

I would be interested to know if you have any views today concerning whether or not these should be segregated, these activities.

Mr. CLAFLIN. Actually, we have never taken it up as a subject of discussion. Most people in the industry act as both dealer and

broker at different times during a period in a day. I would think trying to make a differentiation would be difficult to handle from an administrative point of view.

Mr. WHITE. I think as an appendix to the Chairman of the Commission's statement they noted a study they had made in the 1930's which showed—or, rather, they concluded at that time they did not believe it necessary or advisable to separate the functions. When asked the question of, if this joint resolution were passed, whether it would extend to that, I believe they said they would consider it.

But I didn't get any impression that that was one of the important things they would consider. That was the impression I got.

Mr. MACK. I think you understood correctly. You are correct that the original Commission recommended against such segregation in 1936. It seems to me it would be appropriate, after 25 years, to again review that problem.

Mr. GLENN. I would like to submit a hypothetical question to counsel.

Suppose I am a registered dealer not belonging to the association, and suppose you are a registered supplier belonging to the association, and I attempt to place an order with you and you tell me that you can't accept my order because I do not belong to the association. Isn't there some violation of one of our Federal statutes, such as restraint of trade?

Mr. WHITE. I think first of all, I would do business with you but I would not at the same prices as I would with another member. As I pointed out, that specific point was considered by the Congress before they adopted the Maloney Act, and they recognized that the preferential status of a member, when he was dealing—at least, he would have a preferential treatment and other members would in pricing and granting discounts. That specific point was covered by the Congress and permitted to be embodied in the rules so that there would be an advantage for people dealing in the over-the-counter market (brokers and dealers) to join the association. But as I attempted to point out, contemplated by Congress was the implied exemption from any antitrust or other Federal laws that contradict the scheme of the organization they permitted to register under the Maloney Act.

Mr. GLENN. That is all, Mr. Chairman.

Mr. MACK. Mr. Keith?

Mr. KEITH. I have no questions.

Mr. MACK. Have you given much study, to the problem of the use of reciprocal brokerage business, for the award of sales as an inducement to increase sales of shares? I know you have dealt with that problem and have had that problem come before you.

Mr. CLAFLIN. Yes, our association has given a lot of study to it. We have a committee that spends a great deal of time on it, our investment company committee.

Mr. MACK. This involves principally mutuals?

Mr. CLAFLIN. Yes. We also had a special committee that was dismissed shortly ago that studied this particular problem in some detail, working along with our investment company committee. We put our thoughts together and brought down some of our ideas to the Securities and Exchange Commission, who felt that we were being somewhat premature as they were studying it also, and felt that they wanted to get to the point where they knew where they stood and how

they felt about it before really crystallizing on whether we were going in the right direction.

I think the matter is under study by both ourselves and the Securities and Exchange Commission, and we are working as close as we can with them on the matter.

Mr. MACK. Do you have any rules to prevent this arrangement? In other words, today is it unethical or is it illegal?

Mr. CLAFLIN. There might be several ways you could attack the situation. One I was thinking of was our so-called section 10, which is commercial bribery, where this area could be attacked. In other words, a wholesaler of a fund paying an excessive amount of reciprocal business to a dealer to urge him to sell his fund versus someone else's fund might well violate our commercial bribery section. Also, it might be considered under our real keystone provision, "conduct inconsistent with high standards of commercial honor."

Mr. MACK. Have you considered it as grounds for suspending a dealer?

Mr. CLAFLIN. We were on that track and did have it before the SEC and they felt we were ahead of them. At the moment it has died there. When they get their thinking crystallized they may want to start again on that, or they may have some other course that they feel we should proceed on.

Mr. MACK. How many cases do you have underway at the present time that would fall into the category of being rigged or manipulated stock?

Mr. CLAFLIN. Stock?

Mr. MACK. Yes.

Mr. WHITE. In the general area, Mr. Chairman, of manipulation? We would have to review the complaints that are now on file throughout the United States, we generally can pinpoint those to various districts. We can't give a figure at the moment, but I am sure we have some in district 12, which is our New York area, and perhaps in some other areas. I couldn't pick a figure, but I am sure we have some.

Mr. MACK. Well, it is a major problem with you, is it not?

Mr. WHITE. I don't think that we have that many manipulations cases. As I said earlier, ferreting out manipulation is difficult. We have used some of our rules and invoking them find or uncover manipulations at the same time. But I wouldn't say it was a major problem, although we are certainly aware of the possibility of manipulation.

Mr. MACK. Do you have information concerning the number of alleged manipulation cases pending?

Mr. WHITE. That would be a very small number, because we might have a case filed based on two or three violations of our rules, where, after we have a hearing, we would see evidence of manipulation. We might wind up—in fact, all we could do would be to find violations of our rules. We can take those other factors into consideration in imposing a penalty. But the manipulation generally develops as the case which was bottomed on violation of our rules is developed.

Mr. MACK. Thank you very much for your testimony, gentlemen.

Mr. CLAFLIN. Thank you, Mr. Chairman.

Mr. MACK. The committee will stand adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 3 p.m., the subcommittee recessed to reconvene at 10 a.m., Thursday, June 29, 1961.)

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## SECURITIES MARKETS INVESTIGATION

THURSDAY, JUNE 29, 1961

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCE AND FINANCE  
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room 1334, House Office Building, Hon. Peter F. Mack (chairman of the subcommittee) presiding.

Mr. MACK. The subcommittee will be in order.

This morning the Subcommittee on Commerce and Finance of the Interstate and Foreign Commerce Committee is continuing hearings on House Joint Resolution 438.

We have the president of the New York Stock Exchange, Mr. Keith Funston, as our first witness.

Mr. Funston, we will be pleased to have your statement this morning.

**STATEMENT OF KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE, ACCOMPANIED BY FLOYD BRANDOW, OF MILBANK, TWEED, HOPE & HADLEY, NEW YORK, N.Y.**

Mr. FUNSTON. Thank you, Mr. Chairman. My name is Keith Funston. I am accompanied by Floyd Brandow, of the firm of Milbank, Tweed, Hope & Hadley, of New York.

We have appeared before this subcommittee on numerous occasions in the past, and throughout this association we have been most appreciative of your continuing concern with the health of the securities industry and the well-being of the investing public.

At the outset, let me emphasize that if it is the decision of this committee and the Congress to approve Resolution 438, the exchange will cooperate in every way possible.

Resolution 438 calls for an investigation and study of the existing rules of the national securities exchanges and national securities associations, to determine whether or not they are adequate for the protection of the investing public. While it is not perfectly clear from the text of the resolution, we understand that a study of the procedures by which present rules are enforced is also contemplated.

Speaking for the New York Stock Exchange, I believe that our rules are effective in those areas of the securities business in which we have jurisdiction. I also believe these rules are supported by an enforcement program that is both strong and vigorously pursued. If we believed otherwise, we would move immediately to amend our

rules and procedures because the exchange recognizes full well that its health and success are dependent on fully and faithfully serving the investing public.

All of our rules, of course, have been filed with the Securities and Exchange Commission, and under section 19(b) of the 1934 act, the Commission is given the right to alter or supplement those rules insofar as necessary or appropriate for the protection of investors. We believe that the Commission has been vigilant in exercising the supervision over our exchange which is contemplated by the statute, and we have had no reason to believe the Commission thinks that any change in our rules is either necessary or appropriate to protect the investing public.

On virtually a daily basis we have kept the Commission fully informed concerning our enforcement techniques and procedures. Again in this area we are unaware of any indication that the Commission thinks our enforcement program wanting or ineffective.

The exchange has some 219 staff members whose primary duty is to enforce our rules and we feel confident that we are doing a vigilant and effective job. Of course, despite our constant efforts, breaches of our rules do occur, at times unintentionally. Whenever we do uncover a violation, prompt and appropriate disciplinary action is taken by the exchange and is immediately reported to the Securities and Exchange Commission.

The registered representatives employed by member firms to serve the public are screened, trained, tested, made aware of our rules and held accountable for their actions. All of the exchange community's 28,000 registered representatives are full-time employees. They must be individually approved by the exchange.

Against this background of vigilant self-policing and continuous liaison with the Securities and Exchange Commission, we do not believe any special investigation into the rules and enforcement procedures of the New York Stock Exchange is necessary or would prove productive.

I am in no position to comment authoritatively on the rules or enforcement techniques of other exchanges or national securities associations. At present, several investigations are being conducted by the Securities and Exchange Commission—including studies of the rules and enforcement procedures of the American Stock Exchange, the distribution of so-called hot issues in the over-the-counter market, and problems relating to mutual funds and investment advisers.

These studies, which are now underway, indicate that several problem areas in the securities industry are already identified. The first order of business should be to deal with them.

However, the Securities and Exchange Commission is limited in personnel and in funds to press the necessary inquiries and to suggest any appropriate solutions. We believe, therefore, that the funds called for in this resolution should be given to the Securities and Exchange Commission to enable it to conclude current studies.

We think it would be unwise, however, to direct the Securities and Exchange Commission to undertake broad new studies if these will divert its energy from the inquiries presently underway. It seems to us that it is more important to reach conclusions regarding presently known problems than it is to delay those conclusions in the search for new problems.

However, if the Securities and Exchange Commission believes the current resolution can best meet its needs, the New York Stock Exchange would certainly accept the Commission's judgment.

Apart from this resolution, there are several legislative steps which could now be taken to provide investors with additional safeguards. These steps also are well known and require little further study or investigation.

We suggest that the Commission's own legislative program, as passed with certain modifications by the Senate in the 86th Congress, but which was not enacted, be pursued as vigorously as possible. This program, calling, among other things, for an extension of certain provisions of the Securities Exchange Act of 1934 to cover all registered brokers and dealers rather than only members of national securities exchanges and those transacting business through such members, offers one excellent opportunity for providing additional and needed safeguards for the Nation's investors.

Legislation should also be enacted requiring all publicly owned corporations, whether or not listed on a national securities exchange, to meet the disclosure requirement of the 1934 act. Proposals to meet this problem, at least partially, have been before the Congress. I refer to Senate bills S. 2054 of the 84th Congress and S. 1168 of the 86th Congress. A bill along these lines needs to be reactivated and supported.

Finally, legislation should be enacted which will treat without discrimination all those who extend or maintain credit for the purchase or carrying of securities.

These legislative proposals, it seems to us, offer the most immediate opportunities for further strengthening the safeguards provided investors. They could be enacted while the Securities and Exchange Commission is completing its studies and reach appropriate conclusions on the several problems which it is currently pursuing.

Thank you, sir.

Mr. MACK. Does that conclude your statement this morning?

Mr. FUNSTON. Yes, sir.

Mr. MACK. I note that you have made several legislative recommendations this morning. Have you previously submitted them to the Congress, or is this the first occasion?

Mr. FUNSTON. No, sir; the programs that I am suggesting here, have been submitted in one form or another over the years, to the Congress by us or have been the subject of extended hearings at one time or another.

Mr. MACK. On page 3 of your statement you refer to the Commission's own legislative program.

Mr. FUNSTON. Yes, sir.

Mr. MACK. I am not aware of the fact that the Commission has a legislative program for this year. If they do have, it has not been submitted to the Congress.

Mr. FUNSTON. I think you are right, Mr. Mack. What I meant there when I said the Commission's legislative program, was to refer to the legislative program that was brought before the last Congress, and hearings about which were held both here and in the Senate. Then this legislative bill died and was never acted upon.

Mr. MACK. To keep the record straight, it was acted upon in the Senate at a very late hour in the session, as I recall.

Mr. FUNSTON. That is right.

Mr. MACK. One of the reasons that it was not acted on earlier was the fact that the Commission was working with the exchanges, your representatives and representatives of the National Association of Securities Dealers, representatives of industry, to solve certain problems existing in the legislation. Is that correct?

Mr. FUNSTON. Yes, sir. There were about 85 proposals, as I recall, that were made, and there were three in particular that gave us trouble. After discussions with the Securities Subcommittee of the Senate Banking and Currency Committee the Senate made amendments in the bill which I believe were acceptable to the SEC and which corrected the deficiencies that we felt had existed prior thereto.

Mr. MACK. This committee held hearings on March 24, April 23, June 3, July 8, 9, 14, 15, and August 4, 1959, and as late as May or June of 1960 there was still some discussion concerning resolving problems with the industry concerning the legislation before the Congress.

I believe at the time your representative appeared before the Congress they indicated that they would be opposed to some phases of the legislation unless it was amended.

Mr. FUNSTON. That is correct.

Mr. MACK. I just wanted the record to clearly reflect the situation existing at the time.

Mr. FUNSTON. Our only point, sir, was that we believed there was a great deal of merit in that legislative program which could be considered for the benefit of the investing public at the present time.

Mr. MACK. Of course, this committee has a legitimate legislative interest in this matter, and that is one of the reasons for the hearings today, to hold hearings on this proposal, this legislative proposal, which is in the form of an inquiry, a study. We plan to utilize the study in a legislative manner.

In addition to that, I think the chairman of this committee has indicated that we would have a continuing interest in the securities field generally for the next year or 18 months, which indicates that we might hold additional hearings on legislative proposals at a later date.

I noticed on page 3 of your statement you say:

We think it would be unwise, however, to direct the Securities and Exchange Commission to undertake broad new studies if these will divert its energy from the inquiries presently underway.

Do you conclude from the resolution that it would have that effect if adopted?

Mr. FUNSTON. No, sir. I am really in no position to evaluate that. I think that is a question that only the SEC can evaluate. Over the past few years there has been considerable concern on their part that they are lacking the funds and the personnel to keep up with things. We do know that they have certain studies underway now which we think are important to conclude.

I think the evaluation would have to be left mainly with them as to whether they could undertake a new survey which would not interfere with some of the things they are working on now. As I under-

stand from what the chairman said the other day, they are intending to pursue with all vigor the studies that they have underway, and if they can undertake some more, I think that is all to the good.

Mr. MACK. I wanted to be certain that I understood your statement. I could not see any reason why the passage of this resolution would interfere with any studies in any way.

Mr. FUNSTON. It all depends, of course, on what is the intent of the resolution and the areas that you want them to go into. As I gather, again from reading the newspapers, the areas that you would want them to go into particularly, and that the chairman feels are most essential, they are working on at the present time.

Mr. MACK. Mr. Funston, I would like to inquire concerning pronouncements that you made recently in the form of warnings to the general investing public. I believe you made two statements within a 6-week period.

Mr. FUNSTON. That is correct.

Mr. MACK. One was on April 5 and the other was on May 16. You expressed your concern over unwise speculation, et cetera. I think as that time you suggested that brokers discourage orders for certain stocks.

Mr. FUNSTON. No, sir, I did not make that suggestion. The nearest I came to saying that was in the second statement, on May 16, at the very end of it. I said the public will understand, therefore, that if brokers do discourage them from making acquisitions which they are bent upon making, and they are discouraged, the public should realize that it is for their own good that the brokers are making that suggestion.

Mr. MACK. Did you refer to the "hot issues" in that statement?

Mr. FUNSTON. Yes, in the second one I did; yes.

Mr. MACK. I presume you feel an obligation to make these announcements from time to time?

Mr. FUNSTON. Absolutely. Whenever we believe, as a matter of proper education of the public, that such statements are required, we feel it is our duty to make them. I made two this year for reasons which I do not want to bore you with the details on, but I will go into them if you wish.

But the statements that I made this year, and the program that we undertook was not nearly as strong as the statements that we made in the spring of 1959, when we thought the speculative situation, un-sound speculative situation, was considerably worse than it was this spring, nor were the statements as strong as the ones that I made in the spring of 1955 or in the fall of 1954, or the spring of 1952.

Mr. MACK. You also made an announcement in the spring of 1957, I believe.

Mr. FUNSTON. I forget for the moment what that one was about. I am not familiar with that one.

Mr. MACK. I will accept your word for the statements that you made.

Now I would like to ask if you did this on your own or if you met with your board of governors to make a decision.

Mr. FUNSTON. The first one, the one in April, I went to the board and said that I was thinking of making such a statement. Let's see, I met with the advisory committee and they agreed that it was neces-

sary and timely. The second one, I just did it. I did not talk to anybody. Time is terribly important in these things; in other words, it just has to be done.

I just felt that those were the days to do it and 2 or 3 days later might be too late. So usually when these things come up we act on them pretty fast. Of course, you prepare for them well in advance in all different cases. In other words, we study the situation very carefully and document a situation before we go ahead.

Mr. MACK. Are you planning to make another one this week?

Mr. FUNSTON. No, I think the situation is quite changed now. The whole situation is much different now than it was in April and May.

Mr. MACK. Then you do not think it is necessary to make another statement?

Mr. FUNSTON. No, I do not.

Mr. MACK. Do you feel that your statements do influence the market?

Mr. FUNSTON. Well, there is some debate about that. Some people think it does and some people do not. I think it is pretty hard to prove.

Mr. MACK. You have had so much experience in this field over a long period of time, I thought you might be able to answer.

Mr. FUNSTON. My personal opinion is that it does or otherwise I would not make the statement.

Mr. MACK. I thought that would be the case. You would conserve your energy by not making a statement. I have noticed that some of the newspapers have given you credit for the drop in the stock. I have an article here that says, "Drop Laid to Funston Warning." The prices and volumes dropped on the market this year. So it was pretty effective.

Mr. FUNSTON. I don't know. Some newspapers say that and some do not. I know I got two letters from stockholders, one after each of those statements, saying why didn't I keep my big mouth shut, that everything was going all right until I made the statement, and then their stocks went down.

I think, though, it is a debatable point on balance, just how much effect it does have. Some people have attributed that it had a considerable effect; others have said that it was negligible. So I do not know.

Mr. MACK. You do not think it is necessary to send a letter out in advance of the time that you make a statement, then, saying that you are going to make such a statement on such-and-such a date?

Mr. FUNSTON. Well, that would be quite in violation of the exchange's policy that you should not give out any inside information, that there ought to be timely disclosure. Whenever we make a statement, we think it ought to be made to everybody.

Mr. MACK. That is exactly the point I am making. You have met with your board of governors and you have all agreed that the president of the New York Stock Exchange will make this pronouncement, and all of the insiders know that you are going to make the pronouncement and no one on the outside has that information.

Mr. FUNSTON. Are you trying to imply that any discussions that we have with the board of governors in the exchange represent dissemination of information to insiders?

Mr. MACK. No, I am not. I am saying that when you arbitrarily, or a group of you, decide to make this announcement, the people who you consult with and confer with have the information, and the people who are purchasing stock do not have the information.

I certainly am not accusing you of doing this intentionally, to rig or manipulate the market. I just want your honest opinion today as to what effect this does have.

Mr. FUNSTON. I am a little surprised that you would impute that discussions that go on within the board of governors of the stock exchange in any way represent inside information. The board of governors of the exchange deals with many matters of a disciplinary nature, and of the greatest confidence. We do not regard that as inside information at all.

When I talked to the board on the first instance, it was just to talk to them. Nobody saw the release I was going to issue. I just wanted to check my own judgment as to whether or not, in the opinion of these men who have practical dealings all the time, they thought the situation was such that it would warrant some sort of a warning, and they said they thought it would.

Mr. MACK. Let's just consider the statement itself.

What is the reason for the timing of your warning? In other words, is there some certain reason that you make it at one particular time?

Mr. FUNSTON. Yes. Just take the situation that existed in April, when the first statement was made. I think it was the latter part of January that there began to be a tremendous amount of activity in the market. Between then and early in April, the activity kept mounting in terms of the volume on the exchange, particularly the volume on some of the other exchanges, and in the over-the-counter market.

There was evidence, also, that an advisory service would come out with some information on a recommended stock, and then immediately the public would rush right in to buy that particular stock, to the point where on certain occasions it was difficult to handle the stock on the floor of the exchange and provide an orderly market. There was considerable indication that the amount of purchases that were being made in low-priced shares was increasing very rapidly.

The member firms with whom we check regularly on a weekly basis were reporting that the number of new accounts being opened showed a great surge. There were evidences of people wanting to buy stocks in companies when they did not know what they made, what they earned, if anything. Somebody heard a tip and a rumor and they just were wild to buy that stock.

All of these just indicated a rather unhealthy situation on the part of a few, not of the majority. A very small minority needed some cautioning.

I mentioned earlier the reason for our feeling in 1961, that the speculative situation was not nearly as bad as it was back in 1959. It was that the people who were using the market in what I would call improperly, were not the—well, I call them the Aunt Janes—they were not the unsophisticated new investors. In 1961, they were apt to be sort of semiprofessional investors, who thought that they now knew enough about the securities industry so that they could get in and get out, and make a fast buck and get away with it.

Mr. MACK. You felt there was a responsibility as president of the New York Stock Exchange to make such a statement?

Mr. FUNSTON. Yes. I think that when anything helps the general public get a better perspective upon the securities markets and the New York Stock Exchange, it is my duty to speak out.

Mr. MACK. It has been called to my attention in the June issue of Exchange that you have an article "Who's Who in Space," with a listing of all of the satellite and missile companies. It seems to me you would be encouraging investments there at the same time you are making your pronouncements warning them to be careful about the same thing.

Mr. FUNSTON. These are two entirely different things. In the first place, the article in that magazine is an informational piece. In other words, it tells about who's who in space and so on. There is no sell in that document.

But even so, that particular article came out, I believe, the 1st of June. Our cautionary statement, and I think we ought to be very clear about this, was not making any sort of a statement that the market was in an unhealthy condition. As a matter of fact, I purposely said in one or both of those press releases that we regarded that the market was generally sound. What we were objecting to was the people, the very small minority, who were using the market improperly, who were unsoundly speculating. There is quite a difference between those two.

Mr. MACK. Then whose interests were you trying to protect?

Mr. FUNSTON. The general public interest.

Mr. MACK. The investors?

Mr. FUNSTON. Absolutely, and the would-be investors. That is the sole purpose we had in mind. And, of course, in the long run, we were protecting our own interests, too, because there is nothing that could be worse not only for the general economy of the country, but for the exchange community itself, than to let an unsound speculative situation go rampant and uncorrected.

Mr. MACK. What do you think would have ultimately happened?

Mr. FUNSTON. I don't know. On these things, the higher they go, the farther they fall, of course. The more unsound a situation becomes, the more unhappy becomes the reaction to that situation.

Mr. MACK. So you wanted to level it off to an area where it wouldn't drop off too far?

Mr. FUNSTON. We didn't want to level anything off. We just wanted the people who were approaching the market improperly to get some sense and start using the same amount of judgment in the purchase of securities as they did in the purchase of any commodity. We wanted them to stop following tips and rumors. We wanted them to get the facts. We wanted them to exercise the same cautions in approaching the stock market that has been in all of our advertising, in all of our promotional activities, for these many years.

These things go by surges. As I said, now the market is quite different than it was 2 months ago. If we played a part in bringing some people to their senses, I think we performed a great public service.

Mr. MACK. You indicated that you were concerned about the height of the stock.

Mr. FUNSTON. The what?

Mr. MACK. The height that it would go to.

Mr. FUNSTON. No, I was thinking mainly not of the market.

Mr. MACK. You said the higher it goes, the farther it falls.

Mr. FUNSTON. What I meant there particularly, sir, was the volume. In other words, these great bulges of activity. Now, it is interesting, I think, that one of the interesting phenomenon about the market activity this spring in contrast with some of the periods in the past was that the price movements, despite this large volume, were not very large.

After the 1st of November, the market moved up quite abruptly, and, say, through January, on not very large activity. Then the activity began to commence. The interesting thing was, and a rather healthy thing, that despite the tremendous activity, the price movements were not very large.

Mr. MACK. Then you were more concerned about the volume than you were the prices of the stock?

Mr. FUNSTON. We were concerned neither about the volume nor about the prices, per se. We were concerned about the very small minority of the investing public that we believed were using the securities markets improperly. We were not as concerned with the markets on the New York Stock Exchange as we were about the market someplace else. In the first release, you will note we talked generally about the approach the public should have. In the second one, we pinpointed it to new issues and to activity in low priced securities, very few of which are on the New York Stock Exchange. No new issues, of course, are on our stock exchange, and very few low priced shares.

Mr. MACK. You said you were more interested in other securities or other areas than you were in the New York Stock Exchange.

Mr. FUNSTON. That is correct.

Mr. MACK. Do you think someone else would have been an appropriate person to make such a pronouncement under the circumstances? How did it happen they designated you?

Mr. FUNSTON. Well, I don't know; maybe it was because I was following it closely enough and was concerned enough, and also, of course, our members, the members of the stock exchange, were involved in this because they handled not only securities listed on our exchanges but securities that are traded on the other exchanges and in the over-the-counter market. So we feel that we have a responsibility in that area, too.

Mr. MACK. Following your most recent pronouncement, there was a general decline in stocks on both exchanges, especially the American Exchange.

Mr. FUNSTON. Well, yes, there has been a decline in recent weeks, yes.

Mr. MACK. Whether you make this pronouncement on your own motion or whether you confer with your board of governors, in any case it seems that you are assuming some responsibility for influencing the market generally.

Mr. FUNSTON. No; I don't see how you can say that, Mr. Mack. It all depends on what you mean by influencing the market. The stock market is public opinion.

Mr. MACK. Of course, we agreed that it was done for the purpose of influencing investors originally, did we not?

Mr. FUNSTON. That is correct. But the stockmarket is public opinion. When I use stock market in this sense, I am using it in the sense of the whole securities industry. It is the law of supply and demand. Any time that anybody makes any statement that has to do with influencing the public mind, it may have an effect. The fact that you are having this hearing, the fact that the newspapers are announcing, as they are, what goes on here each day, in the sense that you are talking to me about, also has an effect on influencing the market. But what these things are, I would say, is informing the public. It is educating the public. Then through the law of supply and demand, the public makes the market. I wouldn't call it influencing the market.

Mr. MACK. The purpose of these hearings certainly is not for the purpose of influencing the market.

Mr. FUNSTON. But they are having exactly the same result as any statements that I might make do in the same sense.

Mr. MACK. Your statement, of course, was to caution investors.

Mr. FUNSTON. Right.

Mr. MACK. If that was successful, then it would influence the market.

Mr. FUNSTON. If investors took my statement as saying "Well, now, maybe we ought not to buy stock," that, of course, would lessen a little bit of the demand for the stock and there would be less purchasing. It is in the same way that a congressional hearing causes a reaction. If somebody gets some idea out of a hearing that makes him decide "I better not buy stock" or "I better sell stock" that has the same kind of an influence. I think it is a healthy thing.

Mr. MACK. I am not arguing that this might not be necessary. But I have raised the question to clarify the matter in my own mind, as to whether or not the investors are being fairly treated when, at a certain time, a leader in the securities field, the president of one of the major exchanges, makes a big pronouncement that would have the effect of influencing the stock market generally. I have wondered, as a matter of fact, if some of the investors wouldn't complain about the announcement being made, whether it is the decision by yourself or by a group of your colleagues in the stock exchange.

Mr. FUNSTON. Well, I think that our difference probably has to do with the term of influencing the market. To my mind, influencing the market has a rather sinister implication, and I would not at all subscribe to that as it applied to these statements that I made. I would suppose also that it would depend when I was making the statements, on whether it turned out that I was right or wrong. If I was irresponsible in making these statements and it was proved that I was off base when I made them, then I would think I would be charged with irresponsibility and with not completely recognizing the effect that a statement on my part might have. But I don't think the claim can be made in these two statements we are talking about, that they were irresponsible statements.

Mr. MACK. I don't think anyone is inferring that the statements were irresponsible. I think, as a matter of fact, most of the members of your industry approved of the statements being made. But I raise the question of the timing. I have noted that the market was always at a peak when you made these statements, and that you do not make the statements when the market is at a lower level of activity.

Mr. FUNSTON. I think the reason for that, sir, is that the activity to which we object and that we are concerned about usually comes at a time when the market is going up very fast. That is one of the things that attracts people into the market. That is the time when this fringe element is apt to come in and aggravate the situation, to their own longrun detriment.

In other words, what the price level of the market is, is of no concern in these matters. One thing that the exchange is very careful about in everything that we do, is to make no judgments as to value. The law of supply and demand, and making sure that that operates in a free way, without manipulation, is the responsibility that we are concerned with. The price that results from the law of supply and demand is something that neither we nor anyone else can have any influence on. That is what the general public does.

Mr. MACK. Would you say it was a coincidence that the market was at its peak when you made these statements?

Mr. FUNSTON. Well, it usually happens. If you look back at periods in the past, in 1959, when we undertook a much stronger cautionary program than we undertook this year, and 1955, it is just the nature of the beast, that the market, when these situations occur, is at its peak. Maybe it is not at its peak, but at least it is at a higher level than it was when the activity was not so pronounced.

Mr. MACK. I was wondering if the inexperienced investor would be fairly treated if these statements were successful. That is the reason that I asked the question, because the average investor might have purchased on a rising market and following your pronouncement the stock would drop several points and the result would be that he would be losing money rather than making money. That was the reason that I raised the question this morning.

What about controlling the activity by margin requirements, Mr. Funston? Is that one of the purposes of the law, which requires certain margins?

Mr. FUNSTON. Yes, sir. Under the law the Federal Reserve Board has the right to impose margin requirements on the purchase of listed securities, not on the purchase of unlisted securities. At the present time, the margin requirements are 70 percent. It is our job to enforce these margin requirements among our members, and we do that.

Mr. MACK. Do you feel that the margin requirements should be raised, if you have unusual economic activity or unusual speculative activity?

Mr. FUNSTON. Under the law, the Federal Reserve is given authority to regulate margins to prevent the excessive use of credit for the purchasing or carrying of securities. Our feeling is that these margin requirements in general are higher than they need be. Our feeling in general is that they are apt to be put up too quickly and then reduced too slowly. Our feeling is that the margin requirements should be extended to embrace unlisted securities as well as listed securities, that certain lenders who at the present time are completely without regulation and who are loaning money for the carrying of securities—and I am referring particularly to the factors—ought to be brought under the margin requirements. We also believe that the Federal Reserve Board ought to, when they change the margins, give more publicity to the reason for the changes.

Mr. MACK. Do you think the margin requirements have been successful?

Mr. FUNSTON. Yes. I think that the margins have been, in general, a great force for strengthening the securities industry. My belief is that too much is expected by the public of margin requirements. In other words, there is a feeling some places that by putting margins up 10 or 20 points you can somehow control the securities markets. Well, you can't do it. As long as you have credit generally so free and easy outside, money will flow to the markets on a cash basis rather than a credit basis. Indeed, that was another source of strength in the market this spring that was not nearly as worrisome as sometimes in the past. The market was mainly on a cash basis. The public was buying, maybe improperly in a certain segment, but they were doing it for cash. They weren't borrowing.

Mr. MACK. It is true that individuals can borrow money on securities when they are deposited in banks? Is that a limitation?

Mr. FUNSTON. If we talk about a listed security, no member of the stock exchange can loan on a listed security, on any security, without following the margin requirements. Some broker-dealers who are not members of the exchange can loan on unlisted stocks. The banks can loan anything that they want to on unlisted securities, but they cannot loan money to an individual to purchase or carry listed securities unless they follow the margin requirements. That is regulated by regulation U.

Mr. MACK. They can take their securities and go back to banks and borrow money on the securities themselves, can they not?

Mr. FUNSTON. That was tightened up, Mr. Mack, a couple of years ago. To avoid the margin requirements, a person borrowing money from a bank, even with securities as collateral, no matter what collateral is used for it, has to sign a purpose statement, in which he says:

We swear that in getting this money we are not going to use it for the purchase or carrying of securities.

This rule can be evaded in the sense that maybe a man will sign the statement and still will intend to buy some securities. But he will put a mortgage on his house, so he can sign the statement "I am going to put the mortgage on the house." But that is a policing problem.

Mr. MACK. You don't think that it needs any more active supervision?

Mr. FUNSTON. Mr. Mack, I don't know that I am in a position to say that it needs more active supervision. We have questioned very much in the past how well that was being enforced, but I think that is a primary responsibility of the Federal Reserve and I believe they have looked into it and they believe that it is being enforced pretty well.

In recent months we have had a couple of disciplinary actions on the exchange, which were very serious and which were aggravated by loans that were made by "factors" on a very small margin. We don't think that is right. We think factors ought to be brought under the margin rules. We think that the whole implication of the margin rules ought to be broadened to put all securities and all broker-dealers on the same basis, and all lending agents.

Mr. MACK. How are your disciplinary actions taken against the members?

Mr. FUNSTON. Well, we have three different levels at which it occurs. In the first place, let me say that the exchange has 1,600 employees and all of these employees are responsible, of course with varying degrees of effectiveness because a pageboy on the floor can't be too effective in this area, but they are all responsible for seeing that the rules and regulations of the exchange and the SEC and the Federal laws are adhered to.

Mr. MACK. You mentioned a specific number on page 2 of your statement that 219 staff members—

Mr. FUNSTON. Right. Of the 1,600, some 219 have specific responsibility for seeing that our rules are adhered to. Then the way that this is enforced is: (1) certain actions are taken by the staff of the exchange in enforcing the rules; (2) certain actions are referred to the advisory committee of the board; and (3) certain actions are dealt with by the board, itself, depending upon the severity of the infraction.

Mr. MACK. Who directs the investigation?

Mr. FUNSTON. I do. The staff of the exchange directs it. If I may take just an example—I don't know how much detail you want me to go into.

Mr. MACK. Who finally makes the decision? Would that be the board of governors?

Mr. FUNSTON. Yes.

Mr. MACK. It is an appealing process?

Mr. FUNSTON. Yes. The residual disciplinary power resides in the board. They delegate certain authorities to the advisory committee. They also delegate certain authorities to me, which I, in turn, redelegate to the members of the enforcement staff of the exchange.

Mr. MACK. Then you would make recommendations for the disciplinary action which would be taken against the member?

Mr. FUNSTON. Yes, sir.

Mr. MACK. Are they all initiated by you or your exchange, or does the Securities and Exchange Commission initiate any?

Mr. FUNSTON. As far as I know, in my 10 years there, I don't recall, and I may be wrong in this, any case where the SEC has had to come to us and say "Here is a situation. You better look into it." They are initiated by us and, of course, where we get the information to initiate them depends on many different avenues. We have a very complete auditing staff, investigatory staff. That is one source. The governors of the exchange who are policing the floor may pick up things. The general public is a great source of information for us. Other competitors in the business are a source of information. In other words, we get leads from wherever we can.

Mr. MACK. If I understood you correctly, you said that you do not recall an occasion when the SEC had suggested to you to make a certain investigation.

Mr. FUNSTON. That is right.

Mr. MACK. Would your decision be reviewable by the Securities and Exchange Commission?

Mr. FUNSTON. Yes.

Mr. MACK. Is it that a decision would be appealable to the Securities and Exchange Commission?

Mr. FUNSTON. I would probably say reviewable would be better.

Mr. MACK. Are all of your decisions reviewed by the Securities and Exchange Commission?

Mr. FUNSTON. No. Any disciplinary action that we take we refer to the SEC, the statement of it, and sometimes they will question us about the action and get further information. I would assume that if somebody wanted to complain about any one of those cases, they could go to the SEC about it. The same thing goes for any of the actions that we take that are not reported. Well, I don't know about that.

May I ask counsel?

Do we report all kinds of disciplinary action?

Mr. BRANDOW. I think the Commission is fully informed of all disciplinary action taken and the steps taken, but there isn't any statutory review procedure set up as there is in the case of the NASD in certain areas.

Mr. MACK. Then it is not reviewable?

Mr. FUNSTON. Not in the formal sense.

Mr. MACK. Then the Commission would not be in a position to compel the exchange to take disciplinary action?

Mr. FUNSTON. Yes, the SEC can revise anyone of our rules or regulations, and I am sure that under that power if they felt that we are not dealing strongly in any situation they could step in and tell us that they wanted a change.

Mr. MACK. What is the extent of your jurisdiction in the matter of disciplining your members?

Mr. FUNSTON. It is very broad. When the exchange was first—

Mr. MACK. I would like to further ask if it goes beyond the actual operation of the exchange?

Mr. FUNSTON. Under the original constitution of the exchange, when it was set up in 1792, the purpose of the exchange was to promote just and equitable principles of trade, and I think the other phase was to provide for high standards of business conduct.

When a man comes in and signs the constitution of the exchange, a member, he agrees to abide by these rules, and the exchange can, by invoking any one of these things, exercise whatever discipline is necessary to bring about compliance with these stands. So our power is very broad. It is generally recognized. The members sign the constitution agreeing to it when they buy a seat on the exchange, and the same rule applies to all of the allied members of a member of the exchange.

Mr. MACK. Then it would include other activity in other fields?

Mr. FUNSTON. Yes, sir. Any member of the New York Stock Exchange is responsible to the exchange for the performance of just and equitable principles of trade in any line of business in which he is engaged.

Mr. MACK. Last year you took disciplinary action against one of the members of the exchange. I think you are to be commended on the action that you took. It was the first time, I think, in 22 years that you have expelled a member of the exchange.

Mr. FUNSTON. Right.

Mr. MACK. This case would have been decided by the board of governors finally?

Mr. FUNSTON. Yes, sir. Sir, if I may just say one thing, this wasn't the first time in 22 years that we had expelled a member. We had expelled some other people in the past 22 years. It was the first time in 22 years that a member doing business with the public had gotten himself into such a situation that had it run its normal course, he would have gone into bankruptcy and the public would have lost its money. As you say, we did step into that situation and have handled it.

Mr. MACK. How many members have you expelled in the last 10 years?

Mr. FUNSTON. I would say, just a guess, and I can check and send it in, I think three or four, or maybe more.

Mr. MACK. What other types of disciplinary cases have you had before the board of governors?

Mr. FUNSTON. Well, the way this works is that—and if I start going into too much detail, I hope you will stop me, because I don't want to bore you with it—when a disciplinary action—

Mr. MACK. Without consuming too much time, I would like you to tell us about other cases which the board of governors has dealt with in the last year. That is, where disciplinary action was taken.

Mr. FUNSTON. It is hard to remember. We usually have each year about one or two trials before the board, and then we have about a dozen cases that come up before the advisory committee. And then there are a number of matters that are handled by the staff. If I can find a paper here, I have examples.

Mr. MACK. It is not necessary to take the time. If you could submit for our record two or three other cases which you have considered, that would suffice.

Mr. FUNSTON. Here is the type of major cases since 1936. I have a list of nine of them. Do you want me to give them now or send them in for the record later on?

Mr. MACK. I would just as soon have them included in the record, if you don't mind.

Mr. FUNSTON. Fine.

Mr. MACK. Without objection, they will be placed into the record at this point when you submit them.

(Material referred to follows:)

#### NEW YORK STOCK EXCHANGE

#### DISCIPLINARY PROCEDURES

#### I. REGULATION OF EXCHANGE

Under the constitution, the board of governors is vested with all powers necessary for the government of the exchange, the regulation of the business conduct of members and allied members, and the promotion of the welfare and objects of the exchange. Among its objects is the maintenance of high standards of commercial honor and the inculcation of just and equitable principles of trade and business. These broad standards and principles have been delineated through the adoption by the board of detailed rules and policies on practically every phase of the securities business.

## II. METHODS OF SUPERVISION

To carry out its responsibility to see that membership adheres to the standards and principles which have been established, the board has instituted various methods of supervision; these include the financial questionnaire system, exchange examiners' surprise visits to firms' offices, surprise checks on specialists' dealings, floor trading reports, etc. As a result of such supervision, facts are developed from time to time indicating possible violations.

## III. DISCIPLINARY POWERS

The consideration of possible violations and the discipline of members and allied members for violations rests solely with the board. Generally, the cases divide themselves into two categories, minor (less serious) cases and major (more serious) ones. Over the years, a pattern of procedure for handling each category has been established by the board.

The handling of minor cases has been delegated by the board to the advisory committee with authority to impose limited penalties, while major cases are presented to the board for determination.

## IV. DETERMINATION OF PROCEDURE

There arises from time to time a case concerning which a determination must be reached whether it should be considered by the advisory committee or by the board itself, i.e., whether a case should be regarded as minor or major.

In each such case, the chairman, the vice chairman and the president, acting as an informal committee, consider the facts ascertained by the exchange staff and decide whether the facts in the particular case warrant a proceeding before the board. This step insures that only those cases which appear to be of a more serious and substantial nature are presented to the board itself.

## V. TYPES OF MINOR CASES

Minor cases (which have averaged eight a year for the past 10 years) have included:

A technical and unwillful violation of the minimum capital requirements.

Failure to adhere to regulation T of the Federal Reserve Board and exchange maintenance margin requirements in several instances.

Isolated instances of failure to place account names on orders prior to execution.

An infraction of the rules governing exchange member floor trading.

A violation of rules regarding execution of orders.

Failure properly to perform specialists' function.

Unauthorized gratuities to floor employees.

## VI. PROCEDURE IN MINOR CASES

The facts with respect to such cases are developed by the exchange staff, which obtains from the member or partner concerned his explanation for the occurrence.

A memorandum is then prepared by the staff and sent to the member or firm involved in order that he or the firm can point out any inaccuracies and submit any further comment or explanation.

The memorandum and the member's or firm's comments are sent to the advisory committee. At its next meeting the advisory committee determines by majority vote of those committee members present whether a violation has occurred and, if so, what penalty should be imposed. The maximum penalty the advisory committee can impose is a censure and a fine of \$250 for each violation.

At a subsequent meeting, the member or partner appears before the advisory committee and is given an opportunity to make further comment and explanation.

If there is no new information elicited the disciplinary action, previously determined upon, is then taken.

If new information is given to the advisory committee, the member or partner is asked to retire. The committee then determines whether to change its previous decision. If a determination is made that disciplinary action should be taken, the member or partner is recalled for that purpose.

A report of all such actions is made to the board of governors at its next meeting. Similar information is thereafter given to the SEC in accordance with an agreement so to do.

In certain cases, the advisory committee has felt publicity, without names, concerning a particular case would have a salutary effect. This publicity has taken the form of a brief description of the violation and of the penalty imposed. In floor procedure cases, the notice has been posted on the exchange floor bulletin boards; in office procedure cases, it has been disseminated as an educational circular.

#### VII. TYPES OF MAJOR CASES

Major cases since 1936 (which have averaged two a year for the last 10 years) have included:

Member fraudulently misappropriated customers' securities and pledged them as collateral for personal loans.

Member forged signature of customer on check issued by clearing firm to which member introduced account and deposited proceeds in member's own bank account.

Allied member embezzled his firm's funds through falsification of records.

Money loaned by member firm to an individual was used to purchase control of investment trusts, the portfolios of which were liquidated to pay off the loans.

Execution of customer's order designed to mark up price of stock at close.

Repeated violations of capital requirements.

Failure to use due diligence in a large number of cases to obtain essential facts concerning customers.

Violations of commission law, by rebates to customer or nonmember broker-dealer, or by employment of person in nominal position because of business obtained by him.

Violation of exchange policy prohibiting the making of any agreement through which gratuity fund payments would go to other than deceased member's family.

#### VIII. PROCEDURE IN MAJOR CASES

##### (a) *Person presenting the charges*

Charges presented to the board are customarily signed by a senior staff member of the exchange department which administers the particular rules involved. This is done only after the informal committee of the chairman, vice chairman, and president have determined that the alleged facts warrant such a proceeding and have so reported in a memorandum to the board.

##### (b) *Presentation of charges to board*

After the informal committee's report and the charges have been read to the board, it determines whether to adopt a resolution setting the date of the hearing and directing the secretary to notify the member or allied member of the procedure to be followed under the constitution.

In advance of the board hearing, each governor is sent a copy of the informal committee's report, the charges and any written answer to them, the board resolution prescribing a hearing, a memorandum describing the hearing procedures applicable to the case, a business history of the person charged or his firm and a résumé of any previous similar cases.

#### IX. HEARING OF CHARGES

At the prescribed meeting, the charge and any written answer of the person charged are read.

The facts upon which the charge is based are placed before the board by the exchange staff through documents and records and through interrogation of the person charged or through other witnesses.

The person charged is given opportunity to question any witnesses produced. Governors may also question the person charged, the witnesses and the exchange staff.

The person charged is then given full opportunity to present his defense or explanation in any way he chooses, which may be through documents and records, witnesses, and through written or oral statements.

Again, the governors may raise any questions.

If there is no further evidence to be submitted or questions asked, the person charged and the exchange staff are asked to retire.

The Board then commences consideration of the charge.

## X. CONSIDERATION OF CHARGE

Either before any motion is made or after a motion is seconded, any governor may ask that the question be considered informally. After such informal discussion, the board can again consider the question formally.

There are ordinarily three kinds of motions to be considered. Briefly, the three types of motions are:

## 1. Motions as to guilt.

The person is either guilty or not guilty.

A majority vote of the governors in office (17) is required.

## 2. Motions as to penalty.

In determining the penalty, consideration is given to the degree of seriousness of the offense and the degree of culpability.

The penalties which the board can impose are:

(a) Censure.

(b) Censure and fine not exceeding \$5,000.

(c) Suspension.

(d) Expulsion (obligatory) for fraud (sec. 1 or 2 of art. XIV).

(e) Expulsion for other than fraud (secs. 3 to 9 inclusive of art.

XIV).

(A vote of a majority of the governors then in office (17) is required, except in the case of expulsion for other than fraud, where a vote of two-thirds of the governors then in office (22) is required.)

In any instance in which the board may suspend or expel, the board by a majority vote of the governors in office (17) may in lieu thereof impose—

(a) a fine not exceeding \$5,000 for each violation, or

(b) a censure, or

(c) may remit or reduce the penalty on such terms and conditions as the board shall deem fair and equitable.

The motions are put to a vote in the order of severity; e.g., the most severe is voted on first.

## 3. Motions as to publicity.

Publicity with name of person involved is required in the case of suspension or expulsion.

If penalty is other than suspension or expulsion, the board determines whether or not publicity shall be given to its decision.

In certain cases, the board has felt publicity concerning a particular case would have a salutary effect. This publicity (in most cases without names) has taken the form of a brief description of the violation and of the penalty imposed. In floor procedure cases, the notice has been posted on the exchange floor bulletin boards and, in office procedure cases, it has been disseminated as an educational circular.

In the board proceedings, it has been the practice over the years for the chairman to preside, and the vice chairman and the president to participate in the discussion and to vote on the determination of guilt as well as the penalty to be imposed. This is specifically provided for by section 2 of article III of the constitution, the pertinent part of which reads:

"No governor shall be disqualified from participating in any meeting, action, or proceeding of the board of governors by reason of being or having been a member of a committee which has made prior inquiry, examination, or investigation of the subject under consideration. No person shall participate in the adjudication of any matter in which he is personally interested."

Also, "Robert's Rules of Order" contains the following provision:

"The members of the committee preferring the charges vote the same as other members."

## XI. NOTIFICATION OF THE DECISION

Promptly after the board arrives at its decision, the chairman notifies the person charged of the results of the board's deliberations. The SEC is also notified of the board's decisions.

## SUMMARY

In its efforts to administer justice, the exchange and its board have not followed either court-marital or trial practices, but have evolved procedures proven to be fair, just, reasonable, and expeditious, both from the viewpoint of the exchange and from that of the person charged.

Although the staff ascertains the facts, the board itself or its advisory committee considers each case individually, determines whether a violation has occurred, decides the penalty to be imposed, and then administers the discipline.

The minor (less serious) cases are considered by the advisory committee. All other cases are placed before the chairman, vice chairman, and the president, acting as an informal committee. This committee does not determine the guilt or innocence of the person charged; it merely decides a procedural question: Is the case of such serious nature that it should be submitted to the board for decision, or should it be referred to the advisory committee?

In either proceeding, the person involved is furnished in writing with full information concerning the case and is given every opportunity to present his defense or explanation to the governors before a decision is reached.

Inasmuch as each case involves conduct directly connected with the securities business, and the governors are well versed in the business, it appears unnecessary, and it probably would be confusing, to have the person charged permitted to be represented at a hearing by professional counsel. Experience over the years has demonstrated the wisdom of the constitutional provision which prohibits the person charged from having professional counsel present.

Mr. MACK. The Chair recognizes Mr. Glenn.

Mr. GLENN. Mr. Funston, are there any material differences between the rules and enforcement procedures of the New York Stock Exchange and the American Stock Exchange?

Mr. FUNSTON. Yes, sir; very great differences. Our rules generally are tighter and the enforcement is much tighter.

Mr. GLENN. I notice in your statement you say that the rules and enforcement procedures of the American Stock Exchange are being looked into by the Securities and Exchange Commission, but you don't think there is any necessity for doing the same thing to the rules and procedures of the New York Stock Exchange?

Mr. FUNSTON. No, sir; I do not.

Mr. GLENN. That is all I had, thank you.

Mr. MACK. Mr. Keith?

Mr. KEITH. Mr. Funston, in a recent article in the Wall Street Journal there was considerable discussion about the activities of specialists on the American Stock Exchange. It was a rather critical commentary, I would say. Do you have specialists that operate in essentially the same way in which they do on the American Stock Exchange, and is there an opportunity for the type of activity that was commented upon in the Wall Street Journal?

Mr. FUNSTON. Yes, Mr. Keith, our specialists operate generally in the same way that they do in the American Exchange, except our specialists do not handle odd lots, which are less than 100 shares. That is handled by another organization. The difference is that up until recently the American Stock Exchange did not have the same enforcing procedures that the New York Stock Exchange does. I will just give you some examples of that. In policing the dealings of the specialists, we have surprise reports in detail for each stock for a 2-week period, four times during the year. In other words, at times unbeknownst to the specialist we go in and call for a record of all of his dealings. We have a series of statistics to judge the performance of a specialist which are just as detailed as the manager of a baseball team has for judging the performance of a ballplayer. In contrast to that, until within the past weeks when they have adopted the same policing rules that we have, the American Exchange just reported monthly reports of total dealings only of a specialist, not by stocks.

The second thing is that when it comes to allocating stocks at the exchange, our board assigns stocks principally on the basis of the past performance of the specialist as a dealer. In other words, on his record. On the American Exchange the procedure was more to allocate stocks, on the basis of how the listing was obtained.

With respect to capital requirements, we require proof of compliance of our specialist with our capital requirements, at least twice a year, and they are being audited all the time on a surprise basis. The American Exchange, as far as we could make out, made no specific check of this at all.

The enforcement staff of the exchange—we have 21 enforcement people whose sole job it is to police and enforce the specialist rules. In addition to that, we have 31 floor officials who are following these matters. We don't know exactly what the situation was on the American, but we have the impression that the enforcement staff was very small. Then the final thing is that with respect to market studies, we make continuing market studies of the performance of all specialists, covering 30-day periods in each stock that he deals. We determine the percentage of his stabilization records, the percentage variations between his bids and asks, between actual sales and so on and so forth. As far as we know, those sort of studies were not made at the American, but I believe it is their intention to make them from now on. But we have, of course, reviewed what happened over there very carefully to insure that it couldn't happen where we are. We believe we are adequately protected and have not had to change.

The only place that we have really felt we had to change our auditing procedure was that we felt we ought to get an affirmative statement from specialists in the future as to whether they bought any stock off the board or not.

Mr. KEITH. I am advised by counsel, who has looked into this in some detail, that a very substantial portion of your business is concerned with the specialists activity, some 15 percent of the total volume.

Mr. FUNSTON. Yes, sir.

Mr. KEITH. So it is a most significant area. The thought that comes to my mind concerning these surprise inspections is: What do they reveal that causes you to continue that kind of auditing activity?

Mr. FUNSTON. They reveal how good a job the specialist is doing in his main responsibility of making a close, continuous market in the stocks in which he is dealing. For example, the 15.8 percent figure, or whatever it is of specialist dealings, is an average figure. In the case of an individual stock the percentage varies. In so-called bread and butter stocks, like General Motors, Standard Oil of New Jersey, the big stocks, where the public activity is such that there is enough buying and selling so that the specialist does not have to participate very much in those dealings, the specialist maybe deals in 5 percent of the transactions. On the other end of the scale are the least well known stocks, where the public is not so active in the market, where the specialist may have to deal in 30 or 40 percent of the dealings. One of the studies made is to see if he is participating in the market as much as he should to keep a close, orderly, active market. Another study is the percentage of stabilization. A specialist in making

a market in the stock is supposed to have a great preponderance, and the rule of thumb is about 80 percent, of his trades to be so-called stabilizing trades. In other words, buying when the market is going down, selling when the market is going up, a stabilizing factor.

Another criterion that is looked at is the amount of stock that he goes to bed with at night, as it were. In other words, they are supposed to make a market in the stock and buy when the demand is weak and sell when the demand is strong. They are either long in the market or short in the market. That is all checked up to make sure he is doing his job.

Then another percentage that is looked at is the spread between his bid and asked prices. Say it is a \$40 stock. Unless 95 percent of all of his bids and asks are within a half point he is not regarded as doing a good job. It is the same way on the price variations from the last sale. Unless a very high percentage represents a very small variation from the last sale, he is not doing a good job. Last year, 88 percent of all the transactions on the stock exchange occurred at either the same price as the last sale or a quarter of a point variation. One of the reasons that happens is that the specialists are checked on so closely to see that they make that kind of market.

Mr. KEITH. Did I understand you to say that his job was to buy when the market was going down and to sell when it was going up?

Mr. FUNSTON. No, that isn't his job. His job is to make a market in the stock. I don't know whether this will help clarify the thing, but before I went to the stock exchange, I always wondered why it was that someone was always willing to do just the opposite of what I wanted to do in buying stock at a price which was very close to the last sale. In other words, I thought "Well, here I want to buy. Therefore, who is willing to sell at a price close to the last one?"

The reason why that happens is the specialist. The specialist is on the floor of the exchange from 10 in the morning until 3:30 in the afternoon at his post, and all dealings in the stock in which he is the specialist have to take place on the floor right in front of him. The buyers and the sellers meet there and the auction market takes place. Sometimes there will not be a member representing the public who wanted to buy or sell at a price near the last sale. Say on a \$40 stock some member of the public is willing to pay \$38 for it and some person is willing to sell it for \$40. Well, that is a two point spread. That is much too big a spread. The specialist is supposed to keep in between \$38 and \$40 a market which varies no more than half a point. So, say between  $38\frac{3}{4}$  and  $39\frac{1}{4}$ . And he has to be willing to either buy or sell the opposite of what the public wants to do within that range.

Mr. KEITH. Would the public interest be served if a specialist handling public orders was not permitted to buy or sell for his own account?

Mr. FUNSTON. I think that would be one of the—wait a minute. What you are saying is do you think that a specialist who is buying and selling—what you mean is a specialist who is buying and selling for his own account, should he be permitted to act as an agent. Is that the question?

Mr. KEITH. The question has been prepared for me by counsel, but I think it is intended to mean that he, himself, can get in on this arrangement.

Mr. FUNSTON. You see, sir, the way the question was phrased did not make clear that the essence of being a specialist is dealing for his own account. That is being the specialist. So that a man who is acting as an agent for others cannot be a specialist. I think I get the question. The question is, Should a specialist who is dealing in his own account be permitted to act as an agent buying and selling for other people? Is that the question?

Mr. KEITH. Yes.

Mr. FUNSTON. Well, I would say that if you want to ruin the auction market, and if you want to hurt the public more than most anything else I can think of, you would separate these two functions because the fact that the specialist, who is a dealer, can also act as an agent, is one of the things that gives him the incentive to make a good market. He knows that if he can make a good, close market as a dealer, then that will encourage transactions in that stock, which transactions will ease the burden on him as a dealer, and in certain instances, acting as a broker's broker, he may be able to participate as an agent. The only time that a dealer can participate as an agent is when he is acting for another broker who is willing to give up part of his commission so that he will not have to stand around at that post and wait until the price changes are such that it will fall to the point where some customer of his is willing to buy it or will rise to some point where some customer of his is willing it sell it. That is a long-winded answer, but I can expatiate all the more, if you want.

Mr. KEITH. I am advised by counsel that it is a good one.

Mr. FUNSTON. I am grateful.

Mr. DINGELL. Mr. Curtin?

Mr. CURTIN. Mr. Funston, you mentioned forms of disciplinary action. What other forms of disciplinary action do you have in addition to expulsion?

Mr. FUNSTON. Yes, sir. Expulsion is the worst. Suspension is the next. A fine is the next, and a censure is the next. These are all actions that are taken by the board. Then there are actions taken by the staff which may involve a warning, and then there are actions also that are taken by the staff where the board gives me the authority to suspend registered representatives.

In other words to fire them. They are registered representatives of member firms. And also the same thing with employees of member firms. We can't be arbitrary, of course, we have to have good reason.

Mr. CURTIN. Have you had certain members that you have had to take disciplinary action against frequently and then finally expel?

Mr. FUNSTON. I think there are certain members that our organization watches more closely than others, because of past problems. But I think that the numbers we expel, sir, are really very few. You have to be there to get an idea of the iron discipline that the exchange endeavors to carry out, and I believe does.

Every public governor that we have, at the first trial that he sits through, or the first disciplinary action, is aghast at the tightness and the pervasiveness of our disciplinary action.

Mr. CURTIN. How many members are there in your exchange?

Mr. FUNSTON. 1,366 members, and there are associated with them as partners who are subject to all of the same jurisdiction as members, about 4,000 more allied members.

Mr. CURTIN. What is the average number of trials you have in a year?

Mr. FUNSTON. We have one or two trials a year that go to the full board; about a dozen that are handled by the advisory committee; and then many other actions that are taken by the staff. We have a complete procedure here. I have all the details here, the types of cases and how it works out. Mr. Mack asked that we submit for the record the statement of our disciplinary procedures.

Mr. CURTIN. That is all, Mr. Chairman.

Mr. DINGELL. Mr. Funston, I was not able to hear your statement read, but I have gone over it very carefully. I was wondering if you would want to elaborate for the committee on whether or not you feel that the provisions of the resolution now under consideration by this committee are necessarily in the public interest.

Mr. FUNSTON. That the what—the provisions?

Mr. DINGELL. As to whether or not we need the legislation now pending before the committee. You never clearly stated in your prepared statement whether you favored Joint Resolution 438 or whether you do not favor it. You indicated that if it was the feeling of the SEC that it was necessary, you would endorse that position. However, you never clearly stated what your own views were, either as an officer of the exchange or an individual.

Mr. FUNSTON. I do not believe I would care to go beyond what I said here. We think the important thing is to handle the known problems in the industry that are currently being investigated by the SEC, and the legislative program which has been considered by the Congress before.

That is of primary importance. We think that that is more important than having an investigation to find new problems, until we get the present problems solved. It may be, and as I understand from what I read in the papers that it is the intent of this committee, in the way that the hearings are going, that some of the areas presently being investigated are the ones that you may conclude are important and should be pressed. If the SEC can get the top talent and the funds and the personnel to carry on an investigation beyond pursuing assiduously the matters that are before them now, then we think that the resolution would be a good idea. But we are not in a position to make that evaluation. The SEC is the one that would have to do the work. If they conclude that they can and it is desirable, then we would be for it.

Mr. DINGELL. I note the exchange has a rule 318 reading in part:

Without prior approval of the exchange, no individual member and no member or allied member in a member organization shall become (1) a partner in any nonmember business organization; (2) an officer or employee of any nonmember business corporation, firm, or association; (3) an employee of any firm or individual engaged in business of securities; (4) associated with any outside securities, financial, or kindred business.

Would you tell the committee the reason for this rule?

Mr. FUNSTON. Yes. We insist that members of the exchange and all of their employees be full-time employees who are devoting themselves to the securities business and not getting into any other areas.

Mr. DINGELL. Would this be as broad as the membership of firms which happen to be members of the exchange?

Mr. FUNSTON. I do not follow you, sir.

Mr. DINGELL. Would this rule apply to personnel who happen to be members of the exchange?

Mr. FUNSTON. Yes, it does. It includes all partners of the firm, that is right, and we go even further. Member firms of the exchange have to get the approval of the exchange for the kinds of businesses that they go into.

The reason for this rule also is to make sure that member firms of the stock exchange stick to the securities business or some closely allied line.

Mr. DINGELL. I notice the exchange has a rule No. 21 which relates to disqualification of the member from the board of governors or any committee authorized by the board with respect to voting on the admission of securities to list or to dealings upon the exchange.

Would you want to give the committee the reason for this rule?

Mr. FUNSTON. That is to prevent a conflict of interest. If, for example, we are voting to list a new security and this security has recently been through an underwriting, we do not think that the governor ought to vote on that because he might have a special interest in wanting that security listed because it would help his underwriting deal.

Mr. DINGELL. Mr. Funston, with regard to the requirement that a security be registered under the act of 1934 before it may be listed, what other requirements do you impose before admitting a security to the list?

Mr. FUNSTON. We have a number of numerical requirements, the purpose of which are to make sure that a security is large enough so that we could make a good market in that stock. For example, a company has to have at least 1,500 round lot stockholders, it has to have 500,000 shares in the hands of the public, it has to have \$1 million earnings for 3 years before it is listed, it has to be a seasoned company, a leader in its business, and then has to make agreements with us that they will do certain things: solicit proxies, that all their shares have the right to vote, that they will give quarterly reports, they will refer certain matters of importance to the stockholders before they take action. I can go on if you are interested.

Mr. DINGELL. It is my understanding that your own rules are more stringent than those of the Commission; is that correct?

Mr. FUNSTON. Very much so.

Mr. DINGELL. With regard to your listing requirements, just what is the position of the exchange concerning disclosure of the interests of management and others in contracts and transactions with their own company?

Mr. FUNSTON. Would you repeat that?

Mr. DINGELL. With regard to your listing requirements, what is the position of the exchange concerning the disclosure of the interests of management and others in contracts and transactions with their own companies?

Mr. FUNSTON. I do not believe we have any specific listing requirement for that. Before we list a company, we examine them to make sure that there are no conflicts of interest as it relates to the securities. For example, we will not list any company that has voting trusts. We also examine to see if there is any interlocking conflicts, such as a management having leases as individuals with the company.

Matters of that sort we will not countenance. But we do not have any rule that says that no contracts are permitted. The reason why

we do that, of course, is that we do not believe we should arrogate to ourselves the responsibility of the board of directors.

Mr. DINGELL. Recently there was an example of certain disclosures being required by the Commission in connection with registration under the Securities Act of 1933, of insider interests in the various transactions with the companies, specifically with reference to Union Oil Co.

Are the requirements for such disclosure as strict on forms 10-K and 8-K under the Exchange Act?

Mr. FUNSTON. I am sorry, sir. You will have to repeat that again. That is pretty technical. I may have to write you about this one, but I will try to answer it if you will give it to me again.

Mr. DINGELL. Recently there has been an example of certain disclosure being required by the Commission in connection with the registration under the Securities Act of 1933 of insider interests in the various transactions with the companies, specifically with reference to the Union Oil Co.

Are the requirements for disclosure as strict on form 10-K and 8-K under the Exchange Act?

Mr. FUNSTON. I will have to write you about that, Mr. Dingell. I know the situation you are talking about. That, of course, is policed by the SEC, the 1933 act. Counsel may know the answer to the question, but I do not know.

Mr. BRANDOW. I could not give you a detailed comparison of the disclosure requirements under the 1933 act as compared with the 1934 act. My feeling is that probably the 1933 act is more comprehensive.

Mr. FUNSTON. Do you want me to write to you about that?

Mr. DINGELL. Maybe we can go into that further and decide, Mr. Funston.

Mr. FUNSTON. All right.

Mr. DINGELL. Do you make additional requirements under your rules going beyond these of the Commission relating to this type of disclosure?

Mr. FUNSTON. Do I think that what?

Mr. DINGELL. Do you make, in other words does the exchange make additional requirements under your rules going beyond those of the Commission relating to this type of disclosure?

Mr. FUNSTON. As it relates to the 1934 act or the 1933 act?

Mr. DINGELL. I will let you elaborate on that if you want.

Mr. FUNSTON. It is hard for me to answer you unless I know exactly what question you have in mind.

Mr. DINGELL. This is with regard to disclosure of insider information.

Mr. FUNSTON. If I may make a general statement on disclosure, the exchange was the granddaddy of disclosure. This is the thing that we have been fighting for for years and years. We do think that the disclosure requirements should be strengthened. That has been in the legislative programs we have suggested in the past.

We think that the insider trading ought to be, instead of filed by the 10th of the following month filed within 10 days of having been made and there ought to be some teeth put into the law, which there aren't now.

So we are all for full disclosure, and we are for timely disclosure. We have taken steps as recently as last fall to strengthen that by advising all listed companies that we expected them to put out news releases, not to hold for release, but for immediate release, on anything that might affect the future price of a security.

As far as the issue you are talking about, whether we should go further in the area of requiring disclosure of contracts, I guess that is what you have in mind, that is one I would want to think over pretty carefully. We have to be very careful that we do not put ourselves in the position of trying to assume the responsibility of the board of directors of a company.

Mr. DINGELL. In other words, you do not want to substitute your judgment for that of management.

Mr. FUNSTON. That is right. And it seems to me that they have to be responsible for that area.

Mr. DINGELL. With regard to your rules, Nos. 318 and 321, what is the position of the exchange generally as to transactions by insiders, and insiders' dealing with their companies, where the corporation's securities are listed on the exchange? In other words, what is your general position with regard to insider trading? Should it be discouraged or encouraged?

Mr. FUNSTON. We think that the Congress has already decided that insider trading should be reported when it is made, and that if there is any evidence of anybody taking a short-term profit, that the entire profit is payable back to the corporation.

So we think what the Congress ought to do in that connection is to tighten up the legislation, as I have just indicated, and make those reports come in not by the 10th of the following month, but 10 days after, and put some teeth into the bill so that if some insiders do take short-term profits they have to pay some kind of a penalty instead of just paying the profits back.

Again I repeat that this proposal has already been made as a legislative suggestion by us several times.

Mr. DINGELL. Where the exchange approves an officer or one of your members being on the board, and then perhaps having subsequent dealings with that corporation as an outsider, with his position as officer or director of the corporation, what is your position with regard to disclosure in that case?

Mr. FUNSTON. Well, of course, as I understand it, it always is disclosed in the registration statements. In the proxy statements each year a company has to disclose any kind of dealings that it has had with any members of the board of directors. So I believe that is disclosed already under the proxy rules.

Mr. DINGELL. Was this done in the *Union Oil* case to which we have been directing our attention?

Mr. FUNSTON. I do not know, sir. I have not seen the proxy statement. Those proxy statements, of course, are approved by the SEC, so I do not know.

Mr. DINGELL. In connection with the disclosure of the activities of the listed corporations for benefit of stockholders and the investing public, do you require that each listed company send to its stockholders an annual report?

Mr. FUNSTON. Yes, sir. That has to be sent out within 3 months of the end of the fiscal year.

Mr. DINGELL. Must this be sent prior to the solicitation of proxies?

Mr. FUNSTON. Yes, sir. I think it is at least 2 weeks. Maybe it is a month before.

Mr. DINGELL. Do you require that all listed corporations must solicit proxies?

Mr. FUNSTON. Yes. We have required that all companies that have been listed since 1955 do solicit proxies, and we have a rule that says that any listed company that is presently listed which does not agree to solicit proxies by the end of this year will be subjected to delisting from the exchange.

Mr. DINGELL. Mr. Funston, you have done a fine job. We want to thank you, as a member of the committee, and I am sure for the entire committee, for the courtesy you have given us in appearing this morning and the fine job you have done. I am sure the committee joins me in expressing to you our thanks and gratitude.

Mr. FUNSTON. Thank you, Mr. Dingell.

Mr. DINGELL. The committee will stand adjourned, subject to the call of the Chair.

(Whereupon, at 11:58 a.m., the subcommittee recessed to reconvene at the call of the Chair.)

The first of these was the fact that the United States was a young nation, and its people were still in the process of forming a national identity. The second was the fact that the United States was a large nation, and its people were still in the process of forming a national identity. The third was the fact that the United States was a young nation, and its people were still in the process of forming a national identity. The fourth was the fact that the United States was a large nation, and its people were still in the process of forming a national identity. The fifth was the fact that the United States was a young nation, and its people were still in the process of forming a national identity. The sixth was the fact that the United States was a large nation, and its people were still in the process of forming a national identity. The seventh was the fact that the United States was a young nation, and its people were still in the process of forming a national identity. The eighth was the fact that the United States was a large nation, and its people were still in the process of forming a national identity. The ninth was the fact that the United States was a young nation, and its people were still in the process of forming a national identity. The tenth was the fact that the United States was a large nation, and its people were still in the process of forming a national identity.

## SECURITIES MARKETS INVESTIGATION

MONDAY, JULY 10, 1961

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCE AND FINANCE  
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room 1334, House Office Building, Hon. Peter F. Mack (chairman of the subcommittee) presiding.

Mr. MACK. The committee will come to order.

This morning, we are continuing our hearings on House Joint Resolution 438, and our first witness this morning is the president of the American Stock Exchange, Mr. Edward T. McCormick.

Mr. McCormick, we are very happy to have you here, and we would be pleased to have your testimony. It is my understanding that you would like to complete your statement before the committee asks questions, and the Chair will be very happy to grant that request.

**STATEMENT OF EDWARD T. McCORMICK, PRESIDENT, AMERICAN STOCK EXCHANGE; ACCOMPANIED BY JOSEPH F. REILLY, CHAIRMAN, BOARD OF GOVERNORS; CHARLES J. BOCKLET, VICE CHAIRMAN, BOARD OF GOVERNORS; AND MICHAEL E. MOONEY, GENERAL COUNSEL**

Mr. McCORMICK. Thank you very much, Mr. Chairman.

My name is Edward T. McCormick. I am president of the American Stock Exchange. Here with me are Joseph F. Reilly, chairman of the exchange's board of governors, Charles J. Bocklet, vice chairman of the board, and Michael E. Mooney, general counsel to the exchange.

I wish to thank you for this opportunity to appear before you. In view of what has been said by certain segments of the press and the impression given by certain persons that have appeared at these hearings, I urge you to allow Mr. Reilly and myself a chance to read our statements in full. We believe that we have something to say that will do much to clear the atmosphere in the area in which your committee is operating. We will, of course, be happy to attempt to answer any questions you may then have.

I would appreciate it if the committee would permit me to make a statement concerning the American Stock Exchange and then listen to Mr. Reilly who would like to discuss in some detail the floor procedures and other operations of the exchange including its rules and

enforcement programs. In the course of Mr. Reilly's statement he will refer, among other things, to the matter of the *Re & Re* case which has been so widely publicized and mentioned in these hearings.

To begin with, I wish to state that the American Stock Exchange is not a second-class exchange. Our exchange is over 100 years old and is the second largest and the fastest growing exchange in this country. It boasts among its regular and associate members every major investment banking house that is a member of the New York Stock Exchange. In its board of governors are represented some of the outstanding firms and individuals in Wall Street.

I wish to add that I will stack the honesty and efficiency of our specialists against any other specialists or over-the-counter dealers in the country.

As you may know, the American Stock Exchange is a voluntary, unincorporated association. Its membership consists of 910 regular associate members who do business through more than 2,900 offices located in 49 States and the District of Columbia.

Importantly, about 88 percent of our regular and associate member organizations are also members of the New York Stock Exchange.

The American Stock Exchange has been registered with the Securities and Exchange Commission as a national securities exchange for more than a quarter of a century, as long as any other national exchange. It is subject to the provisions of the Securities Exchange Act of 1934 which provides that any member who willfully violates any provision of that act, or any rule or regulation thereunder, shall be deemed guilty of an act inconsistent with just and equitable principles of trade, and our constitution further provides that any such violation may be grounds for suspension or expulsion.

We have supplied the committee with a current copy of our constitution and the rules adopted thereunder. We believe that our present rules are adequate to provide proper protection to the public and they are now, and will be, effectively enforced.

As you may know, the Securities and Exchange Commission is kept currently apprised of the content of our constitution and rules. Several of these rules have actually, over the past 25 years or more, been adopted at the Commission's suggestion.

With respect to our surveillance and enforcement programs, we have repeatedly invited the staff of the SEC to visit our offices and the trading floor to observe our operations. They have frequently accepted these invitations. We have at all times welcomed any suggestions from the Commission or any other source that would improve either the rules or our procedures. There has never been any instance, when after full discussion, any final recommendation of the Commission has not been adopted by us.

We are regarded by many as the exchange for small business and it is true that we accept for trading companies that do not meet the size, and I emphasize the size requirements of the New York Stock Exchange. I have always felt and say now that this country and its Congress have never and should never determine that the privileges of an exchange market are to accrue only to the big; that only the stockholders of the industrial giants should be protected by a nationwide ticker-tape network that prints every transaction chronologically coast to coast within seconds of the completion of every trade on the trading floor.

I ask, why should only this privileged group, the big, have the benefits of a quotation service that provides at every single second of the day from 10 a.m. to 3:30 p.m. (the market's trading hours), a firm bid and offer for at least one unit (100 shares) of every stock admitted to trading.

Yes, we list smaller companies and this fact has created certain problems in the past. However, we have attempted to meet these as they arose and have solicited and accepted the help and advice of the agency delegated to regulate the securities markets, the Securities and Exchange Commission.

We do have many small companies on our market today, but we also have many large ones. For example, the owners of over 320 of the approximately 900 common stock issues traded on our floor have received dividends—without interruption—for from 10 to over 110 years.

Small companies do not always stay small. Many that have grown large have not stayed with us, but have transferred to the New York Stock Exchange. To be specific, of the 1,526 common stock issues now traded on that exchange 634 or 41½ percent got their start on our exchange. Were we wrong to give them a home in their earlier days?

Among the companies which enjoyed their first exchange market with us were Armour & Co., and Swift & Co. of the food industry; practically all of the airlines, Aluminum Co. of America, Cities Service, Columbia Pictures, Eversharp, A. & P., Gulf Oil, Jones & Laughlin, Pittsburgh Plate Glass, Quaker Oats, Singer Manufacturing and many others. These securities, incidentally, contributed a very large proportion of all trading on the New York Stock Exchange during 1960.

Coming now to the joint resolution before the committee, I wish to say, by all means let's have the study. Such funds as may be needed to do the job properly should, of course, be made available. Speaking for the American Stock Exchange, we will cooperate in every way in the study.

The securities markets are an important and vital part of our economic system. They are essential to provide the funds necessary to maintain and expand our Nation's business. Corporate securities are today one of the principal forms of wealth in our country. We appreciate, as you must, that investor confidence in our securities markets is of maximum importance. We caution, therefore, that in the course of any study, care be taken to bolster, not to undermine, this confidence.

I should like to suggest very, very seriously that this committee and its expert staff have an active and continuing role in establishing the area of investigation, its goals, its methods, and its conclusions.

Before Mr. Reilly speaks I should like to refer to one facet of the *Re & Re* matter. Much has been headlined, again by certain members of the press, concerning my personal contact with the Res. Here are the facts.

In 1954 and early 1955, over 6 years ago, I entered into three transactions through the Res in securities traded over the counter—none in which they acted as specialists. These were all confirmed to me through William P. Hoffman & Co., a firm registered as a member of the NASD and as a broker-dealer with the SEC.

At a later date, one of these securities, Thompson Starrett, preferred, was listed on our exchange but prior to such listing I had divested myself of this security at an aggregate loss of \$32. My total cost or investment in these three transactions totaled approximately \$2,500.

To put that in its proper context, the exchange happens to pay me a salary of \$75,000 a year. I have not owned a single share of stock traded on the American Stock Exchange since 1957.

Mr. Chairman, if you will bear with us, I would like to yield to Mr. Reilly, who is prepared to give you in considerable detail, some of the facts in which you would be interested.

Mr. MACK. We would be pleased to hear from Mr. Reilly at this time. Mr. Reilly, of course, the hearings are based on a resolution which I introduced and that is the main purpose of the hearings, and while you are free to discuss any matter, we are not conducting an investigation as such into the *Re* case, and I am sure you are aware of that fact.

Mr. REILLY. Yes, Mr. Chairman.

Mr. CHAIRMAN. I am Joseph F. Reilly, chairman of the board of governors of the American Stock Exchange, an office which I have held since February 1960.

Before I became a member of the American Stock Exchange I represented big business. That is, I am one of 19 children. Therefore, I consider myself, at least, a director in the corporation known as the family. And our family has not only depended upon, but has upheld our capitalistic system.

From my experience since I started with the American Stock Exchange as a page boy 36 years ago I am in a position to state, without qualification, that our members are truly dedicated Americans. As good Americans, they adhere to a strict code of ethics. To discover that they had a pair of "Busters" on the exchange has turned these other members into FBI men who seek an investigation by the Securities and Exchange Commission and also ask, "How could the Res operate without being detected?"

I submit that the first indication of nominee trading which has been given so much publicity during the past weeks could have been discovered by the SEC in 1957. However, since the exchange does not have the power to subpoena nonmembers, our floor committee sent a transcript containing all the information to the regional office of the SEC for its scrutiny. Our vice chairman, who was the policeman on the beat, so to speak, during that period is here to answer any questions about that situation.

At this time I congratulate you, Mr. Chairman, and the members of the subcommittee for Resolution 438. Its purpose is not debatable, but I respectfully state that you did not request sufficient funds to do the job.

Commonsense dictates that, based on the growth of the securities business during the last 25 years, all should welcome a thorough study of the entire industry unless they have forgotten the study by the SEC in 1936 which resulted in 16 rules being promulgated by the Commission, and that these rules have made it possible for the securities business to expand beyond the expectations not only of national stock exchanges, but of broker-dealers throughout the Nation.

More important at this moment to those who opposed the Commission's effort in 1936, and all those who lukewarmly endorsed the 1961 Resolution 438, the expansion in the securities business occurred because of the contribution these 16 rules have made in protecting the interests of the investing public, permitting them to buy and sell securities with confidence.

Commonsense also leads to the conclusion that we in the securities business, in reviewing the last 6 months' activities in the purchase and sale of securities, must agree that a study is desirable after 25 years, due to this economic growth. A study mainly directed toward the new methods of distributing securities; new opportunities to manipulate the market because of easy credit from foreign sources and new and unconventional sources at home; whether or not banks are delaying transfers thereby causing a backlog of fails; a review of the interpretation of the laws incorporated within the 1933 act pertaining to the promoters, insurers, officials and directors of companies selling controlled stock under investment letters; also under the 1933 act rules 133 and 154. Further, as to whether or not there has been a proper liaison between the home office of the SEC and their regional offices, which all of us have depended upon for years as to whether or not we were enforcing the rules agreed upon in 1936, which rules have been subsequently reviewed continuously.

I know our capitalistic system cannot stand another 1929 collapse and I do not anticipate one. I, however, firmly believe one way of avoiding any thought of this contingency is the work this committee is doing in trying to give the Securities and Exchange Commission the tools in the form of manpower to conduct a study of our expanding industry.

I may be a maverick, but to do this job I do not believe that \$750,000 is adequate. The registration fee imposed only upon the exchanges by the provisions of the Securities Act of 1934, and which presently states that the exchange shall collect 1 cent for each \$500 resulting from transactions made in securities dealt in on the exchanges, could possibly be increased and assessed on all brokers and dealers in over-the-counter trades throughout the industry in order to defray any additional cost that may be required to complete the study.

Some may suggest that this means a building up of a bureaucratic agency. I remind them that our Congress controls the Securities and Exchange Commission. Your bill is clear evidence of this fact.

As the Securities and Exchange Commission investigates the American Stock Exchange and directs an inquiry into the entire securities business, the segregation of the functions of a specialist as broker-dealer will be looked into once again. The thought that occurs to me is, "Will all the technicians rich in law understand that this type of broker is a man who needs more than a pad and pencil?" It requires a man with resources both in money and intelligence. When everyone understands his realistic operation it will be discovered that, based on his operation, the specialist broker-dealer function is the delicate machinery that maintains the flow of capital. If tampered with, I can guarantee from my experience in our business, it will destroy the liquidity of the market. Knowledgeable officials of our Government, of the investing public, and of our industry know that any system which advocates narrow spreads between bid and offer

prices encourages investment on both a short- and long-term basis in securities. Investment by the investing public, based on sound markets and information, not on rumors, is the backbone of our capitalistic system.

As a result of the Res' operations, the newspapers and magazines have turned the public spotlight on specialists' activities. It is time the specialist's operation was explained as to how it works on a national stock exchange.

A specialist is a regular member of the exchange. He must qualify before our committee on floor transactions—who are officially elected by the membership—as to his financial ability; as to his knowledge of rules governing the functions of a specialist; must have the facilities in the form of personnel; set up his own clearing firm or make an arrangement with a clearing agent, who is also a member, for the handling of all of his administrative work; for example, comparing trades and delivering or receiving stock resulting from his transactions. When he qualifies he is registered by the exchange. All stocks are assigned to him probationally and always remain the property of and within the domain of the exchange. Stocks can be and are removed if he fails to maintain a fair and orderly market. His specialist registration can also be revoked (rule 170), if he fails to comply with the six functions of a specialist as laid down in 1937 by Mr. Saperstein, a former director of the Securities and Exchange Commission's Trading and Exchange Division. He is required to make price adjustments to the public if, in the judgment of the committee on floor transactions, he has failed to maintain proper price continuity. When he begins to operate as a specialist he is assigned to a trading post and stocks are allocated to his care. He is now surrounded by time clocks. Commission brokers handling limited orders for the public, away from the market, will place same with him and he immediately assumes their agency obligations. These orders are time-stamped and filed according to stock and price sequence. All public orders are given priority based on time of entry. These orders become what is known as the "specialist's book" and he cannot operate for his own account in competition with the public bids and offers in his book. In fact, he must, under the rules, post his own bid and offer in advance if he is closing up the market. Once posted, regardless of the size of the order coming into the market, he must buy the amount he was bidding for. Regardless of the trend of the market, he must buy or sell against the trend.

Whether or not good or bad news is released from the company whose security he specializes in, he cannot back away in the absence of public bids or offers. He is expected to become a buyer or seller. His function is to maintain an orderly sequence of trades with the public setting the basic price and trend of the security. In the course of his regular functions, he is subjected to many rules such as being prohibited at any time to divulge any information as to the orders on his book (rule 173); excessive trading beyond his financial means (rule 3); a record of all orders, modifications, executions, and cancellations must be kept for 12 months (rule 180); he cannot change the price of a transaction (rule 185); he cannot reopen a contract once it is closed (rule 8); he cannot be a director or officer of a company in whose stock he specializes (rule 186); cannot solicit proxies for a

company in whose stock he specializes (rule 186(b)); cannot even vote his interest in a security if there is a contest in the company in whose stock he specializes (rule 186(d)); cannot trade over the counter, even though he is registered with the Securities and Exchange Commission, in the stocks he specializes in (rule 187); he is also prohibited from dealing in the stocks of other specialists registered at adjoining sections of the trading post where he is specialist (rule 188); he cannot purchase over the counter for his personal customers outside of or during business hours the stocks in which he specializes (rule 189); he is prohibited from having business deals with the companies in whose stocks he specializes (rule 190); he must notify the chairman of the committee on floor transactions of any unusual price change in the security he specializes in (rule 177).

He cannot trade over the counter in any equity securities of the companies in which he specializes; he cannot acquire or grant puts, calls, straddles, selling agreements, or options in the stocks in which he specializes (rule 175); he must keep a record of his trades, time and what type of tick when trading for his own account, that is, whether the sale is minus, zero minus, zero plus, or plus from the last sale. He must fill out a specialist's trading report known as an ST Report, a frequent requirement, within 12 hours, when requested by the chairman of the floor committee. The report must show his opening position, his purchases and sales, his short sales, what type of tick, his net long position, and the amount of odd lots he dealt in.

He must notify the floor committee when he introduces a customer to another member or member firm. Many of these rules were passed starting in 1959 to date. Others were a part of the 16 rules that were promulgated in 1936 by the Commission.

I must say I will be ever grateful to Mr. Philip Loomis, a director of the division of trading and exchanges; Mr. Charles R. McCutcheon, an assistant director of the division of trading and exchanges; and Mr. Robert Hull, a fieldman for the Securities and Exchange Commission; and to our president, Edward T. McCormick, who have spent so much time explaining the underlying philosophy of the 1933 act and the 1934 act.

As a result of this education from the men that I have mentioned, I introduced the following new rules affecting the operations of our specialists. Although there was some opposition from our members, I succeeded in having these rules passed by the floor committee and the board. As a result of this newly developed liaison with the home office, we have, since 1959, amended rule 175; added new rules 186, 187, 189, and 190. Our basic constitution is a substantial duplicate of that of the New York Stock Exchange, but I assure you that I am not being competitive, but trying to be informative, when I say that no other national securities exchange has adopted all these rules. They were not only added to prevent another "Re" situation, but have gone beyond that by circumscribing our specialists' operations, permitting them to function only within the confines of their book.

Also, our present rules for floor traders, which were written after extensive discussions with the director of the trading division and his subordinates in the home office in 1959, are more restrictive than those of any other exchange. We took advantage of their thinking and believe we have benefited.

The question, perhaps, on your mind, Mr. Chairman, and in the minds of the committee may be: "These rules are wonderful and are most restrictive, but, more importantly, how are they enforced?"

Since the time when I took over as chairman in February 1960, our surveillance system has been revamped and expanded. That is, on my request our president enlarged the floor committee from 7 to 12 members and our alternate governors from 4 to 8. An alternate governor is a regular member and, generally speaking, is one with previous experience as a member of the committee on floor transactions. At the organization meeting of the floor committee each year our 20 trading posts are broken down, according to activity, into 10 sections. A governor is assigned to each section by the chairman of the committee and he becomes responsible for the supervision, regulation, and enforcement of rules pertaining to contracts taking place at the trading post under his charge. He will also settle disputes arising out of contracts and facilitate the execution of orders during extremely active markets. While he does not sit on the shoulders of the specialists under his supervision, he does keep in contact with their operations. He is assisted in this control of what is taking place in his sections by the Trans-Lux machines posted on the north and south ends of the trading floor which reflect all the sales that are taking place within seconds of their execution.

The floor governors are elected on the basis of their knowledge of rules and regulations. By watching the course of prices these experts can tell at a glance whether a specialist is maintaining price continuity. In fact, he makes it a point to note any unusual activity which takes place in sections not under his immediate control and makes it his business to ascertain from the chairman of the committee what is taking place so that the committee may be abreast of the activity of members at every post on the floor.

Backing up this enforcement is the reporting division to which we have added 10 additional persons since 1959, making a total of 56 reporters working in this department. They are responsible for making certain that all sales are properly recorded. Indirect controls result from the auction market maintained on the exchange. That is, the commission broker becomes highly competitive as far as the specialist is concerned in that they give orders to him which are away from the market day in and day out. Therefore, when they have a market or a limited order to execute for their customers they look for close bids and offers in relationship to the last sale. If the market is not in their opinion satisfactory they immediately complain to the official in charge of the particular trading post. Though the floor officials are basically responsible for floor operations, their work is augmented by our staff division of floor transactions. The vice president in charge of the division not only handles complaints from the public as to execution of their orders, but his division also disseminates all data when receiving instructions from the chairman of the floor committee as to possible violations taking place on the floor. We have prepared a detailed statement of the additional operations of this staff group which, in the interest of saving time, we herewith submit for the record.

Mr. MOONEY. This is a 40-page résumé which Mr. Reilly would like to have entered into the record, if you find it acceptable.

Mr. MACK. You may leave it with the clerk of our committee. We will receive that for our files and determine whether or not it ought to be included in the record at this point.

(Document referred to has been placed in the committee files.)

Mr. REILLY. The *Re* case, so recently the topic of such widespread publicity, raises the questions, "How did they operate?" and, "What has the exchange done about the problems raised by the *Re* matter?" Upon review of the violations alleged in the brief filed by the Trading and Exchange Division of the SEC against the *Res*, it appears that multiple violations were alleged to have occurred in several of the stocks in which the *Res* specialized. Upon analysis it seems that there was a pattern of alleged infractions in each stock, not different violations in each stock. For example, in one of the stocks in which the *Res* were specialists, Swan-Finch Oil Corp., a nominee account, such as Charles Grande, was used for the purchase of allegedly unregistered shares. By this unique device distribution of the unregistered stock was thereafter made on the exchange, while the *Res* were maintaining a market in the stock. It is further alleged that in the process of such distribution the market in the stock was manipulated. In each of the other stocks referred to in the brief, the pattern is generally the same, the violations recurring.

Now, the question should be, "Did the governors of the American Stock Exchange govern?"

I was not on the board of governors of the exchange in 1957, but Mr. Bocklet, upon reading the brief that was presented against the *Res* in 1961, revealed the following information to me as the present chairman. He was chairman of the floor committee in 1957 and his committee collected all data resulting from certain unusual activity in the common stock of Swan-Finch Oil Corp. The transcript was complete in all details showing: Price range; volume over a period of time; officers and directors; any unusual trades that took place. It also revealed the names of the largest buyers and sellers and the names of the States in which they resided and the firms they dealt through. It also disclosed that one Charles A. Grande sold 256,200 shares of stock. It is important to remember that Mr. Grande, according to the allegations in 1961, was the first nominee used.

The minutes of a meeting of the committee on floor transactions in February 1957 show that it was the unanimous opinion of the committee that the original copy of the transcript as prepared by the exchange staff should be forwarded to the Securities and Exchange Commission's regional office. Further, our records show that the regional office of the SEC filed an action in June 1957 in the Federal court (file No. 119-232) against certain defendants, among which were Swan-Finch Oil Corp; Charles A. Grande; Jerry A. Re and Gerard F. Re, and that the defendants consented to a permanent injunction against any further sales of unregistered stock, that is, further violations of the Securities Act of 1933.

I might add that under the registration provisions of the Securities Exchange Act of 1934 and the constitution of the American Stock Exchange we have no power to enforce the registration provisions of the 1933 act.

From my conversation with Mr. Bocklet he stated his committee was curious as to the Grande sales, but not having the power of sub-

pena under our constitution to question nonmembers, could not interrogate Grande and, in turning the transcript of transactions over to the regional office of the SEC, felt they were doing the best that they could under the circumstances. The reason for the referral should be obvious.

In retrospect, after reading the allegations in the brief of the Trading and Exchange Division the thought occurs that if the same Federal investigators who did such an excellent job in developing the 1933 act case against the Res had used the same transcript submitted by us and their power of subpoena in 1957 to establish the 1933 act violation, the Res operation might have been cut off then.

I have with me the transcript to which I referred and a copy of the Federal court order of 1957 in the *Swan-Finch* matter. Mr. Chairman, I present them for your records.

Mr. MACK. They will be received.

(The information referred to follows:)

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

(Civil action file No. 119-232)

ORDER OF PERMANENT INJUNCTION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff

against

SWAN-FINCH OIL CORPORATION, LOWELL M. BIRRELL, JOSEPH TAL & Co., ANTHONY J. CORDANO, CHARLES A. GRANDE, STEVEN RANDALL & Co., INC., FRANK M. NAFT, TANNEN & Co., PHILIP TANNEN, GERARD A. RE, GERARD F. RE, S & C TRADING INC., BIRNBAUM & Co., NAHUN BIRNBAUM, NORRIS ADAMS, LTD., COUNTY EQUITIES, INC., THE GREATER NEW YORK INDUSTRIES, INC., GREATER NEW YORK LABORATORIES, INC., ECHO FALLS OIL Co., MARY B. PRIOR, ROY H. CALLAHAN, PATRICK J. WOISTED, TELDAN TRADING CORPORATION AND BENJAMIN C. COHEN, Defendants

This cause having come on for hearing before me upon the complaint of the plaintiff and an order to show cause dated April 15th, 1957; and the defendants Gerard A. Re and Gerard F. Re having filed their answers thereto; it is hereby

ORDERED, ADJUDGED AND DECREED, by way of a final injunction, that the defendants Gerard A. Re and Gerard F. Re, their agents, servants, employees, attorneys, and assigns, and each of them, be, and they hereby are, enjoined from directly or indirectly:

(a) Making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to sell common capital stock, \$5.00 par value, of Swan-Finch Oil Corporation, or any other securities, through the use or medium of any prospectus or otherwise;

(b) Carrying such securities, or causing them to be carried, through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or delivery after sale, unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; and

(c) Making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to offer to sell any such securities through the use or medium of any prospectus or otherwise, unless and until a registration statement has been filed with the Securities and Exchange Commission as to such securities, or while a registration statement filed with the Securities and Exchange Commission as to such securities is the subject of a refusal order or stop order of the Securities and Exchange Commission or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act of 1933,

provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended.

/s/ SIDNEY SUGERMAN,  
United States District Judge.

Dated June 27, 1957.

Gerald A. Re, one of the defendants in this action, having read the foregoing order of permanent injunction and being fully aware of the terms and consequences thereof, does hereby consent to the entry of the order against him.

GERARD A. RE.

JUNE 26, 1957.

STATE OF NEW YORK,  
City of New York, ss:

On this 26th day of June 1957, before me appeared Gerard A. Re, known to me personally and to me personally known to be the person who executed the foregoing consent to an order of permanent injunction and he duly acknowledged to me that he had executed the same.

\_\_\_\_\_, Notary Public.

JUNE 26, 1957.

Gerard F. Re, one of the defendants in this action, having read the foregoing order of permanent injunction and being fully aware of the terms and consequences thereof, does hereby consent to the entry of the order against him.

GERARD F. RE.

JUNE 26, 1957.

STATE OF NEW YORK,  
City of New York, ss:

On this 26th day of June 1957, before me appeared Gerard F. Re, known to me personally and to me personally known to be the person who executed the foregoing consent to an order of permanent injunction and he duly acknowledged to me that he had executed the same.

\_\_\_\_\_, Notary Public.

JUNE 26, 1957.

Mr. REILLY. Mr. Chairman, I wish to thank you and your committee for having given me this opportunity to present the foregoing statement.

Mr. MACK. Mr. McCormick, do specialists on the American Stock Exchange perform the same functions as they do on the New York Stock Exchange?

Mr. McCORMICK. They are identical, except for one important difference; that is, that on the American Stock Exchange the specialists also operate as the odd-lot dealers. In other words, they have the responsibility of executing all buy and sell odd-lot orders, whereas, on the New York Stock Exchange, two separate and distinct firms handle the bulk of the odd-lot orders.

Mr. MACK. They are not specialists? You do not regard them as specialists?

Mr. McCORMICK. No. The two firms on the New York Stock Exchange are not specialists, that is correct.

Mr. MACK. What percentage of the volume of stocks bought and sold on the American Stock Exchange represent the activities of the specialists?

Mr. McCORMICK. It varies from stock to stock, Mr. Chairman. In some cases, where the character of the stock is such that the public itself maintains a minimum spread, the participation of the specialist is small. In specialties, where the public interest exhibited on the market results in a wide spread, the specialists then participate much more actively, and I would say that in some cases, taking both the buy and sell side, they may participate in excess of 30 percent of the trades.

Mr. MACK. How do they become specialists in these particular stocks?

Mr. McCORMICK. Are you referring, Mr. Chairman, to the exchange's policy in allocating securities to particular specialists?

Mr. MACK. Yes, that would be one of the questions I want to ask.

Mr. McCORMICK. We recently adopted a rule that leaves the discretion—

Mr. MACK. You mean by recently, within the last month?

Mr. McCORMICK. Yes. Allocation is entirely within the discretion of the committee.

Mr. MACK. That is the floor committee?

Mr. McCORMICK. The floor committee, that is right, sir.

Prior thereto, we had three basic policies. First, if a specialist created the interest that led to the listing, the stock was assigned to him.

Mr. MACK. I am not quite sure I understand what you mean by "created interest."

Mr. McCORMICK. In other words, through his contacts, he stimulated the interest of the officials of the company to list. The committee would review the contacts he had made and decide whether or not he had been instrumental in creating the interest that resulted in bringing the stock. It was assigned to him, if the committee was so persuaded.

Mr. MACK. In that case, the specialist would have solicited or sold someone the idea of listing on the American Exchange?

Mr. McCORMICK. That is correct. In other words, if through his own personal contacts he was able to persuade a company whose stock was traded over the counter that it should be listed, we would assign it to him, with the proviso, of course, that he had the money and the ability to handle that particular stock.

Mr. MACK. He would be a specialist at the time that he made the contact to encourage the listing of the stock, is that not correct?

Mr. McCORMICK. He would become the specialist in that particular stock subsequent to that time.

Mr. MACK. Then, he would have the ability to act as a specialist?

Mr. McCORMICK. He would if he had both the money and the ability to handle the particular stock.

Mr. MACK. Then, the question would be as to whether or not he had the ability to handle this particular stock?

Mr. McCORMICK. There is no question about it that he, in the opinion of the committee, would have to have both the monetary and mental capacity to handle the stock.

Mr. MACK. What kind of a test would you make to determine whether he had the ability to handle this particular stock?

Mr. McCORMICK. The committee on floor transactions is on the floor all day.

Mr. MACK. What I am trying to find out is what type of ability must he possess to handle one stock when he is already qualified and has displayed the ability to handle the other stocks?

Mr. McCORMICK. There is a variation, Mr. Chairman, as to the ability required to handle different stocks. The committee, knowing the background and the operations of the specialist, can make that appraisal, I assure you.

Mr. MACK. Then, would the specialist need to be familiar with the background and operation of the corporation which issued the stock?

Mr. McCORMICK. Not necessarily.

Mr. MACK. Would you give us an example of what would be needed in the way of ability in the case of a stock that was about to be assigned to a particular specialist?

Mr. McCORMICK. Yes. Let's take a situation which involved a re-appraisal on the part of the committee on floor transactions.

Let's take the case of General Development, for example. That stock was assigned to a particular post. It became quite active. It required the injection of a considerable amount of capital, and a considerable amount of skill.

It was determined that those qualities plus a third factor, the availability of manpower at that particular post, was lacking. The floor committee reappraised the situation and transferred it to another post. Now, in this transfer all these matters that I am telling you about were examined. One, there was not enough. Where do we put it; we found a spot for it. Those things are difficult to pinpoint, one, two, three. You must know the man. Incidentally, it takes a native intelligence to be a good specialist.

Mr. MACK. The question I have raised here is what is needed in the case of a particular stock when the specialist has already qualified as a specialist. What additional skill or ability does he need to handle the particular stock?

Mr. McCORMICK. Again, I have to go back to what I have said before and that is that it involves an appraisal of capacity. For example, it would be difficult for me to define what it would take to be a good president of an exchange.

Mr. MACK. I can understand your limitations. I cannot understand that particular limitation. I can understand the monetary problem and the employment of personnel that might be necessary, but I was particularly interested in knowing about the skill or ability that is required of this individual.

Mr. McCORMICK. It would be equally difficult for me to define what qualities would make a good exchange president, or a good Congressman. Those are particular skills that I think must be appraised by the people who are either electing me as a president or you as a Congressman.

Now, probably the greatest expert in floor operations in all of Wall Street is Mr. Reilly and he might be able to enlighten you on this.

Mr. REILLY. Mr. Chairman, actually speaking in terms of a man making contact, he sells the advantage of listing based on the fact that it is a centralized market, a continuous market, and that the companies should appreciate the benefit of advertising the price of their stock on the Trans-Lux.

As for the qualification of a specialist, most specialists were born into it long before there was a 1934 act and very seldom do we permit a new member to become a specialist unless he has trading experience prior thereto, and has the special ability of maintaining the market. It is generally based on the general condition of the market itself; in other words, the type of issues that we have and new issues.

In the particular area of specializing in any stock, he would operate in the area perhaps a point or two points above or below the bid or

offer of the public. His ingenuity figures to take place on its anticipation based on general conditions taking place in the market.

Mr. MACK. I understand that and I appreciate the explanation. I know you are trying to be helpful. But most all of your specialists possess the skill and ability to handle most any stock, is that not correct? Do not specialists possess the ability to handle most any individual stock?

Mr. REILLY. Yes. If a man is qualified under the floor committee rules, he is ready and adequate to handle it.

Mr. MACK. When a specialist brings in or sells a new issue, then normally he is the one who is assigned that stock, is that not right?

Mr. McCORMICK. Mr. Mack, if I could try to clarify what I think is in your mind, you are wondering why an individual, who contacts the company and persuades them that it would be advantageous to list on the exchange, gets the stock, is that right?

Mr. MACK. Yes. Did you make that statement, that he does get the stock?

Mr. McCORMICK. Oh, he has, up to now.

Mr. MACK. In the past, and up until a month ago, he has gotten the stock when he solicited or sold it?

Mr. McCORMICK. If he had the ability and the money to handle the stock.

Let me pursue that one moment. The object and purpose of that policy was that the staff members should not be the sole, let's say, salesmen of the advantages of the auction market, that the specialists are quite personable and quite capable, and therefore, they were encouraged to go about the country also selling the idea that it was a good idea to list on the American Exchange.

Incidentally, this is not new or novel. Although not in writing, I understand every other exchange in the country gives consideration to the efforts of specialists in bringing in securities.

Mr. REILLY. Mr. Chairman, may I interject?

Mr. MACK. Go right ahead.

Mr. REILLY. Mr. Chairman, the specialist, just because he contacts and sells the advantage of listing to the officials of companies, doesn't always get the stock. It is based on the activity he has in the post, too. If he is too active, the floor committee will not allocate that stock to him.

In other words, if he is quite active at his post, the committee will not go along and give him the stock even though he worked for it. This has caused, in the past, some embarrassment as far as the exchange is concerned, but nevertheless, we take the attitude that we are responsible for our exchange operations. Therefore, we do not go along with a company's request based on the specialist making contact and selling the idea of listing, unless he is able to handle it, and that still comes back to the idea of what is his activity, plus his financial resources and plus the personnel he has helping him to do his administrative work. So there are many instances, Mr. Chairman, in which they haven't received the stock.

Mr. MACK. Then, the specialists are interested in getting more stock under their control, that is, so that they will be specialists in additional stocks?

Mr. McCORMICK. That is true of specialists on every exchange.

Mr. MACK. They have responsibilities to stabilize the market, except as you have explained today. They are, in effect, salesmen for the American Stock Exchange; is that not correct?

Mr. McCORMICK. That is correct. I think they should be.

Mr. REILLY. Also, Mr. Chairman, the floor committee in the past many times have removed the stock because of the increased activity and the specialist's inability to control. So, therefore, as those stocks remain the property of the exchange, the floor committee has the power to remove them if the specialist cannot handle them properly. We have had many cases where stocks have been so removed.

Mr. MACK. The floor committee is the committee that assigns the stocks to the specialists?

Mr. REILLY. Yes, sir, Mr. Chairman.

Mr. MACK. The floor committee is also the policing committee over the specialists?

Mr. REILLY. Yes, Mr. Chairman.

Mr. MACK. You have explained the function of specialists this morning. I presume that they in the end make money out of performing their functions.

Mr. REILLY. That is right, Mr. Chairman.

Mr. MACK. And one of the functions of a specialist, of course, is to provide a stable market; is that correct?

Mr. REILLY. That is right.

Mr. MACK. Would you explain to us whether or not the public interest would be served if a specialist handling public orders was not permitted to buy or sell for his own account?

Mr. REILLY. Mr. Chairman, working in these markets, and based on experience the specialists sometimes a hundred percent on both sides of the market make a close market. In other words, without the specialists there, and based on public orders alone, there could be in many instances four- and five-point spreads, and in lesser times three-point spreads and as we go down the spread begins to close down based on the activity in the general market itself, so without the specialist operating there you would have nothing but wide spreads, and I don't believe that it is conducive to public investing in the markets.

Mr. MACK. What type of an examination did your floor committee make concerning these activities of trading for his own account?

Mr. REILLY. In trading?

Mr. MACK. Trading for their own accounts.

Mr. REILLY. Again, Mr. Chairman, most of these rules came as a result of my liaison with the home office. I mentioned Mr. McCutcheon and the other gentleman. We have what we call, by watching the general condition, the continuity of price on the Trans-Lux. We call for an ST report of the specialists' operations. In other words, that does not mean the stock has to be active. It is based on the continuity of sales or the movement of the stock itself. This ST report requires the following information: the specialist's opening position, what type of tick, his short sales, and the amount of odd lots he dealt in and his closing position.

After we have received that information, since our sales are timed at the trading post when a sale is taking place, the record room brings those sales in and we match them up against the specialist's trading

report as submitted to the floor committee. Then we can tell at a glance whether or not he is trading against the trend or going with the trend.

Mr. McCORMICK. Mr. Chairman, I would like to add something to that statement.

The New York Stock Exchange has a policy under which they check four times a year on certain stocks that they specialize in, a 2-week period. We did not have that. However, we did come to the SEC and we developed this ST form of reporting. As a matter of fact, I think it is better than the system used by the New York Stock Exchange because we don't wait and get a report every 3 months. We get it within 12 hours of the time we think there is something to look into.

Now, again, within the last month, we have adopted the system of the New York Stock Exchange, but I think it is something extra. We still think our ST form of reporting is better and we are keeping it. During 1960 and 1961, we have had on the average one ST report every business day. We think it is better and we are going to keep it, but in view of the comments that have been made recently, we will put on top of it the New York Stock Exchange system although we don't think it is necessary or important.

Mr. MACK. Now, the floor committee takes disciplinary action, or does the board of governors take that action?

Mr. McCORMICK. It varies, Mr. Chairman. There are penalties that can be placed by a committee up to a certain level. Beyond that, it must be acted upon by the board. Committees, regardless of the type of penalties they assess, must report to the board.

Mr. MACK. That is the floor committee or what committee?

Mr. McCORMICK. All committees. There is an important difference between our operation and the other exchanges.

Mr. MACK. The floor committee would have jurisdiction in this area?

Mr. McCORMICK. In this area, but we also have the outside supervision committee which handles questions of capital requirements, advertising, and things of that sort. We have a series of operating committees. For example, the floor committee meets every Monday, the listing committee every Tuesday, outside supervision, most Wednesdays. So that we have a committee meeting almost every day, and all these committees are composed of governors.

Mr. MACK. Excuse me for interrupting you, but are you not saying that you have a committee meeting for each individual committee once a week?

Mr. McCORMICK. No; outside supervision, I would say, meets probably every other week; finance maybe twice a month.

Mr. MACK. Who is responsible for the enforcement in the meantime?

Mr. McCORMICK. They are in continuous session on the floor.

Mr. REILLY. Mr. Chairman, since I was chairman of the floor committee, I would like to tell you exactly what happens in this area. In other words, the floor committee is assigned to meet once a week, but many times we meet four and five times a week. In other words, if any violation or considerable violation has been committed by a member and any member of the floor committee reports it to the

chairman of the committee, he immediately calls a meeting that afternoon and requests the member who is charged to appear with his books and records.

Actually, our constitution provides for eight standing committees, but there are three committees that enforce the rules stipulated in the constitution, that is outside supervision, which takes care of office operations completely; the floor committee which takes care of floor operations completely, and, finally, the committee of business conduct. Each standing committee such as the outside supervision and the floor committee have a maximum penalty they can impose of a \$250 fine. Of course, the floor committee has the power to revoke a specialists' privileges and also under rule 111 to suspend the traders' privileges.

Mr. MACK. Is that with review of the board of governors?

Mr. REILLY. That comes later.

Mr. MACK. I hope you don't take too much this morning.

Mr. REILLY. I will make it very brief. Actually, when a preliminary investigation shows that a provision or a rule of the constitution has been violated, indicating unintentional violation, the floor committee will handle it. Anything more serious than that will go before the business conduct committee. The business conduct committee can then prepare charges, the member receives the charges, and the matter goes before the board of governors. We have a trial, the same as in any courtroom.

Mr. MOONEY. Mr. Chairman, for the information of the committee, I would like to give you a very brief description of disciplinary action procedures, the type of action taken by the exchange and a recitation of the number of such actions.

Mr. MACK. Yes. We will receive that for our files and if it is appropriate, we will include it in our record.

(Document referred to has been placed in the committee files.)

Mr. MACK. Then the board of governors has the ultimate responsibility there?

Mr. REILLY. When it gets down to real serious violations; yes, Mr. Chairman.

Mr. MACK. Your board of governors are also participating in various activities, are they not? For instance, some of them are specialists, are they not?

Mr. REILLY. That is right, Mr. Chairman. We have 15 regular members on the board who are operating on the floor and we have 12 allied members who are partners of regular members operating the offices, three public governors, and ex-officio governors would be the president and chairman of the board.

Mr. MACK. And some of the board of governors are floor traders?

Mr. REILLY. It is broken down into segments; in other words, in a majority of instances, a member of the floor committee must be a specialist because he has to be acquainted with all rules and regulations pertaining to the functioning of the specialists, but we have added to that commission brokers.

Mr. MACK. I said floor committee.

Mr. REILLY. Floor committee; yes, Mr. Chairman.

Mr. MACK. They are specialists?

Mr. REILLY. They are broken down into so many specialists, and commission brokers, and traders as generally represented.

Mr. MACK. On the board of governors?

Mr. REILLY. Yes. These qualified men are put on the floor committee.

Mr. McCORMICK. There are 12 members on the floor. We want to clarify the fact that the majority of the board is not represented by specialists.

Mr. MACK. I did not say the majority of the board, but specialists are members of the board; is that not correct?

Mr. McCORMICK. That is correct.

Mr. MACK. How many of them are specialists?

Mr. REILLY. I would say offhand there must be about five members, I believe.

Mr. MACK. Five out of the 12

Mr. REILLY. Thirty-two. The board has 32, Mr. Chairman. On the floor committee there are 12. The president is an ex-officio member of that committee.

Mr. MACK. Again, how is your board broken down? You have 12 active members?

Mr. REILLY. We have 15 regular members.

Mr. MACK. Fifteen regular members?

Mr. REILLY. That is right, and they operate on the floor, Mr. Chairman. We have 12 allied members who are partners, office members, operating the offices.

Mr. MACK. Do the allied members have an equal vote with the regular members?

Mr. REILLY. Yes, Mr. Chairman.

Mr. McCORMICK. I might say, Mr. Chairman, that this is the same breakdown as other exchanges have.

Mr. MACK. Do you have any rules that require the members of the board of governors to disqualify themselves when you are voting on disciplinary matters?

Mr. REILLY. If they are interested in a case, Mr. Chairman, they have to disqualify themselves.

Mr. MACK. That would be true if they were interested in an individual stock as well as if they were involved in the disciplinary matter?

Mr. REILLY. Definitely, Mr. Chairman.

Mr. MACK. Are these individual members of the board of governors required to make any special reports on stock transfers, outside business, financial interests, and things of that nature?

Mr. REILLY. They are subject to the same reports as any regular member.

Mr. MACK. I want to recognize the other members of the committee. I would like to ask, first, Mr. McCormick, something about the statements that were issued concerning speculation recently.

I do not know whether you recall or not, but when you were before my committee 2 years ago, I asked about this very same matter, and indicated that I had observed that you made these announcements when the market was at its peak and not when it was at lower levels. I inquired of Mr. Funston, when he was before the committee, concerning that same subject, and he felt that his statement did influence the market. I presume that you feel that your statement also is worth your time and effort.

Mr. McCORMICK. As a matter of fact, Mr. Chairman, the American Stock Exchange has always taken the position that the public should be informed. I have here a file of statements I have made and I have not made them just at the top of the market. I did not indicate any panic about the type of investment going on. I merely gave what I thought was intelligent advice.

As a matter of fact, my statements are a little repetitious because I have advised and counseled for years one simple thing: take a pad and pencil in your hand and figure out the price-earnings-yield basis on what you are buying, and with that in hand decide whether what you are buying will give you satisfactory results. I have not at any time pressed the panic button about the market. I don't think it is my business to do so. I think it is my business to tell people to buy intelligently.

Mr. MACK. Mr. McCormick, I presume you have a record of the times you made these statements?

Mr. McCORMICK. They are right here.

Mr. MACK. I would receive that information for our files if you care to make it available to me so—

Mr. McCORMICK. I would be delighted, sir.

Mr. MACK (continuing). That we can reexamine the announcements.

Mr. McCORMICK. Right.

Mr. MOONEY. Mr. Chairman, if I may, just to identify these documents; they are a series of news releases and I have them in inverse chronological order. There is also appended hereto a number of copies of the Exchange magazine with paper clips indicating statements about the market or general advice to investors which we think the committee might be interested in.

Mr. MACK. Yes, I will be glad to have those for our files.

To be perfectly fair then, you feel that you have made these statements periodically, but they were not given proper recognition in the press and news media, except when the market was at a very high peak? Do I understand you correctly?

Mr. McCORMICK. I wouldn't say that; no.

Mr. MACK. In other words, you feel that your statements have been carried in the press whenever they were made?

Mr. McCORMICK. Yes. As a matter of fact, you will find from the evidence there that I quite frequently made my statements in addressing groups in speeches.

Mr. MACK. Last month, Mr. Keith Funston made a statement that was given extensive publicity throughout the country, and when he was before this committee he indicated that he was more interested in a marketplace somewhere else in other securities, in other areas, than in the New York Stock Exchange.

Do you care to comment upon the speculative activity that may have gone on in the securities traded over your exchange?

Mr. McCORMICK. Yes. As a matter of fact, in my releases, and I think I put one out about the same time, I made this statement:

I think it is a good time for investors to take pad and pencil in hand and make some calculations concerning the existing relationship between prices, earnings, and yields for individual stocks.

I didn't say anything about small companies, etc. I said this:

This suggestion applies to both the long established and relatively new enterprises.

Mr. MACK. Were you referring to stocks being traded over your exchange?

Mr. McCORMICK. I was referring to stocks traded every place, including the New York Stock Exchange.

Mr. MACK. Then you felt that we should be concerned about speculation in the established firms as well as the new firms?

Mr. McCORMICK. The old, well-established firms as well as the new ones.

Mr. MACK. I presume you have made these statements because you felt that it would be unhealthy for this trend to continue.

Mr. McCORMICK. It is not my business and I have never set myself up as an appraiser of the market. I merely am in a position, as is the SEC, and I am a former SEC Commissioner, of continuing to alert the country, whether the market is down, or up, or sideways, to invest intelligently, know what you are doing, and those are all the statements I have ever made.

Mr. MACK. Then you made your most recent statement about the same time the president of the New York Stock Exchange made his statement.

Mr. McCORMICK. Yes; at the request of the press. "Mr. McCormick, do you have any comment?"

Mr. MACK. As I understand it, the difference between the two statements was that Mr. Funston made his statement on his own motion and you made your statement in response to inquiries?

Mr. McCORMICK. That is correct.

Mr. MACK. Therefore, the timing of Mr. Funston's statement was more important than yours; that is, in that it must have been made because he felt that the stocks were getting to unusually high levels.

Mr. McCORMICK. I don't know why Mr. Funston made his statement.

Mr. MACK. You were very happy to make your statement at that time, though, were you not?

Mr. McCORMICK. Exactly. As a matter of fact, some of the press is getting tired of getting the same thing from me because I have always urged caution and intelligent investing.

I have said it so many times they don't think it is news.

Mr. MACK. At the time Mr. Funston made his statement, did you have any opinion as to whether or not the market was at an unusually high level?

Mr. McCORMICK. I can assure you that if I had not been called by the press, I would not have issued any statement at this particular time.

Mr. MACK. Have you ever discussed with your Board of Governors whether or not you should make such a statement?

Mr. McCORMICK. Definitely not. I am the only spokesman for the American Stock Exchange and anything I feel I should say, I say it.

Mr. MACK. Therefore, you see no need for the Board of Governors to decide when these warnings should be made?

Mr. McCORMICK. Definitely not.

Mr. MACK. And do you see any reason why you, or the President of the New York Stock Exchange, or any other important official

should have the sole responsibility for making these warnings at any particular time?

Mr. McCORMICK. I have no comment about Mr. Funston's authority. It happens that under our constitution, I am the sole spokesman for the American Stock Exchange and when they lose confidence in me, it is up to them to change it.

Mr. MACK. Thank you.

Mr. Dingell, do you have any questions?

Mr. DINGELL. Thank you Mr. Chairman.

Mr. McCormick, I am concerned about the initial process of listing stocks on your exchange. Would you tell the committee briefly how that is accomplished? In other words, what safeguards do you apply to protect the investor and make sure that the company which is listed meets the general character that you think it should have for protection of the investing public?

Mr. McCORMICK. Mr. Congressman, as I stated earlier, we do take on smaller companies. However, our analysis of the company is as thorough as the analysis made by any exchange. We have a committee of securities that meets every Tuesday to review the facts that are presented by the companies seeking listing with us. These companies must meet our listing requirements, and also those of the SEC.

Mr. DINGELL. What are your listing requirements, very briefly?

Mr. McCORMICK. We require that a company have at least 100,000 shares in the hands of the public, that is, outside of the management group, and at least 500 stockholders. We feel that based on these requirements, we can maintain a proper and efficient auction market. We do not have an earnings record requirement like the New York Stock Exchange that allegedly requires a million dollars in earnings for each of the last 3 years. We do not have that and that, I think, is the key to our exchange.

We give a small company that is coming up a chance to get the advantages of an auction market. And I think we perform one of the greatest functions in the exchange market because as I said earlier we provide an exchange market for small companies. This creates problems, but I think we have coped with them.

Mr. DINGELL. Do you go into the financial solvency or into the financial integrity of the firm concerned?

Mr. McCORMICK. We certainly do. We check their financial statements thoroughly. I happen to be a certified public accountant, and I think I am as qualified as anyone who looks over a financial statement of anyone attempting to register anywhere.

Secondly, if we don't know the basic background of every officer, director, and major stockholder, we get a private organization to give us a report on them.

Mr. DINGELL. Do you list any speculative issues?

Mr. McCORMICK. I think every exchange does.

Mr. HEMPHILL. Would you yield?

Mr. DINGELL. Yes.

Mr. HEMPHILL. You say you have the names of all officers and directors. Did you investigate their capability from a management standpoint?

Mr. McCORMICK. That is impossible.

Mr. HEMPHILL. You make no investigation of that at all?

Mr. McCORMICK. All we can do is read a financial statement and tell whether they have done well or badly.

Mr. HEMPHILL. Well, if they do not have any earning record, which is not one of your requirements, I believe you said——

Mr. McCORMICK. That is right.

Mr. HEMPHILL. Then the potentiality would depend in part on the management capability of those in charge, would it not?

Mr. McCORMICK. That is right.

Mr. HEMPHILL. And you make no investigation of that?

Mr. McCORMICK. It is impossible to make such an investigation.

Mr. HEMPHILL. Even through private sources that you could employ?

Mr. McCORMICK. Mr. Congressman, we have all seen very fine companies go down hill. How do you appraise management?

As a matter of fact, I wish you could.

Mr. HEMPHILL. Do you make any investigation as to the background and experience of the people in charge of management of the particular company?

Mr. McCORMICK. Everything they have done for 5 years, for every one of them.

Mr. HEMPHILL. And that is a part of the record before your committee which meets on Tuesday?

Mr. McCORMICK. That is correct.

Mr. HEMPHILL. Thank you.

Thank you, Mr. Dingell.

Mr. MOONEY. May I, Mr. Chairman, in this line of questioning, it may or may not save some of the committee's time, we have prepared a five-page description of the qualifications and conditions for listing corporate securities with the various exhibits required by the exchange. May we offer that for your record, please?

Mr. MACK. We will receive it for our files and determine whether or not it should be included in the record.

(Document referred to has been placed in the committee files.)

Mr. MOONEY. Thank you.

Mr. DINGELL. I have one specific stock which began listing on your exchange which I have some interest, not by way of ownership, but merely to determine whether or not you have properly complied with your own regulations for listing.

Mr. McCORMICK, are you familiar with Canadian Javelin?

Mr. McCORMICK. Yes.

Mr. DINGELL. Are all of your listing requirements met in connection with that stock?

Mr. McCORMICK. They were.

Mr. DINGELL. Did you examine into the character of the president of the company?

Mr. McCORMICK. Yes, we did.

Mr. DINGELL. Board of directors?

Mr. McCORMICK. Yes.

Mr. DINGELL. That was a Canadian company; am I correct?

Mr. McCORMICK. That is correct.

Mr. DINGELL. Is it the practice of your exchange to list Canadian firms?

Mr. McCORMICK. Yes, indeed.

Mr. DINGELL. Did Canadian Javelin file or request listing on your exchange? Do you recall?

Mr. McCORMICK. I will say this. They requested listing a number of times, but their acceptance was after the SEC had cleared a registration statement.

Mr. DINGELL. After the proceedings?

Mr. McCORMICK. They had an injunction proceeding against, I believe, the president, and an associate of his, and we listed it only when probably the largest ore developing company in the entire world agreed to put many millions into the company and/or its subsidiaries. That is when we finally considered listing, after having rejected it a half dozen times. Pickens-Mather is good enough for me. I might add this, Mr. Congressman: that the SEC itself suggested that one of the conditions of clearing a pending registration statement would be that they list.

Mr. DINGELL. Does that occur to you to be a sound basis for lifting the injunction, in other words, that they list?

Mr. McCORMICK. No, I think Pickens-Mather was the thing that convinced me.

Mr. DINGELL. You said that one of the requirements for lifting of the injunction was that they list on the American Exchange.

Mr. McCORMICK. That didn't influence me any more than some of the other things that some people at SEC say.

Mr. DINGELL. I am not inquiring into whether you were influenced. I want to know whether or not that is a sound basis for them to lift their injunction against the sale of stock by Canadian Javelin.

Mr. McCORMICK. I think you ought to direct that question to the SEC.

Mr. DINGELL. I would like to have your opinion on it.

Mr. McCORMICK. That would not influence me in the slightest.

Mr. DINGELL. I did not ask you whether it influenced you. Let me repeat my question, please. Is it in your opinion that a proper consideration on the part of the SEC in requesting an injunction be lifted that a firm list itself on your exchange?

Mr. McCORMICK. Mr. Congressman, I was on the staff and a Commissioner for 17 years. I never have heard of any such precedent, never.

Mr. DINGELL. In other words, that was a rather extraordinary precedent on the part of the SEC?

Mr. McCORMICK. It certainly was.

Mr. DINGELL. Are you aware of the fact that there have been a number of stockholder suits filed against Canadian Javelin and against the previous management of that company?

Mr. McCORMICK. I understand there have been suits against the management, all directed to benefit the company itself.

Mr. DINGELL. I am aware of that. Were these suits pending at the time of the listing?

Mr. McCORMICK. Yes.

Mr. DINGELL. Was that considered by the American Stock Exchange in its listing of this particular firm?

Mr. McCORMICK. Definitely. If they won the suit, they would be better off than the balance sheet showed.

Mr. DINGELL. Does this not raise serious questions, though, as to the management and the integrity of the management that should be considered by the American Stock Exchange?

Mr. McCORMICK. As I have said, I was confident that when Pickens-Mather went for these millions they were going to be the managers, and were, in fact, the managers.

Mr. DINGELL. The real manager at the time of the listing, though, was somebody else, is that not a fact?

Mr. McCORMICK. In name only.

Mr. DINGELL. It would appear that this too should be a consideration, the fact that there was a listing of a nominal manager, at least in name only? Is that not something that you should consider?

Mr. McCORMICK. We did consider it.

Mr. DINGELL. Why did you disregard this or what other aspects of the situation compelled you to list it in view of this consideration?

Mr. McCORMICK. A simple fact. The people really in charge were reputable.

Mr. DINGELL. If they were really reputable, why would they have a front man?

Mr. McCORMICK. A question of time.

Mr. DINGELL. Who was the nominal management and who was the real management?

Mr. McCORMICK. I think the Pickens-Mather Corp. were really running the company, and another thing; let's let the record speak for itself. What has happened to Canadian Javelin since?

Mr. DINGELL. I am not concerned about that.

Mr. McCORMICK. I would like to ask a question. Did we make a mistake?

Mr. DINGELL. Suppose you tell us what has happened to Canadian Javelin since.

Mr. McCORMICK. The company has now its railroad in. It now has its pilot plant working.

Mr. DINGELL. Are you aware of the fact that in these stockholder suits there has been an offer to settle in the amount of millions of dollars in these stocks sold?

Mr. McCORMICK. Exactly, by Mr. Doyle to the company, and they will get the additional million.

Mr. DINGELL. Mr. Doyle was the man that you mentioned as being the nominal management; am I correct?

Mr. McCORMICK. That is right.

Mr. DINGELL. It is rather extraordinary that nominal management then would offer to settle stockholder suits in the amount of some millions of dollars; am I correct?

Mr. McCORMICK. I think you have to ask Mr. Doyle.

Mr. DINGELL. Is that not rather extraordinary in that normal management would offer to settle stockholders suits in the amount of millions of dollars?

Mr. McCORMICK. I don't know why the directors of Westinghouse agreed to pay fines and go to jail. I don't know.

Mr. DINGELL. We are not discussing the Westinghouse case. We are discussing the wisdom of listing a particular firm, the superintendence that your particular exchange gave to that previous and subsequent to the listing. Is it not rather extraordinary that the man

whom you call a nominal manager of a firm which was listed on your exchange should offer to settle the amount of some millions of dollars in stockholder suits which were pending? Is that not rather extraordinary?

Mr. McCORMICK. They were pending against him, and the funds go to the corporation. There are many similar cases. I understand on the New York Stock Exchange, Mr. Olin has agreed to give up \$2 million. I don't know how the New York Stock Exchange could have known when the Olin industries were merged into a listed company that there was a shortage in the inventory.

Mr. DINGELL. I am not greatly concerned with other matters on the exchange. I just want to follow this through in order to establish a perspective here, so that we can determine whether or not there is a need for this investigation.

Why should the nominal management come up with an offer of millions of dollars to settle stockholders' suits pending?

Mr. McCORMICK. You will have to ask him.

Mr. DINGELL. Where would this money come from, this millions of dollars offer of settlement that he made to stockholders?

Mr. McCORMICK. It is a very simple answer. Where did Rockefeller get his money? I mean they were lucky.

Mr. DINGELL. Did this money come from the corporation, or did it come from his personal funds?

Mr. McCORMICK. He happened to do a very simple thing. Apparently, he found an ore body.

Mr. DINGELL. Do you not think these are questions that should have been carefully considered?

Mr. McCORMICK. They were. They were carefully considered and every fact that you have stated about Mr. Doyle we knew.

Mr. DINGELL. You knew and you listed the stock, anyhow?

Mr. McCORMICK. Yes.

Mr. DINGELL. Are you aware of the fact that the Wall Street Journal called this thing in a recent article a fantastic swindle?

Mr. McCORMICK. I have little interest in what the Wall Street Journal thinks, and, as a matter of fact, much less in the last month.

Mr. DINGELL. Are you telling us, then, the Wall Street Journal is not a reputable financial organ?

Mr. McCORMICK. I don't want to express an opinion.

Mr. DINGELL. If what you tell us is true here, it would appear then that you would not consider the Wall Street Journal as being the basis for action of even listing or delisting a firm like Canadian Javelin; is that correct?

Mr. McCORMICK. Ask the Wall Street Journal why they did not give us any names that they referred to inferentially and otherwise when we requested them.

Mr. DINGELL. Have you in any way considered delisting Canadian Javelin since the story?

Mr. McCORMICK. Definitely not.

Mr. DINGELL. Do you think that the facts that we have discussed so far are basis for consideration of delisting?

Mr. McCORMICK. Definitely not. If we had any basis we would have acted before now.

Mr. DINGELL. Are you aware of the fact that some of these stockholder suits developed that the registration filed with the SEC was materially false?

Mr. McCORMICK. Obviously, I wouldn't know whether they have any false statements or not. Up to now, none of them has been established.

Mr. DINGELL. Do you not think that this should be a matter of scrutiny in listing or delisting a firm like this Canadian Javelin?

Mr. McCORMICK. At this point, I have no knowledge of any misstatement on any document filed with us. I have no knowledge that there is any misstatement in anything filed with the SEC.

Mr. DINGELL. Do you ever check matters like these stockholder suits when they come to your attention to determine whether or not there is material false statement?

Mr. McCORMICK. If it is going to have an important impact on the company, yes.

Mr. DINGELL. Do you not think that these stockholders' suits would have an effect on the company?

Mr. McCORMICK. Only favorably.

Mr. DINGELL. Only favorably. Do you think that this is the kind of company that should be listed on your exchange?

Mr. McCORMICK. Definitely.

Mr. DINGELL. You do. Are you aware of the fact that Mr. Doyle has recently agreed to settle a suit for \$3.25 million?

Mr. McCORMICK. That is correct.

Mr. DINGELL. And that the manufacturers allege in the suit that Doyle stole millions of dollars worth of stock and company assets?

Mr. McCORMICK. I am aware of that.

Mr. DINGELL. Does that not ring some warning bells to you that perhaps some additional scrutiny is required by your exchange?

Mr. McCORMICK. Not beyond what we have done.

Mr. DINGELL. Are you aware that Doyle's testimony later before the SEC and the referee in the stockholder actions directly contradicted the registration statement on which the SEC based its decision not to proceed on the civil and criminal aspects of the suit?

Mr. McCORMICK. Am I aware of what?

Mr. DINGELL. I will repeat that.

Are you aware that after Doyle's testimony later before the SEC and referee in stockholder actions directly contradicted the registration statement on which the SEC based its decision not to proceed into the civil and criminal aspects?

Mr. McCORMICK. Whatever the facts are, we are aware of them.

Mr. DINGELL. You say you are aware of them?

Mr. McCORMICK. I assume so.

Mr. DINGELL. At least, you are chargeable with knowledge or with awareness in superintendence of the affairs of the exchange; is that correct?

Mr. MOONEY. We are not aware of any statements such as you referred to, Congressman Dingell. They have not been brought to our attention.

Mr. DINGELL. If matters of this sort were brought to your attention, do you think you would take some action against Canadian Javelin?

Mr. MOONEY. It would depend on what their statements were and what their material impact was. We don't know what they were and we would have to reserve our judgment until we found out what the statements were, Mr. Congressman.

Mr. DINGELL. When allegations of this sort are made in lawsuits do you not think that it should give you concern to scrutinize the affairs of the company to make sure that investors are being protected and that the reputation of your exchange is properly maintained?

Mr. MOONEY. Mr. Congressman, when Mr. McCormick said that the lawsuits did not cause him pause so far as the company was concerned, he was referring only to the lawsuits of which he had knowledge, namely, the suits against Mr. Doyle for recovery against Mr. Doyle, as to which it appears apparent that Mr. Doyle is negotiating some settlement on his own behalf as against the dissident stockholders or the claiming stockholders.

The results of any such suit could only be a contingent asset to the company. There is no chance at the present time, so far as we have any knowledge of those suits, of a contingent loss to the company.

Now, when you mention allegations of fraud or statements by Mr. Doyle that are in conflict with what he has said or allegedly said in a registration statement, to my knowledge, we have no actual or other knowledge of those statements.

If we saw those statements, and we might be able to obtain them, what we would do about them would depend upon what was in the statements, the materiality, and certainly, we would take such action as might be required under the circumstances.

I would like to make one note before I finish my statement to you. We have made some reference to the injunction that was brought against the company, the complaint that was filed against the company before it listed. We were under the impression that one of the factors militating for the listing was that it was one of the conditions that it should be listed on the American Exchange.

Apparently, there has been some misunderstanding in that context and, further, if there has been any impression given that the injunction has been lifted at the present time, we are advised that it has not.

Mr. DINGELL. That the injunction was still pending and is still pending at the time of the listing.

Mr. MOONEY. I understand that's true. We would have to check that to be absolutely sure. If I had known you were going to discuss Canadian Javelin, Mr. Congressman, we might have had more facts at our disposal, and we will certainly supply anything that you desire us to supply.

Mr. DINGELL. Let me start out by saying that I hope you will consider there is nothing personal in my remarks this morning in directing my statements not only to you, sir, but also to Mr. McCormick. I want you to be very clear on that, sir. This should not be considered a matter of personalities.

I am just concerned, and have been concerned for a long time about the general nature of the protection afforded to investors, not so much by reason of any discrepancy in the activity of yourself or your exchange, or by reason of the activity of the SEC or inactivity by the SEC. I want to see to it that utmost protection is given to the average citizen in the market seeking this valuable protection, and

that is the reason I wanted to discuss it this morning, so that it would be clearly a part of the committee record, and so that we can determine whether or not an investigation of the kind which you have so strongly endorsed is in the public interest.

Let me go a little bit further. Let us go back over this Canadian Javelin matter. You mentioned that the injunction is still pending. Am I correct?

Mr. MOONEY. That is what we have been given to understand. I would have to check the record to make an affirmative statement on that myself.

Mr. DINGELL. You may submit any supplemental information that you desire.

Mr. MOONEY. Yes, be very glad to.

(Information referred to follows:)

We are informed by counsel to Canadian Javelin that the injunction consented to by the company and other defendants in September 1958 is still in effect. (See pp. 16 and 17 of the attached listing application of the company.)

[From Listing Application No. 3255, Canadian Javelin, Ltd.]

By complaint dated September 23, 1958 the Securities and Exchange Commission instituted a civil action in the District Court of the United States for the Southern District of New York against the company, John C. Doyle, Harold LeBrock, Maurice Lachmann and 20 other defendants alleging that since about August 1, 1954 and continuing through July 25, 1958 the defendants offered for sale and sold the company's capital stock without filing a registration statement under the Securities Act of 1933, and alleging other violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. On September 25, 1958, the company and the four executive officers of the company who were defendants and five other defendants appeared voluntarily by counsel before said district court and consented to a permanent injunction being entered against the company and the nine individual defendants enjoining them from any act or practice which will constitute a violation of the Securities Act of 1933 and the Securities Exchange Act of 1934. Counsel for the company stated to the court that the company proposed to file an application for listing its capital stock on a stock exchange in the United States and to file a registration statement with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The company also stated to the court that it would add additional directors of responsibility and stature to its board and this has been done. The company stated to the court that it proposed to transform its own corporation into an American corporation and the company is now considering a merger or other reorganization which would permit its subsidiary, the Javelin Corp., a Delaware corporation, to become the surviving parent corporation.

Mr. DINGELL. This is a suit against whom? Against Doyle? Who is the injunction running against? Did it run against Doyle, or Canadian Javelin, or just what is it?

Mr. MOONEY. It is my understanding that the injunction ran against Doyle, against the company, and against other persons who may have been selling the securities without registration in the United States.

Mr. Dingell, if you wish particularized information, in that respect, I would have to refresh my recollection and obtain a copy of the injunction for your files, if you wish to have it.

Mr. DINGELL. Certainly. That would be permissible.

What I want to see, though, in just a general way this morning, if you can, is the nature of the injunction. The injunction was against sales of securities of Canadian Javelin, am I correct?

Mr. MOONEY. Mr. Congressman, the ordinary tenor of an injunction of this type would be a prohibition against future sales of those securities in violation of the statute. It is not a prohibition against all sales in futuro. It is violative sales only.

Mr. DINGELL. We have here then a situation where the prohibition ran against violative sales, but that would have been cured by the listing which was made on the American Exchange, am I correct?

Mr. MOONEY. Listing is not any form of baptism or confession. It cures no sins that have been previously committed.

Mr. DINGELL. I am aware of that, but, in effect, if you follow this to its logical conclusion, the listing of the stock on the American Exchange for all intents and purposes cures the defects which were prohibited by the injunction, am I correct?

Mr. MOONEY. Mr. Congressman, if you please, listing on the exchange does not cure things. All listing on an exchange does is provide a marketplace for transactions in a security and presumptively lawful transactions in the security.

The injunction in Canadian Javelin was against future unlawful sales.

Mr. DINGELL. And when the listing on the American Exchange took place, they could engage in lawful sales, and so escape the ban of the injunction, am I correct?

Mr. MOONEY. No, they could not be relieved from the ban of the injunction. Let's take an example.

Let us say that Mr. Doyle, assume for the purpose of the case, or any person, is in control of the corporation, quite clearly in control of the corporation. At the time the security is listed he is subject, or has been subject, to an injunction against unlawful sales, sales in violation of the registration requirements of the statute, the 1933 act. The stock thereafter becomes listed. That does not mean that thereafter as a control person he can effect sales in violation of the statute. It has no impact upon his status one way or the other. He is still subject to the Securities Act of 1933—

Mr. DINGELL. I am fully aware of that.

Mr. MOONEY (continuing). As though the stock had never been listed in any form or fashion. All listing does is provide an additional marketplace for the securities and, more importantly, as it did in this case, provide the disclosure of information for the investors through the registration statement and such reports as are required under the statute, and also the market price of the stock is published every day.

Mr. DINGELL. Just one last question, Mr. Chairman.

I would like to have, if possible, from Mr. Mooney, or Mr. McCormick, a very brief answer on this. Do you feel it is appropriate for the American Exchange to list a stock wherein it is subsequently alleged by parties interested, admitted by parties interested and others, that the registration statements filed with the SEC and other important documents contain such important and material misstatements of fact or at least serious omissions?

Mr. MOONEY. Mr. Congressman, if I may answer the question, there is a distinction between allegations and fact. Now, if somebody tomorrow were to bring suit in the Federal court claiming that United States Steel was guilty of material misrepresentations in sales or any

other series of violations of law of the United States that might bring it under the burden of fraudulent allegations and such, the mere filing of a suit in itself would not be grounds for delisting of a stock. There is a great gap between allegation and proof.

Certainly, if it were proved, there would be a very serious question raised.

Mr. DINGELL. Of course, a \$3.25 million settlement on the part of Mr. Doyle would rise fair inference of the truth of the allegation.

Mr. MOONEY. Mr. Dingell, coming back in a series of circles to this same point, I think we both should understand that what we are talking about is a suit against Mr. Doyle in personam, a personal suit, not a suit against the company, a suit against Mr. Doyle, in which, if he settles it with this group of stockholders who are acting on behalf of the company, any payment he makes, any settlement he makes, whether it be for \$10 or \$10,000, or \$10 million, will be an asset of the company. It is not to be considered in futuro as a potential sore, or cancer, or defect, or loss. It is an addition.

Mr. DINGELL. It raises a question as to the integrity of the management.

Mr. CHAIRMAN. I apologize for intruding on the time of the committee.

Mr. MACK. Go right ahead.

Mr. DINGELL. Does it not appear to you that perhaps a suit like this ought to raise some question on the part of the exchange to determine whether or not this is stock which is worthy of listing on the American Exchange?

Mr. MOONEY. Mr. Congressman, if again I may, and I am sorry—I hope I didn't interrupt—

Mr. DINGELL. That is all right.

Mr. MOONEY. My great difficulty and the great difficulty of most of us present here today is that I don't know either qualitatively or quantitatively the nature of the suits to which you are referring. To the extent that it is a suit against Mr. Doyle for previous violations of the Securities Act of 1933 focusing only on section 5 of the statute, wherein there is a remedy, or if there is a suit against him by the company for illegal sales of securities only, absent some element of serious fraud and so on, depending upon the degree of seriousness of the charges, you would then have a degree of promptness of action and a decision as to what kind of action you would ultimately take.

I cannot understand the question. We would have to look at the facts and make a determination after scrutiny of the facts.

Mr. DINGELL. Do you periodically analyze stocks listed on the American Exchange to make sure that they are maintaining an adequate standard of truth reporting in compliance with your regulations and SEC regulations?

Mr. McCORMICK. We do.

Mr. MOONEY. Certainly we do the best we can in seeing to it that any company which is admitted to the privilege of listing complies with the requirements of listing.

Mr. DINGELL. Have you made such a scrutiny in the case of Canadian Javelin in the light of circumstances, and litigation, and so forth?

Mr. MOONEY. That is something that I would have to check with the listing department. Unfortunately, the man in charge of the listing department is not here.

Mr. DINGELL. You will submit that for the record?

Mr. MOONEY. His day-to-day activity is not within the purview of my knowledge or anybody here today. He may have made such a check and we may not know about it.

Mr. DINGELL. I want to thank you very much.

Mr. MOONEY. If we had known you were going to ask these things, certainly, Mr. Congressman, we would have every one of these details on hand.

Mr. DINGELL. I want to say that my questions were not intended to reflect personally on anyone. I hope you take my questions in that spirit. Thank you, Mr. Chairman.

Mr. MACK. Then, do you make periodic inspections of the stocks on your exchange to see if they meet these minimum requirements, and when do you make those inspections?

Mr. McCORMICK. We require the filing of the same reports that the Government does and we also require the filing of annual reports, and those are examined by our staff to see that they meet proper accounting requirements.

Mr. MACK. You do not make as thorough an examination, though, periodically as you do at the time that a stock is first listed on your exchange?

Mr. McCORMICK. That might be a distinction, but I doubt it. As a matter of fact, our staff does review the report.

Mr. MACK. Then, how often do you remove listed companies from the exchange?

Mr. McCORMICK. It varies. It depends on the circumstances. I certainly will submit for the record the companies that we have delisted, and there have been quite a few.

(Information referred to follows:)

## Issues removed during 1955

Date removed	Issue	Number of shares removed	Trading volume during 1955 on American Stock Exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Jan. 3	Whirlpool Corp. (common) <sup>1</sup>	3,188,624	( <sup>2</sup> )
Mar. 28	Continental Foundry & Machine Co. (common)	510,835	56,700
June 6	Niagara Share Corp. (common) <sup>1</sup>	1,685,732	12,600
20	General Acceptance Corp. (common) <sup>1</sup>	1,493,239	145,300
July 25	National Fuel Gas Co. (common)	4,191,261	333,000
Aug. 10	Aeroquip Corp. (common) <sup>1</sup>	1,000,000	199,300
Sept. 16	Pittsburgh Metallurgical Co., Inc. (common) <sup>1</sup>	637,706	161,300
Nov. 7	Beckman Instruments, Inc. (common) <sup>1</sup>	1,324,735	288,600
Dec. 6	Pennroad Corp. (common)	5,000,000	681,600
29	Rotary Electric Steel Co. (common) <sup>1</sup>	740,700	177,700
	Total, 10 issues	19,742,742	2,056,100
LIQUIDATED, EXPIRED, WORTHLESS, LIMITED NUMBER OF SHARES OUTSTANDING			
Jan. 7	ACF-Brill Motors Co. (warrants) <sup>1</sup>	\$ 279,988	( <sup>2</sup> )
24	Tobacco & Allied Stocks, Inc. (capital) <sup>1</sup>	\$ 238,972	( <sup>2</sup> )
Mar. 8	Carr-Consolidated Biscuit Co. (common) <sup>1</sup>	\$ 1,219,290	( <sup>2</sup> )
Apr. 7	American Republics Corp. (common) <sup>1</sup>	\$ 1,530,000	90,500
18	Scurry Oils Ltd. (capital) <sup>1</sup>	\$ 227,151	58,200
27	City Specialty Stores, Inc. (common) <sup>1</sup>	\$ 13,301	400
27	City Specialty Stores, Inc. (4½ percent convertible preferred) <sup>1</sup>	\$ 6,294	200
May 12	Willson Products, Inc. (common) <sup>1</sup>	\$ 2,581	6,400
13	Kirby Petroleum Co. (common) <sup>1</sup>	\$ 593,090	14,639
13	Mackintosh-Hemphill Co. (common) <sup>1</sup>	\$ 177,446	53,300
June 13	Devoe & Reynolds Co., Inc. (B common) <sup>1</sup>	\$ 5,387	23,000
13	Marion Power Shovel Co. (common)	\$ 7,303	3,400
13	Pacific Can Co. (common) <sup>1</sup>	\$ 486,291	6,300
July 22	North Central Texas Oil Co., Inc. (common) <sup>1</sup>	\$ 230,870	23,600
Aug. 10	Whitman (William) Co., Inc. (common) <sup>1</sup>	\$ 249,931	1,000
Dec. 20	Calamba Sugar Estate, Inc. (capital)	\$ 250,000	25,600
	Total, 16 issues	5,487,555	306,539
REDEEMED (PREFERRED STOCKS)			
Jan. 19	Kirby Petroleum Co. (50 cents preferred) <sup>1</sup>	500,000	( <sup>2</sup> )
Feb. 8	Brown Co. (\$3.24 preferred) <sup>1</sup>	52,455	( <sup>2</sup> )
14	Central-Illinois Securities Corp. (\$1.40 convertible preferred) <sup>1</sup>	None	550
Mar. 14	Metal Textile Corp. (participating preferred) <sup>1</sup>	12,564	( <sup>2</sup> )
Apr. 18	Union Oil Co. of California (\$3.75 A preferred) <sup>1</sup>	232,500	6,425
Apr. 1	U.S. & International Security Corp. (\$5 1st preferred) <sup>1</sup>	100,000	1,875
June 1	General Finance Corp. (5 percent A preferred) <sup>1</sup>	111,992	1,800
24	Icar, Inc. (5 percent convertible preferred) <sup>1</sup>	94,076	30,500
27	Brown Co. (\$5 convertible 1st preferred) <sup>1</sup>	57,915	16,708
July 12	Armstrong Rubber Co. (4¼ percent convertible preferred) <sup>1</sup>	598	4,375
Oct. 7	Helena Rubinstein, Inc. (class A stock) <sup>1</sup>	100,000	14,050
Nov. 15	General Public Service Corp. (\$6 dividend preferred)	3,305	251
Dec. 8	Reading Tube Corp. (participating preferred stock) <sup>1</sup>	38,389	5,400
	Total, 13 issues	1,303,754	81,934
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Jan. 3	Mapes Consolidated Manufacturing Co. (capital)	\$ 129,100	( <sup>2</sup> )
3	Oliver United Filters, Inc. (class B)	\$ 198,891	( <sup>2</sup> )
Feb. 14	Norden Laboratories Corp. (common) <sup>1</sup>	7,400,000	74,000
Mar. 11	United States Finishing Co. (common) <sup>1</sup>	7,475,974	39,600
11	United States Finishing Co. (\$4 convertible preferred) <sup>1</sup>	7,43,313	7,000
April 4	United States Radiator Corp. (common)	\$ 727,228	63,000
May 2	Ford Motor Co. of France (ADR's)	\$ 1,626,792	677,300
June 13	Pennsylvania Water & Power Co. (common) <sup>1</sup>	\$ 429,848	78,920
July 8	U.S. & International Security Corp. (common) <sup>1</sup>	\$ 496,800	135,800
Aug. 12	Key Co. (common)	\$ 120,000	57,275
Sept. 8	Central Ohio Steel Products Co. (common) <sup>1</sup>	\$ 184,507	37,900
8	Easy Washing Machine Corp. (B common) <sup>1</sup>	\$ 461,245	178,800
30	Domestic Finance Corp. (common) <sup>1</sup>	\$ 1,276,348	56,500
Oct. 3	Niles-Bement-Pond Co. (common)	\$ 868,285	608,000
10	Rowe Corp. (The) (common) <sup>1</sup>	\$ 504,000	83,600
Nov. 1	Clark (The D. L.) Co. (common) <sup>1</sup>	7,300,000	26,000
Dec. 5	Coll's Manufacturing Co.	7,400,000	281,100
	Total, 17 issues	8,642,421	2,405,195
	Grand total, 56 issues	35,176,472	4,849,768

<sup>1</sup> Removed from listing; all other issues removed from unlisted trading.

<sup>2</sup> No sales.

<sup>3</sup> Expired.

<sup>4</sup> Liquidated.

<sup>5</sup> Worthless.

<sup>6</sup> Limited number of outstanding shares.

<sup>7</sup> Merged.

<sup>8</sup> Assets acquired by other corporations.

## Issues removed during 1956

Date removed	Issue	Number of shares removed	Trading volume during 1965 on American stock exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Feb. 28	Cessna Aircraft Co. (common) <sup>1</sup>	731,109	75,700
Mar. 5	Argus Cameras, Inc. (common) <sup>1</sup>	454,084	22,000
May 1	Fenestra, Inc. (common) <sup>1</sup>	556,647	40,700
June 25	Buckeye Pipe Line Co. (capital)	1,310,672	85,000
Aug. 6	Heller (Walter E.) & Co. (common) <sup>1</sup>	1,374,166	49,500
Oct. 9	National-U.S. Radiator Corp. (common) <sup>1</sup>	1,044,429	131,500
	Totals, 6 issues	5,472,007	402,400
REDEEMED (PREFERRED STOCKS)			
Feb. 21	Higbie Manufacturing Co. (5 percent convertible preferred) <sup>1</sup>	27,012	400
23	General Outdoor Advertising Co., Inc. (6 percent preferred) <sup>1</sup>	20,425	100
Apr. 2	North American Rayon Corp. (\$3 preferred) <sup>1</sup>	218,413	6,300
June 7	Graham-Paige Corp. (5 percent convertible preferred) <sup>1</sup>	456	14,375
	Totals, 4 issues	266,306	21,175
LIQUIDATED, EXPIRED, WORTHLESS—LIMITED NUMBER OF SHARES OUTSTANDING			
Jan. 30	Consolidated Liquidating Corp. (common)	<sup>2</sup> 483,234	( <sup>3</sup> )
Feb. 9	Carman & Co., Inc. (Common) <sup>1</sup>	<sup>2</sup> 342,328	( <sup>3</sup> )
Mar. 22	Compo Shoe Machinery Corp. (VTC's 1956) <sup>1</sup>	<sup>4</sup> None	
Apr. 9	Ward Baking Co. (common stock purchase warrants <sup>1</sup> )	<sup>4</sup> 11,879	40,700
10	Eureka Corp., Ltd. (common stock purchase warrants <sup>1</sup> )	<sup>4</sup> 14,392	579,300
17	Rio Grande Valley Gas Co. (VTC's 1956) <sup>1</sup>	<sup>4</sup> None	
Aug. 10	Axe Science & Electronics Corp. (common) <sup>1</sup>	<sup>5</sup> 2,500,000	322,600
31	C. W. C. Liquidating Corp. (common) <sup>1</sup>	<sup>2</sup> 750,000	33,500
Oct. 10	Railway & Utilities Investing Corp. (A)	<sup>2</sup> 145,939	8,400
Nov. 14	United Corp. (option warrants)	<sup>6</sup> 3,732,059	
	Totals, 10 issues	7,979,831	984,500
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Jan. 23	Federated Petroleum Ltd. (common) <sup>1</sup>	<sup>7</sup> 3,658,708	( <sup>3</sup> )
Mar. 16	Mid-West Refineries, Inc. (common) <sup>1</sup>	<sup>8</sup> 755,645	( <sup>5</sup> )
16	Prosperity Co., Inc. (class B common)	<sup>8</sup> 414,750	28,100
Apr. 2	Richmond Radiator Co. (common)	<sup>7</sup> 1,132,143	100,600
June 15	Airfleets, Inc. (capital) <sup>1</sup>	<sup>7</sup> 233,796	29,200
15	Colonial Airlines, Inc. (common) <sup>1</sup>	<sup>8</sup> 520,600	175,900
15	Wasatch Corp. (common) <sup>1</sup>	<sup>7</sup> 230,310	4,700
July 6	Electrodats Corp. (capital) <sup>1</sup>	<sup>8</sup> 910,000	202,700
Oct. 10	Dragon Cement Co., Inc. (common) <sup>1</sup>	<sup>8</sup> 510,000	99,200
2	Apex Electrical Manufacturing Co. (common) <sup>1</sup>	<sup>7</sup> 340,000	70,400
Nov. 1	Emseo Manufacturing Co. (common)	<sup>8</sup> 457,786	35,300
12	Monroe Loan Society (class A common) <sup>1</sup>	<sup>7</sup> 321,157	18,600
Dec. 4	Selby Shoe Co. (common)	<sup>7</sup> 226,850	129,800
31	Clinchfield Coal Corp. (common)	<sup>7</sup> 814,333	138,650
	Total, 14 issues	10,526,118	1,033,150
STATUS CHANGED FROM UNLISTED TO LISTED			
Jan. 3	McWilliams Dredging Co. (common)	385,000	
Feb. 29	California Electric Power Co. (common)	2,900,000	
	Total, 2 issues	3,285,000	
EXCHANGED UNDER PLANS OF REORGANIZATION			
Mar. 28	Standard Power & Light Corp. (common B)		
Oct. 24	Budget Finance Plan (7 percent preferred) <sup>1</sup>		
29	Canadian Cannery, Ltd. (common)	468,137	120
	Total, 3 issues	468,137	120
	Grand total, 39 issues	27,997,369	2,441,345

<sup>1</sup> Removed from listing; all other issues removed from unlisted trading.<sup>2</sup> Liquidated.<sup>3</sup> No sales.<sup>4</sup> Expired.<sup>5</sup> Became open-end investment trust.<sup>6</sup> Worthless.<sup>7</sup> Merged.<sup>8</sup> Assets acquired by other corporations.

## Issues removed during 1957

Date removed	Issue	Number of shares removed	Trading volume during 1955 on American stock exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Jan. 3	Schick, Inc. (common) <sup>1</sup>	1,230,000	900
Feb. 11	Piper Aircraft Corp. (common) <sup>1</sup>	883,067	30,900
Mar. 4	Eastern Gas & Fuel Associates (common)	2,832,333	135,500
4	Eastern Gas & Fuel Associates (3/4 percent preferred)	246,373	2,600
Apr. 15	Consolidated Gas Utilities Corp. (common) <sup>1</sup>	886,027	27,300
May 1	Consolidated Electrodynamics Corp. (common) <sup>1</sup>	1,029,447	70,800
July 15	Hammond Organ Co. (common) <sup>1</sup>	1,523,216	55,400
24	Rome Cable Corp. (common) <sup>1</sup>	629,602	19,300
30	Litton Industries, Inc. (common) <sup>1</sup>	1,546,322	194,900
31	Reliance Electric & Engineering Co. (common) <sup>1</sup>	1,348,958	52,900
Aug. 5	Allied Products Corp. (common) <sup>1</sup>	800,000	34,400
27	United Shoe Machinery Corp. (common)	2,365,958	237,800
17	United Shoe Machinery Corp. (preferred)	423,908	10,930
Nov. 1	Standard Packaging Corp. (common) <sup>1</sup>	2,453,298	661,600
1	Standard Packaging Corp. (convertible preferred) <sup>1</sup>	139,870	83,600
18	Gidding, McBean & Co. (capitl)	1,725,000	43,200
19	Tishman Realty & Construction Co., Inc. (common) <sup>1</sup>	1,847,626	145,100
Dec. 16	Alabama Gas Corp. (common) <sup>1</sup>	925,317	136,000
	Total, 18 issues	22,836,322	1,944,130
REDEEMED (PREFERRED STOCK)			
Jan. 11	Gulf States Land & Industries, Inc. (class A stock)	1,273	( <sup>2</sup> )
Feb. 1	Kings County Lighting Co. (4 percent preferred) <sup>1</sup>	44,000	( <sup>2</sup> )
Oct. 7	General Plywood Corp. (5 percent convertible preferred) <sup>1</sup>	5	45,500
	Totals, 3 issues	45,278	45,500
LIQUIDATED, WORTHLESS, LIMITED NUMBER OF SHARES OUTSTANDING OR ORDER OF SEC			
Feb. 11	British American Tobacco Co., Ltd. (ADR's 5 percent preferred bear)	<sup>3</sup> None	None
11	British American Tobacco Co., Ltd. (ADR's 5 percent preferred registered)	<sup>3</sup> None	None
Mar. 4	Basin Oil Co. of California (capital) <sup>1</sup>	<sup>4</sup> 270,000	2,200
Apr. 15	Great Sweet Grass Oils Ltd. (capital) <sup>1</sup>	<sup>5</sup> 5,000,000	None
17	Kroy Oils, Ltd. (common) <sup>1</sup>	<sup>4</sup> 4,475,000	None
17	Rice-Stix, Inc. (common)	<sup>3</sup> 135,971	25
May 10	Laclede-Christy Co. (common) <sup>1</sup>	<sup>3</sup> 332,268	1,010
29	Segal Lock & Hardware Co., Inc. (common)	<sup>6</sup> 2,707,811	( <sup>2</sup> )
Aug. 22	Central States Electric Corp. (common)	<sup>6</sup> 10,105,023	( <sup>2</sup> )
22	Central States Electric Corp. (7 percent preferred)	<sup>6</sup> 68,800	( <sup>2</sup> )
22	Central States Electric Corp. (6 percent preferred)	<sup>6</sup> 94,840	( <sup>2</sup> )
22	Central States Electric Corp. (6 percent preferred, optional dividend series)	<sup>6</sup> 15,313	( <sup>2</sup> )
22	Central States Electric Corp. (6 percent preferred, optional dividend series, 1929)	<sup>6</sup> 31,661	( <sup>2</sup> )
29	Pinchin, Johnson & Associates, Ltd. (ADR's ordinary registered)	<sup>3</sup> 36	( <sup>2</sup> )
	Total, 14 issues	23,236,723	<sup>3</sup> 3,235
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Feb. 1	American Tractor Co. (common) <sup>1</sup>	<sup>7</sup> 1,111,057	25,000
1	Gerity-Michigan Corp. (common) <sup>1</sup>	<sup>8</sup> 767,500	( <sup>2</sup> )
1	Kings County Lighting Co. (common) <sup>1</sup>	<sup>7</sup> 440,000	4,800
28	Venezuela Syndicate, Inc. (common) <sup>1</sup>	<sup>9</sup> 920,221	92,900
Apr. 2	Superior Portland Cement, Inc. (common)	<sup>8</sup> 271,708	20,000
June 3	American Hard Rubber Co. (common)	<sup>7</sup> 327,813	31,200
July 30	Metal Textile Corp. (common) <sup>1</sup>	<sup>8</sup> 165,000	16,600
Aug. 23	Phillips Packing Co., Inc. (common) <sup>1</sup>	<sup>8</sup> 475,000	55,200
Sept. 9	British Celanese Ltd. (ADR's ordinary Registered)	<sup>7</sup> 61,260	9,400
23	United Specialties Co. (common) <sup>1</sup>	<sup>8</sup> 170,000	50,100
Nov. 1	Ainsworth Manufacturing Corp. (common)	<sup>8</sup> 417,362	371,200
8	Unitronics Corp. (common) <sup>1</sup>	<sup>7</sup> 601,952	400,800
Dec. 9	Midland Steel Products Co. (\$2 dividend shares)	<sup>7</sup> 55,800	6,050
18	J. O. Ross Engineering Corp. (common) <sup>1</sup>	<sup>7</sup> 467,830	24,700
	Total, 14 issues	6,252,503	1,103,950
	Grand total, 49 issues	52,370,826	3,101,815

<sup>1</sup> Fully listed, all other issues admitted to unlisted trading.<sup>2</sup> No sales.<sup>3</sup> Limited number of shares outstanding.<sup>4</sup> Liquidated.<sup>5</sup> Order of SEC.<sup>6</sup> Worthless.<sup>7</sup> Merged.<sup>8</sup> Assets acquired by other corporations.

## Issues removed during 1958

Date removed	Issue	Number of shares removed	Trading volume during 1958 on American stock exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Jan. 2	Siegler Corp. (common) <sup>1</sup> .....	1,714,339	None
Aug. 11	Simplicity Pattern Co., Inc. (common) <sup>1</sup> .....	758,126	134,800
Sept. 29	Missouri Public Service Co. (common) <sup>1</sup> .....	1,087,554	125,900
Dec. 10	Thiokol Chemical Corp. (capital) <sup>1</sup> .....	1,531,887	1,013,600
15	Great Atlantic & Pacific Tea Co. (nonvoting common).....	21,639,206	82,250
	Total, 5 issues.....	27,631,112	1,356,550
REDEEMED (PREFERRED STOCKS)			
8	White Stores, Inc. (5½ percent convertible preferred) <sup>1</sup> .....	1,319	18,700
	Total, 1 issue.....	1,319	18,700
LIQUIDATED, WORTHLESS, LIMITED NUMBER OF SHARES OUTSTANDING OR ORDER OF SEC			
Jan. 2	City Savings Bank Co., Ltd. (American shares capital) <sup>1</sup> .....	<sup>2</sup> 3,292	None
2	Loblaw Groceries Co. Ltd. (common).....	<sup>2</sup> 508,300	None
2	Loblaw Groceries Co. Ltd. (2d preferred stock).....	<sup>2</sup> 445,056	None
20	Gulf States Land & Indemnity, Inc. (\$4.50 preferred).....	<sup>2</sup> 3,131	30
Mar. 12	Swan-Finch Oil Corp. (common).....	<sup>2</sup> 2,804,764	None
May 9	Dempster Investment Co. (common) <sup>1</sup> .....	<sup>2</sup> 149,525	800
9	Jerry O'Mahony, Inc. (common) <sup>1</sup> .....	<sup>3</sup> 1,990,288	None
9	New Bristol Oils, Ltd. (common) <sup>1</sup> .....	<sup>2</sup> 5,663,810	168,100
9	Red Bank Oil Co. (common) <sup>1</sup> .....	<sup>2</sup> 947,182	None
26	Paramount Motors Corp. (capital) <sup>1</sup> .....	<sup>2</sup> 259,110	200
June 9	Bellanca Corp. (common) <sup>1</sup> .....	<sup>4</sup> 1,717,730	None
July 1	Cable Electric Products, Inc. (common) <sup>1</sup> .....	<sup>2</sup> 256,047	None
1	Commodore Hotel, Inc. (common) <sup>1</sup> .....	<sup>2</sup> 482,132	4,700
Sept. 24	Alles & Fisher, Inc. (common).....	<sup>2</sup> 72,464	3,650
Dec. 31	Automatic Voting Machine Corp. (capital) <sup>1</sup> .....	<sup>2</sup> 360,000	20,300
	Total, 15 issues.....	15,662,831	197,780
EXCHANGED FOR OTHER SECURITIES UNDER REORGANIZATION PLANS			
Feb. 28	New Haven Clock & Watch Co. (50-cent convertible preferred) <sup>1</sup> .....	78,076	1,000
June 25	Nuclear Corp. of America (common) <sup>1</sup> .....	None	66,400
Sept. 29	Highway Trailer Industries, Inc. (preferred) <sup>1</sup> .....	14,587	23,650
Dec. 15	Great Atlantic & Pacific Tea Co., Inc. (7 percent 1st preferred).....	260,362	54,780
	Total, 4 issues.....	353,025	145,830
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Jan. 22	Pleasant Valley Wine Co. (capital) <sup>1</sup> .....	<sup>6</sup> 265,000	None
27	Toklan Oil Corp. (common) <sup>1</sup> .....	<sup>7</sup> 1,028,512	3,700
Feb. 7	Merrill Petroleum, Ltd. (common) <sup>1</sup> .....	<sup>6</sup> 2,937,995	61,700
7	Michigan Steel Tube Products Co. (common) <sup>1</sup> .....	<sup>6</sup> 200,000	900
Mar. 14	Liberal Petroleum, Ltd. (common) <sup>1</sup> .....	<sup>7</sup> 3,517,765	53,900
May 9	Scullin Steel Co. (common) <sup>1</sup> .....	<sup>7</sup> 349,242	122,600
23	Vulcan Silver-Lead Corp. (capital) <sup>1</sup> .....	<sup>6</sup> 1,874,700	66,700
July 14	Canso Natural Gas, Ltd. (VTC's for capital) <sup>1</sup> .....	<sup>6</sup> 3,662,669	249,600
Aug. 19	Norbute Corp. (common) <sup>1</sup> .....	<sup>7</sup> 2,174,465	615,400
Nov. 5	Norden-Ketay Corp. (common) <sup>1</sup> .....	<sup>7</sup> 1,302,856	752,300
10	Polaris Mining Co. (capital) <sup>1</sup> .....	<sup>6</sup> 2,296,962	139,400
Dec. 5	Okonite Co. (common) <sup>1</sup> .....	<sup>7</sup> 234,282	102,310
	Total, 12 issues.....	19,839,418	2,168,510
STATUS CHANGED FROM UNLISTED TRADING TO FULLY LISTED			
Jan. 15	Atlantic Coast Fisheries Co. ("old" common).....	2,162,092	None
	Total, 1 issue.....	2,162,092	None
	Grand total, 38 issues.....	65,649,797	3,887,370

<sup>1</sup> Fully listed; all other issues admitted to unlisted trading.<sup>2</sup> Limited number of shares outstanding.<sup>3</sup> Worthless.<sup>4</sup> Order of SEC.<sup>5</sup> Liquidated.<sup>6</sup> Merged.<sup>7</sup> Assets acquired by other corporations.

## Issues removed during 1959

Date removed	Issue	Number of shares removed	Trading volume during 1955 on American Stock Exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Feb. 16	The Diners' Club, Inc. (common) <sup>1</sup> .....	1,442,118	92,500
Mar. 9	U.S. Vitamin & Pharmaceutical Corp. (common) <sup>1</sup> .....	2,000,000	136,200
Mar. 31	McDonnell Aircraft Corp. (common) <sup>1</sup> .....	1,646,167	239,200
Apr. 6	Neptune Meter Co. (common) <sup>1</sup> .....	1,132,010	78,100
Apr. 13	White Stores, Inc. (common) <sup>1</sup> .....	1,112,857	85,600
Apr. 22	Glen Alden Corp. (capital) <sup>1</sup> .....	6,888,602	357,100
May 20	Globe-Wernicke Industries, Inc. (common) <sup>1</sup> .....	884,525	35,800
July 1	Vanadium-Alloys Steel Co. (capital) <sup>1</sup> .....	626,000	69,200
July 20	Wallace & Tiernan, Inc. (common) <sup>1</sup> .....	1,465,013	128,000
Sept. 1	Ryan Aeronautical Co. (common) <sup>1</sup> .....	1,721,662	150,100
Oct. 20	Lear, Inc. (common) <sup>1</sup> .....	2,971,931	2,667,800
Oct. 28	Crowell-Collier Publishing Co. (common) <sup>1</sup> .....	2,685,641	2,101,500
Total, 12 issues.....		24,576,526	6,141,100
REDEEMED (PREFERRED STOCKS):			
Jan. 12	American Air Filter Co., Inc. (5 percent convertible preferred) <sup>1</sup> .....	44	None
Mar. 30	Valspar Corp. (\$4 convertible preferred) <sup>1</sup> .....	1,196	900
July 9	Signal Oil & Gas Co. (\$1.25 preferred) <sup>1</sup> .....	200,000	2,500
Nov. 23	Century Investors, Inc. (convertible preferred) <sup>1</sup> .....	3,402	320
Total, 4 issues.....		204,642	3,520
LIQUIDATED, EXPIRED, LIMITED NUMBER OF SHARES OUTSTANDING OR ORDER OF SEC			
Feb. 9	Cuban Atlantic Sugar Co. (common) <sup>1</sup> .....	2,008,000	<sup>2</sup> 37,300
Feb. 9	International Cigar Machinery Co. (capital).....	600,000	<sup>3</sup> 175
Mar. 18	Western Maryland Railway Co. (7 percent 1st preferred).....	6,514	<sup>2</sup> 210
Mar. 26	Aluminum Industries, Inc. (common) <sup>1</sup> .....	436,129	<sup>2</sup> 2,110
Mar. 16	Sunrise Supermarkets Corp. (common) <sup>1</sup> .....	453,068	<sup>2</sup> 4,300
Apr. 1	Black, Starr & Gorham, Inc. (class A common) <sup>1</sup> .....	125,000	<sup>2</sup> 12,200
Apr. 7	West Canadian Oil & Gas Ltd. (sub. rts.) <sup>1</sup> .....	2,582,002	<sup>4</sup> 1,684,700
May 1	Trunz, Inc. (capital) <sup>1</sup> .....	100,000	<sup>2</sup> 190
June 8	General Acceptance Corp. (warrants) <sup>1</sup> .....	843	<sup>4</sup> 13,200
July 15	Curtis Lighting, Inc. (common) <sup>1</sup> .....	170,160	<sup>2</sup> 1,300
Sept. 11	Davenport Hosiery Mills, Inc. (common) <sup>1</sup> .....	171,200	<sup>2</sup> 19,210
Oct. 1	Kennedy's, Inc. (common) <sup>1</sup> .....	118,425	<sup>2</sup> 25,900
Oct. 15	P. R. M., Inc. (common) <sup>1</sup> .....	175,119	<sup>2</sup> 8,800
Dec. 9	Sicks Breweries, Ltd. (common) <sup>1</sup> .....	952,000	<sup>2</sup> 3,900
Total, 14 issues.....		7,898,460	1,813,495
EXCHANGED FOR OTHER SECURITIES UNDER REORGANIZATION PLANS			
May 1	Lefcourt Realty Corp. (class A convertible) <sup>1</sup> .....	None	None
Nov. 2	Ford Motor Co. of Canada, Ltd. (class A nonvoting).....	None	None
Total, 2 issues.....		None	None
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Jan. 7	Hydro-Electric Securities Corp. (common).....	1,476,393	<sup>5</sup> 200
Jan. 23	Canadian Atlantic Oil Co., Ltd. (capital) <sup>1</sup> .....	3,273,657	<sup>6</sup> None
Jan. 29	Oceanic Oil Co. (capital) <sup>1</sup> .....	1,879,154	<sup>5</sup> 16,200
Feb. 25	Gypsum Lime & Alabastine, Canada, Ltd. (capital).....	880,816	<sup>5</sup> 40
Feb. 27	Sun Ray Drug Co. (common) <sup>1</sup> .....	644,544	<sup>5</sup> 5,400
Apr. 10	Pioneer Gold Mines of B. C. Ltd. (capital) <sup>1</sup> .....	1,751,750	<sup>5</sup> 68,900
Apr. 24	AMI, Inc. (common) <sup>1</sup> .....	240,136	<sup>5</sup> 58,300
July 6	Hevi-Duty Electric Co. (common) <sup>1</sup> .....	376,512	<sup>5</sup> 42,900
Aug. 5	Middle States Petroleum Corp. (common) <sup>1</sup> .....	2,405,386	<sup>5</sup> 7,800
Sept. 10	Knox Corp. (A common) <sup>1</sup> .....	150,000	<sup>5</sup> 150,700
Dec. 3	Humble Oil & Refining Co. (capital).....	72,218,148	<sup>5</sup> 42,110
Dec. 30	Israel-Mediterranean Petroleum, Inc. (VTC common) <sup>1</sup> .....	8,089,000	<sup>5</sup> 1,477,600
Total, 12 issues.....		93,385,496	1,870,150
STATUS CHANGED FROM UNLISTED TRADING TO FULLY LISTED			
18	Mesabi Iron Co. (capital).....	1,358,500	None
Total, 1 issue.....		1,358,500	None
Grand total, 45 issues.....		127,423,624	9,828,265

<sup>1</sup> Fully listed; all other issues admitted to unlisted trading.<sup>2</sup> Liquidated.<sup>3</sup> Limited number of shares outstanding.<sup>4</sup> Expired.<sup>5</sup> Assets acquired by other corporations.<sup>6</sup> Merged.

## Issues removed during 1960

Date removed	Issue	Number of shares removed	Trading volume during 1960 on American Stock Exchange
LISTED ON NEW YORK STOCK EXCHANGE			
Jan. 4	McKee (Arthur G.) & Co. (common) <sup>1</sup> .....	1,132,404	None
28	Great Western Financial Corp. (capital) <sup>1</sup> .....	2,496,052	34,800
Apr. 4	American Photocopy Equipment Co. (common) <sup>1</sup> .....	2,475,000	175,000
25	Standard Financial Corp. (common) <sup>1</sup> .....	2,197,452	129,900
May 17	Armstrong Rubber Co. (A common) <sup>1</sup> .....	1,803,919	179,700
June 15	Raymond International, Inc. (common).....	3,047,022	113,600
20	International Resistance Co. (common) <sup>1</sup> .....	1,454,598	974,700
July 18	Singer Manufacturing Co. (capital).....	4,650,000	285,500
Aug. 17	Holt, Rinehart & Winston, Inc. (common) <sup>1</sup> .....	2,329,055	253,800
22	Aro Equipment Corp. (common) <sup>1</sup> .....	625,120	46,200
Sept. 13	Hoover Ball & Bearing Co. (common) <sup>1</sup> .....	1,372,410	91,300
14	Mays (J. W.), Inc. (common) <sup>1</sup> .....	936,491	156,200
Oct. 3	Basic, Inc. (common) <sup>1</sup> .....	1,234,084	80,000
Dec. 30	Avnet Electronics Corp. (common) <sup>1</sup> .....	2,219,204	1,047,100
	Total, 14 issues.....	27,972,811	3,567,800
REDEEMED (PREFERRED STOCKS)			
Feb. 4	American Natural Gas Co. (6 percent preferred).....	27,481	25
July 20	Development Corp. of America (\$1.25 convertible preferred) <sup>1</sup> .....	297,157	92,400
Oct. 3	Associated Telephone & Telegraph Co. (class A).....	62,203	2,240
	Total, 3 issues.....	386,841	94,665
LIMITED NUMBER OF OUTSTANDING SHARES, ORDER OF SEC, NO TRANSFER FACILITIES, OR LIQUIDATED			
July 11	Krueger (G.) Brewing Co. (common) <sup>1</sup> .....	70,295	<sup>2</sup> 51,000
Aug. 15	Cornucopia Gold Mines (common capital) <sup>1</sup> .....	3,978,800	<sup>3</sup> None
Nov. 10	Cuban-Venezuelan Oil Voting Trust (VTC's) <sup>1</sup> .....	9,242,126	<sup>4</sup> 943,700
Dec. 5	Arkansas Fuel Oil Corp. (common).....	3,801,536	<sup>5</sup> 436,500
	Total, 4 issues.....	17,092,703	1,385,300
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS			
Jan. 15	Colon Oil Co. Ltd. (common) <sup>1</sup> .....	2,196,946	<sup>6</sup> None
Mar. 11	Diversified Stores Corp. (common) <sup>1</sup> .....	402,196	<sup>7</sup> 5,000
Apr. 29	Imperial Color Chemical & Paper Corp. (capital) <sup>1</sup> .....	1,019,604	<sup>8</sup> 93,800
29	Woodley Petroleum Co. (common) <sup>1</sup> .....	852,772	<sup>9</sup> 29,600
July 6	International Petroleum Co. Ltd. (capital).....	14,570,983	<sup>7</sup> 10,300
15	DuMont (Allen B.) Laboratories, Inc. (common) <sup>1</sup> .....	2,361,163	<sup>7</sup> 1,311,300
15	New Superior Oils of Canada Ltd. (common) <sup>1</sup> .....	1,519,417	<sup>8</sup> 52,500
18	United Stores Corp. (common).....	512,934	<sup>7</sup> 98,500
Sept. 2	American Laundry Machinery Co. (common).....	681,639	<sup>8</sup> 71,500
9	General Transistor Corp. (common) <sup>1</sup> .....	906,150	<sup>7</sup> 806,500
9	Sherman Products, Inc. (common) <sup>1</sup> .....	500,000	<sup>6</sup> 172,900
Nov. 28	Stein (A.) & Co. (common) <sup>1</sup> .....	480,000	<sup>7</sup> 131,000
Dec. 14	Northspan Uranium Mines, Ltd. (common) <sup>1</sup> .....	7,219,966	<sup>7</sup> 499,000
14	Reading Tube Corp. (common) <sup>1</sup> .....	730,230	<sup>7</sup> 82,200
29	Century Investors, Inc. (common) <sup>1</sup> .....	150,050	<sup>7</sup> 32,400
29	Webster Investors, Inc. (common) <sup>1</sup> .....	266,520	<sup>7</sup> 7,600
	Total, 16 issues.....	34,370,570	3,404,100
	Grand total, 37 issues.....	79,823,015	8,451,865

<sup>1</sup> Fully listed; all other issues admitted to unlisted trading.<sup>2</sup> Limited number of outstanding shares.<sup>3</sup> Order of SEC.<sup>4</sup> No transfer facilities.<sup>5</sup> Liquidated.<sup>6</sup> Assets acquired by other corporations.<sup>7</sup> Merged.

## Issues removed during 1961 (to July 14, 1961)

Date removed	Issue	Number of shares removed
LISTED ON NEW YORK STOCK EXCHANGE		
Mar. 7	American Meter Co. (capital) .....	738,786
Apr. 11	Bobbie Brooks, Inc. (capital) <sup>1</sup> .....	1,420,759
19	Max Factor & Co. (class A) <sup>1</sup> .....	2,595,354
May 9	Continental Air Lines, Inc. (common) <sup>1</sup> .....	3,256,976
July 12	Duke Power Co. (common) .....	11,505,077
	Total .....	19,516,962
LIQUIDATED, EXPIRED, WORTHLESS LIMITED NUMBER OF SHARES OUTSTANDING		
Mar. 22	Eureka Pipe Line Co. (The) (capital) .....	<sup>2</sup> 50,000
May 17	General Industrial Enterprises, Inc. (capital) .....	<sup>2</sup> 600,000
19	LaConsolidada, S. A. (common) <sup>1</sup> .....	<sup>2</sup> 9,353
July 3	Barcelona Trac. Light & Power Co., Ltd. (ordinary) .....	<sup>2</sup> 1,798,854
	Total .....	2,458,207
REDEEMED (PREFERRED STOCKS)		
Mar. 27	Fajardo Eastern Sugar Associates (\$2 preferred shares beneficial interest) <sup>1</sup> .....	47,604
MERGED INTO OR ACQUIRED BY OTHER CORPORATIONS		
Feb. 3	Hiller Aircraft Corp. (common) <sup>1</sup> .....	<sup>4</sup> 672,597
3	Statecourt Enterprises, Inc. (common) <sup>1</sup> .....	<sup>5</sup> 480,642
Mar. 3	North American Cement Corp. (A common) <sup>1</sup> .....	<sup>4</sup> 496,747
3	North American Cement Corp. (B common) <sup>1</sup> .....	<sup>4</sup> 222,190
10	United Pacific Aluminum Corp. (common) <sup>1</sup> .....	<sup>4</sup> 477,405
17	Harman-Kardon, Inc. (common) <sup>1</sup> .....	<sup>4</sup> 467,852
Apr. 5	Casco Products Corp. (common) <sup>1</sup> .....	<sup>7</sup> 511,356
11	United States Foil Co. (B common) .....	<sup>8</sup> 8,594,032
28	Ford Motor Co., Ltd. (England) (ADR's ordinary registered) .....	<sup>4</sup> 413,440
June 2	Douglas Oil Co. of California (common) <sup>1</sup> .....	<sup>4</sup> 1,449,077
	Total .....	13,685,338
	Total shares, 20 issues .....	35,708,101

<sup>1</sup> Removed from listing; all other issues removed from unlisted trading.

<sup>2</sup> Limited number of outstanding shares.

<sup>3</sup> Inability to supply financial statements.

<sup>4</sup> Assets acquired by other corporations.

<sup>5</sup> Merged.

Mr. MACK. Unlike the New York Stock Exchange, your annual report this year did not have any comment about disciplinary action taken by the American Stock Exchange, but you have made that information available to me this morning?

Mr. McCORMICK. Oh, yes, as a matter of fact, it is made available to the SEC by the 10th day following the month in which any disciplinary action has been taken. They have a complete record of it. Of course, we are submitting to you here not only the overall statistics, but name by name every disciplinary action we have taken and the reason for it.

Mr. MACK. The information has been made available for our file?

Mr. McCORMICK. Certainly; there is no secret about the disciplinary action.

Mr. MACK. How many inspectors or policemen do you have to observe continuously the operation of your exchange?

Mr. McCORMICK. Of our staff, there are about 100 that are engaged in one form or another of policing and surveillance. You are particularly interested in the auditing, I gather, of member firms?

Mr. MACK. I had that in mind.

Mr. McCORMICK. That is a very simple situation. Eighty-eight percent of all of our members are members of the New York Stock Exchange. As to that 88 percent, they are audited by the staff of the New York Stock Exchange. We do not audit them because there is no reason why we should examine into Merrill Lynch, Pierce, Fenner & Smith and the rest of them and duplicate the work of the New York Stock Exchange. That means that we must check a 12 percent group that are members of our exchange and not of the New York Exchange.

Mr. MACK. Then, if I understand you correctly, you rely on the New York Stock Exchange for auditing of the 88 percent?

Mr. McCORMICK. Eighty-eight percent of the members, that is correct. As to the 12 percent, that involves 75 member firms. Those 75 are covered by three expert auditors. To make two investigations a year, they must make 150 investigations. That means that each of the three auditors must make one examination a week, and they are competent to do that. I don't think any other exchange or any other securities agency checks all of the people in their own area twice a year.

Mr. MOONEY. In that context, Mr. Chairman, if I may, I would like to present a statement that we prepared concerning our examination procedures, the number of examinations, and the details of the examination itself. May I submit that for the record?

Mr. MACK. Yes; we will receive that for our files.

Mr. DINGELL. Mr. Chairman, if you would yield, the function of these audits is to do what? Does it have to do with the handling of accounts by the brokers, and specialists, and so forth, or does it actually go into the management practices and so forth of the firms which are listed?

Mr. McCORMICK. It basically involves meeting the capital requirements and compliance with the requirements of the statute.

Mr. DINGELL. Meeting the capital requirements?

Mr. McCORMICK. Capital requirements, regulations, marginal requirements, and regulations of that type.

Mr. DINGELL. Does it have anything to do with a situation as was pointed out in this *Canadian Javelin* case?

Mr. McCORMICK. We do not audit listed companies and no other exchange audits them.

Mr. DINGELL. Do you have any procedure that you go into when matters of this sort involved in this *Canadian Javelin* come to the attention of your exchange?

Mr. McCORMICK. The annual reports are filed with us and they are reviewed.

Mr. DINGELL. What action do you take, referring particularly to flagrant violations of your rules, by firms which you list? Can you list them?

Mr. McCORMICK. We certainly can and do.

Mr. DINGELL. Have you ever done so?

Mr. McCORMICK. Yes; we have.

Mr. DINGELL. What criterion do you have for delisting some of these firms?

Mr. McCORMICK. Failure to file the required financial information. That was done in Cornucopia. It was done in Swan Finch; failure to meet our minimum requirements for distribution.

Mr. DINGELL. How about failure to file truthful forms and statements with the SEC?

Mr. McCORMICK. That is a basis for delisting.

Mr. DINGELL. Thank you, Mr. Chairman.

Mr. MACK. I have noticed in your statement of disciplinary action that you made available to me you have taken action in 70 cases in the last 5 years. Of these how many were fined and reprimanded; some of them censured. In this 7-year period, could you tell me the number of suspensions or revocations?

Mr. McCORMICK. I think you have it before you, Mr. Chairman.

Mr. MACK. I want to verify these, and I have seven suspensions and two revocations.

Mr. McCORMICK. That is correct.

Mr. MACK. In a 5-year period?

Mr. McCORMICK. That is right.

Mr. MACK. That does not seem to me to be a very serious reprimand, or else your house is in pretty good order.

Mr. McCORMICK. I would prefer that you believe the latter.

Mr. MACK. In your suspension cases, the suspension is for a temporary period of time; is that correct?

Mr. McCORMICK. That is correct.

Mr. MACK. Have you had additional cases come before you where certain charges were made and no fine was imposed?

Mr. McCORMICK. Oh, definitely.

Mr. MACK. Would you not think that with the volume of business that you have in American Stock Exchange there should be or would be caused to be more than one suspension or a little over an average of one suspension per year for that period?

Mr. McCORMICK. No; I think that is a terrible record myself. It should be less.

Mr. MACK. How are these actions taken against the members? As you say, you proceed from your committee and then the Board makes the ultimate decision in cases of revocations or suspensions. Is that correct?

Mr. McCORMICK. Yes, sir.

Mr. MACK. Would that mean that you have only had seven penalties imposed by your board of governors in the 6-year period?

Mr. McCORMICK. That is correct.

Mr. MACK. Are these disciplinary actions initiated by the exchange itself?

Mr. McCORMICK. I think that in all of those cases, you will find that to be the case.

Mr. MACK. In other words, the Securities and Exchange Commission does not initiate any of these actions so that you should take such action?

Mr. McCORMICK. The Chairman, Mr. Reilly, says in one case we did get a call from the SEC, that prompted us to investigate.

Mr. MACK. Are these disciplinary actions reviewable by the Securities and Exchange Commission?

Mr. McCORMICK. Everything we do, Mr. Chairman, is reviewable by the SEC.

Mr. MOONEY. If I may amend the answer to put in the legal aspect of it, they are not reviewable as a matter of law, and I think you may be thinking in the context that the decisions of the NASD, National Association of Securities Dealers, are reviewable as a matter of statutory provision by the SEC.

Decisions on the National Securities Exchanges in like context are not, by statutory provision, reviewable by the SEC.

Mr. MACK. Also, the Commission is not in position by law to compel you to take disciplinary action?

Mr. McCORMICK. No; that is correct. They can act on their own.

Mr. MACK. They can encourage you to do so. I would like to ask the extent of your jurisdiction in disciplining your members. Does this pertain solely to their conduct in regard to the American Stock Exchange, their activities as brokers, or does a member's conduct and his activity as a dealer or in other fields such as manager, sponsor, or advisor to an investment company bear upon his conduct within the disciplinary jurisdiction of your exchange?

Mr. MOONEY. Mr. Chairman, if I may, I think that you may be approaching the problems created, I think, when you talked to Mr. Funston, president of the New York Stock Exchange, when he adverted to rule 318 of that exchange and rule 21 of that exchange.

Examination of our constitution discloses that we have a section 2(q), article IV, which says that a member cannot be a partner in more than one member firm or stockholder in more than one member corporation. We don't have any provision comparable to the New York Stock Exchange provision which says that there must be prior approval of any outside connection.

Likewise, in rule 21 of the New York Stock Exchange, which in brief says that a member of the board cannot participate in a vote to list a security, we provide in article II, section 1 of the constitution that no member of the board shall participate in the determination of any matter brought before it in which the member has a personal interest.

To develop further on this theme, so far as the authority of the board is concerned on the extracurricular activity of its member, it does have to some extent some jurisdiction in that context and the provision that I as a lawyer would advert to in that way would be, I think it is section 4(k) of article V of the constitution—I am giving that from memory—which adverts to conduct which might have a reflection upon the reputation of the exchange. There is also the general provision, of course, that a member can be suspended for conduct not consistent with just and equitable provisions of trade.

The scope of that provision is subject to the determination by the board of governors, but what its limitations are, I would hesitate to say myself.

Mr. MACK. Then, the answer to the question is "Yes," that it does extend past the immediate area.

Mr. MOONEY. It does, but to what extent it extends beyond it, it is pretty difficult to say, Mr. Chairman, without specific cases.

Mr. MACK. Some years ago, the Commission's Division of Trading and Exchanges proposed a specific rule in connection with floor trading. This report reads:

Prohibition of floor trading in stocks on the New York exchanges is the only practicable means of ridding the marketplace of the inequities and dangerous consequences of floor trading.

Mr. McCormick, you have many years of experience in the Securities and Exchange Commission, formerly as a Commissioner, and I would like to know now if, in light of your experience with the American Stock Exchange, you feel that it is desirable to prohibit floor trading.

Mr. McCORMICK. No, I would have to say definitely not.

Mr. MACK. You differ with the statement of the Commission?

Mr. McCORMICK. Yes.

Mr. MACK. What is the function of the floor trader? Does he contribute to the stability of the market?

Mr. McCORMICK. I think in balance, yes.

Mr. MACK. He has no function such as a specialist?

Mr. McCORMICK. He does not have the same obligation placed upon him that the exchanges place on their specialists.

Mr. MACK. Then, just what is his function?

Mr. REILLY. Mr. Chairman, the floor trader himself, as the investigation in 1936 proved, generally goes along with trend.

At the same time, as he goes with that trend, he comes right back and acts as a brake on the market. In other words, a specialist must anticipate the development in the market, and the floor trade generally goes with it, but it becomes inconsequential in the American Stock Exchange because we have very few traders actually doing any volume of trading, but he actually does contribute to the liquidity of the market by the very fact that as he buys he puts it back in again.

If the public had bought that stock, it is again reducing the floating supply of the issue and the contract the customers' men have with their customers. So in the interim period this trade performance, in my estimation, has a very definite and important function in maintaining the liquidity in the market, and acts actually as a brake in the entire issue.

Mr. MACK. He too profits by his activity, I understand.

Mr. REILLY. Yes, sir, he does, but I have never seen one in all the years I have been in business retire with any money.

Mr. MACK. You have rules surrounding his activities too, I presume.

Mr. REILLY. Yes, Mr. Chairman.

Mr. McCORMICK. We have the strictest rules of any exchange in the United States.

Mr. MACK. How do you go about supervising floor trading activity?

Mr. REILLY. Again, we worked this thing out with the home office of the SEC in 1959, and we have a trading report from the trader which shows the time of his purchase.

Mr. MACK. Do you have a special committee to service the floor traders?

Mr. REILLY. We have the floor committee.

Mr. MACK. The floor committee would also supervise them?

Mr. REILLY. Yes, and they are required to fill out a certain form every evening and that form is processed the following day for any violations, but then we have this particular form he fills out which

shows his purchase, how much stock was offered at the time, and what type of tick. Also, we have tick enforcement rules such as the color system. When a trader participates at the opening a yellow card goes up, which means that no other trader can operate for 15 minutes regardless of how much the first trader bought. We have a second card which permits under rule 110 a trader to buy 50 percent of the stock offered or 500 shares, whichever is greater. When he buys that a white card goes up. If he buys the amount permitted under the rules, he puts down "stock frozen."

Then, we have a blue card which means governor approval. The blue card shows that a trader, with the permission of a governor, has purchased stock on a plus tick bid below the high sale price of the stock that day. The stock is frozen for 15 minutes from the time indicated. That is a blue card operation.

In any event, the next morning, our enforcement personnel report to the chairman of the full committee any violations of the previous day. The original report goes down to the SEC as it is written by the trader.

Mr. McCORMICK. The individual trader's report, every trade he has made, and the circumstances under which he made it is filled out and the original goes to the SEC daily.

Mr. MACK. Have you taken any disciplinary action in any case of a floor trader?

Mr. McCORMICK. Many times.

Mr. MACK. Some of those, I guess, will be detailed in the report which you filed with the committee today?

Mr. McCORMICK. Yes, every one of them.

Mr. MACK. I have just two or three closing questions.

Mr. MOONEY. I would like just to introduce a history of these trader violations, and even miscues they might better be described as. May I leave this for the record, please?

The document is entitled "Trader Violations."

Mr. MACK. That will be received for our files.

I understand that you also have trading in unlisted stocks.

Mr. McCORMICK. When the Securities Exchange Act was passed, it determined that securities could be listed on the national exchanges by filing a form 10 with the SEC and comparable information with the exchanges. Prior to that time, the American Stock Exchange had on its own motion initiated trading in certain securities. As a matter of fact, at that time, the bulk of the trading on the American Stock Exchange was in these unlisted stocks.

The Congress had this issue up in 1934 and again in 1936, after a very thorough study by the SEC, and determined that the people who were in those securities had purchased those securities largely on the assumption that they had the protection of an auction market, an exchange market. By that I mean a ticker tape that showed every trade chronologically as it occurred, a quotation system, that gives for every second of the day a quotation.

The Congress, after full consideration for a second time in 1936, determined that these benefits should not be taken from those members of the public who had bought these unlisted securities on the assumption that they had these protections. At the present time, something like 80 percent of our stocks are fully listed and 20 percent on the unlisted basis.

Mr. MACK. You have 20 percent of your stocks that are unlisted?

Mr. McCORMICK. Approximately that, yes.

Mr. MACK. What is the advantage of unlisted stocks?

Mr. McCORMICK. As a practical matter, it means nothing because these companies are of such size and character that they comply fully with any requirements of the SEC, and our exchange has urged the Congress repeatedly to pass, first, the Frear bill, then the Fulbright bill, which would mean that any company of a certain size, whether it is unlisted on our exchange or traded over the counter, would have to comply with the requirements of a fully listed company.

Mr. MACK. Why not have them listed and then they would have to comply fully with the rules?

Mr. McCORMICK. The alternative is to say that they cannot have an auction market. I think only the public would suffer.

Mr. MACK. In other words, you say that all of these people could qualify, if I understood you correctly, and there is no difference, really, between the companies on the unlisted market and those on the listed market?

Mr. McCORMICK. Not so far as the market is concerned.

Mr. MACK. As far as you are concerned. Then why do you not on your own motion require these companies to be listed?

Mr. McCORMICK. I have no authority to tell these companies that they must list. I think the Congress does have the authority to put the same requirements on them and all other unlisted public companies as they do on the fully listed companies. I think that is what they ought to do.

Mr. MACK. You have the authority to permit them to trade as unlisted companies and you also have the authority, do you not, to suspend or remove them from trading?

Mr. McCORMICK. The privilege of having an unlisted company is a privilege given by the Congress.

Secondly, the alternative is to deprive the public of an auction market.

Mr. MACK. If I understood you correctly, you wanted the Congress to not force them to be listed, but to comply with all of the rules; is that not correct?

Mr. McCORMICK. That is what I have asked the Congress repeatedly, that all companies whether they have unlisted trading on our exchange, or traded over the counter should be required to meet the same requirements that are now required of a listed company under the 1934 act.

Mr. MACK. There must be some good reason for these unlisted companies remaining in that category if they would normally qualify and could become, under your regulations, listed companies. Is that reason because they are not subject to the same rules as the listed companies?

Mr. McCORMICK. As a matter of fact, they in substance meet all the requirements that would be put on them if they were fully listed. They choose not to. Just as many of the big transcontinental pipelines, many of the big utilities, choose not to list at all.

Mr. MACK. My point was, of course, that there is an advantage for the companies not to be listed.

Mr. McCORMICK. There must be some reluctance on the part of some people to invite regulation.

Mr. MACK. In other words, that permits them a loophole so that they do not have to meet the same standards as other companies?

Mr. McCORMICK. The same loophole that exists for all over-the-counter companies.

Mr. MACK. Does not the American Stock Exchange have the jurisdiction to require them to meet the same minimum standards as the other listed companies?

Mr. McCORMICK. The only alternative would be to deny them an auction market.

Mr. MACK. Deny them completely?

Mr. McCORMICK. Yes.

Mr. MACK. Have you done this in any cases recently?

I have another question here. I thought you had something to say.

Mr. McCORMICK. No; I am sorry.

Mr. MACK. The rules of the SEC, do not, I understand, require officers and directors of these unlisted companies to disclose their purchases and sales of the company's stock in the same way that the officers and directors of fully listed companies are required to do?

Mr. McCORMICK. That is correct.

Mr. MACK. Has the board of governors considered the adoption of a rule making such disclosure of inside transactions mandatory with respect to securities with the unlisted trading privileges?

Mr. McCORMICK. No.

Mr. MACK. You have never?

Mr. McCORMICK. No.

Mr. MACK. Just to be sure I have this clear in my mind, in your opinion, they do not have the authority to do so?

Mr. McCORMICK. That is correct.

Mr. MACK. Could you give us some idea of any other rules which apply to the fully listed securities which do not apply to these unlisted securities?

Mr. McCORMICK. No. I think you have covered it, Mr. Chairman.

Mr. MACK. I have one more. Does a rule requiring disclosure of transactions between two companies having a common directors or officer, or where the officer or director has a financial interest in the other company, also apply to companies with merely unlisted trading privileges?

Mr. McCORMICK. No, sir.

Mr. MACK. That to me seems like quite a loophole.

Mr. McCORMICK. I would like to suggest, Mr. Chairman, that the big loophole is the over-the-counter market and that is that all companies that are not fully listed on an exchange should be required to meet the same requirements of a fully listed company.

Mr. MACK. That, of course, is a matter that we could deal with here at the appropriate time.

Mr. McCORMICK. I would urge you, Mr. Chairman, to make that No. 1 on your hit parade.

Mr. MOONEY. Mr. Chairman, may I add one note, please?

The Congress, when it permitted unlisted trading to continue, also gave the Securities and Exchange Commission the authority to make such distinctions it might find appropriate between the requirements applicable to unlisted and fully listed companies, and the SEC adopted rule X12f-4, as it used to be known—it has some other esoteric designation now which does not come to my mind—which exempted securities admitted to unlisted trading from the requirements of section 12, the registration requirement; section 13, the reporting requirements; and section 14, the annual report requirements; and section 16, the inside trading requirements of Securities Exchange Act of 1934.

Mr. MACK. I have one further question in terms of these unlisted securities.

Do you have some foreign companies who are in this category in the American Stock Exchange?

Mr. McCORMICK. Yes, sir.

Mr. MACK. To what extent is the number of foreign corporations listed?

Mr. McCORMICK. Under the regulations, of course, the Canadian companies are considered to be in the same group as the Americans. I would say, looking back, British, French, German—

Mr. MACK. They refer to your exchange as the top-ranking market in foreign securities.

Mr. McCORMICK. We are, without any question.

Mr. MACK. Could you tell me the percentage of the foreign securities which fall into this unlisted category?

Mr. McCORMICK. I think we must have about 140 foreign companies. I would say just offhand 115 would be listed. We would have to check it.

Incidentally, Mr. Chairman, we have a list of all foreign securities which we didn't bring with us we would love to submit for the record.

Mr. MACK. You may submit that for the record.

(The list referred to follows:)

## 39 ISSUES OF FOREIGN CORPORATIONS (OTHER THAN CANADIAN) DEALT IN ON THE AMERICAN STOCK EXCHANGE

(In the following list the 19 "fully listed" issues are designated with an asterisk (\*). All other 20 issues are admitted to unlisted trading privileges.)

<i>Issue</i>	<i>Organized under laws of</i>
*A.K.U. (United Rayon Mfg. Corp.) (ADR's for Amer. Netherlands Shs. representing Ord. Shs.)	
*Alliance Tire and Rubber Co. Limited (Class A)-----	Israel.
*American Israeli Paper Mills Limited (Amer. Shs.)-----	Do.
*Anglo-Lautaro Nitrate Corp. ("A" Shares in Bearer Form).	Chile.
Associated Electrical Industries, Ltd. (ADR's Ord. Reg.)-	Great Britain.
*Atlantica del Golfo Sugar Co. (Capital)-----	Cuba.
*Atlas Consolidated Mining and Development Corp. (Block Shares).	Philippine Islands.
Banco de los Andes (Amer. Shs.)-----	Colombia.
British-American Tobacco Co., Ltd. (ADR's Ord. Bearer)-	Great Britain.
British-American Tobacco Co., Ltd. (ADR's Ord. Reg.)--	Do.
British Petroleum Co. Ltd. (ADR's Ord. Reg.)-----	Do.
*Burma Mines, Ltd. (ADR's Ord.)-----	Do.
Carreras Ltd. (ADR's "B" Ord.)-----	Do.
*Coastal Caribbean Oils, Inc. (VTC's Com. Cap.) (Reg. Form) (Exp. November 15, 1962).	Panama.
Courtaulds, Ltd. (ADR's Ord. Reg.)-----	Great Britain.
Distillers Co., Ltd. (ADR's Ord. Reg.)-----	Do.
Dunlop Rubber Co. Ltd. (ADR's Ord. Reg.)-----	Do.
General Electric Co., Ltd. (ADRs Ord. Reg.)-----	Do.
*Havana Lithographing Co. (Common)-----	Cuba.
Imperial Chemical Industries, Ltd. (ADRs Ord. Reg.)-----	Great Britain.
Imperial Tobacco Co. of Great Britain & Ireland, Ltd. (ADRs Ord. Reg.)-----	Do.
*Magellan Petroleum Corp. (VTCs Com. Cap.)-----	Panama.
Marconi International Marine Communication Co., Ltd. (ADRs Ord. Reg.)-----	Great Britain.
*O'okiep Copper Co., Ltd. (Amer. Shs.)-----	South Africa.
*Pancoastal Petroleum Co., C.A. (VTCs for Com. Cap.) (Reg. Form) (Exp. 11/15/62)-----	Venezuela.
*Pantepec Oil Co., C.A. (Amer. Shs.)-----	Do.
*Philippine Long Distance Telephone Co. (Common)-----	Philippine Islands.
Rolls-Royce, Ltd. (ADRs Ord. Reg.)-----	Great Britain.
*San Carlos Milling Co., Inc. (Common)-----	Philippine Islands.
*Simca Automobiles (Amer. Shs. representing Cap. Stock)--	France
Singer Manufacturing Co., Ltd. (ADRs Ord. Reg.)-----	Great Britain.
*Syntex Corp.	Panama.
Tobacco Securities Trust Co., Ltd. (ADRs Ord. Reg.)-----	Great Britain.
Tobacco Securities Trust Co., Ltd. (ADRs Def. Reg.)-----	Do.
*Trans-Cuba Oil Co. (Common Class A)-----	Cuba.
United Molasses Co., Ltd. (ADRs Ord. Reg.)-----	Great Britain.
*Western Stockholders Investment Trust, Ltd. (ADRs Ord.)	Do.
Woolworth (F. W.) & Co., Ltd. (ADRs Ord. Reg.)-----	Do.
Woolworth (F. W.) & Co., Ltd. (ADRs 6% Pref. Reg.)--	Do.

## 106 ISSUES OF CANADIAN CORPORATIONS DEALT IN ON THE AMERICAN STOCK EXCHANGE

In the following list the 64 "fully listed" issues are designated with an asterisk (\*). All other 42 issues are admitted to unlisted trading privileges.

## INDUSTRIAL CORPORATIONS

Agnew-Surpass Shoe Stores, Ltd. (Common)	Ford Motor Co. of Canada, Ltd. (Common)
Bell Telephone Co. of Canada (Cap.)	*Gatineau Power Co. (Common)
Brazilian Trac. Lt. & Pw. Co. Ltd. (Ord.)	*Gatineau Power Co. (Preferred)
British Columbia Pw. Corp. Ltd. (Common)	Imperial Tobacco Co. of Can. Ltd. (Common)
Bruck Mills, Ltd. (Class B)	Massey-Ferguson, Ltd. (Common)
Canada Bread Co. Ltd. (Common)	Natl. Steel Car Corp. Ltd. (Capital)
Canada Cement Co. Ltd. (Common)	Page-Hersey Tubes, Ltd. (Common)
Canada Cement Co. Ltd. (Preferred)	*Patino of Canada, Ltd. (Capital)
Canadian Dredge & Dock Co. Ltd. (Common)	Power Corp. of Can., Ltd. (Common)
Canadian Marconi Co. (Capital)	Quebec Power Co. (Capital)
Cockshutt Farm Equipment, Ltd. (Common)	St. Lawrence Corp. Ltd. (Common)
*Consolidated New Pacific Ltd. (Common)	Shawinigan Water & Pw. Co. (Common)
Corby (H) Distillery Ltd. (Class A)	Sherwin-Williams Co. of Can. Ltd. (Ord.)
Corby (H) Distillery Ltd. (Class B)	Simpson's Ltd. (Common)
Dominion Bridge Co. Ltd. (Capital)	Smith (Howard) Paper Mills Ltd. (Common)
Dominion Steel & Coal Corp. Ltd. (Ord.)	Steel Co. of Canada, Ltd. (Common)
Dominion Tar & Chemical Co. Ltd. (Common)	*Supercrete Ltd. (Common)
Dominion Textile Co. Ltd. (Common)	*Thorncliffe Park Limited (Common)
Dow Brewery Ltd. (Common)	Union Gas Co. of Canada, Ltd. (Capital)
	Wood (John) Industries, Ltd. (A Common)

## MINING CORPORATIONS

*Anacon Lead Mines Ltd. (Capital)	Lake Shore Mines, Ltd. (Capital)
*Campbell Chibougamau Mines Ltd. (Cap.)	*Merrill Island Mining Corp. Ltd. (Cap.)
*Canadian Javelin Limited (Capital)	Mining Corp. of Can. Ltd. (Capital)
*Canadian Northwest Mines & Oils Ltd. (Capital) (Susp.)	*Molybdenite Corp. of Can. Ltd. (Cap.)
Cons. Mng. & Smelting Co. of Canada Ltd. (Capital)	*Nickel Rim Mines Ltd. (Capital)
*Elder Mines and Developments Ltd. (Cap.)	*Nipissing Mines Co. Ltd. (Capital)
*Eureka Corp. Ltd. (Common)	*North Rankin Nickel Mines Ltd. (Cap.)
*Faraday Uranium Mines Ltd. (Capital)	*Pato Cons. Gold Dredging Ltd. (Cap.)
*Giant Yellowknife Mines, Ltd. (Cap.)	*Preston Mines Ltd. (Cap.)
Hollinger Cons. Gold Mines Ltd. (Cap.)	*Quebec Lithium Corp. (Capital)
*Kilembe Copper Cobalt Ltd. (Capital)	*Rio Algom Mines Ltd. (Com.)
Kirkland Minerals Corp. Ltd. (Capital)	*Rio Algom Mines Ltd. (Ser. A. Wts.)
	*Silver-Miller Mines Ltd. (Capital)
	*Stanrock Uran. Mines Ltd. (Common)
	*United Asbestos Corp. Ltd. (Capital)
	Wright-Hargreaves Mines, Ltd. (Capital)

## OIL CORPORATIONS

- |   |   |
|---|---|
| *Anglo American Exploration Ltd. (Cap.)           | *Gridoil Freehold Leases Ltd. (Cap.)          |
| *Asamera Oil Corp. Ltd. (Capital)                 | *Home Oil Co. Ltd. (Class A)                  |
| *Bailey Selburn Oil & Gas Ltd. (Class A)          | *Home Oil Co. Ltd. (Class B)                  |
| *Banff Oil Limited (Common)                       | Imperial Oil Limited (Capital)                |
| British American Oil Co. Ltd. (Com.)              | *Jupiter Oils Limited (Capital)               |
| *Britalta Petroleums Ltd. (Capital)               | *Natl. Petroleum Corp. Ltd. (Cap.)            |
| *Calgary & Edmonton Corp. Ltd. (Cap.)             | *North Canadian Oils Ltd. (Common)            |
| *Calvan Consolidated Oil & Gas Co. Ltd. (Capital) | *Okalta Oils Ltd. (Common)                    |
| *Canada Southern Petroleum Ltd. (VYCs Cap.)       | *Pacific Petroleum Ltd. (Common)              |
| *Canadian Homestead Oils Ltd. (Capital)           | *Pacific Petroleum Ltd. (Warrants)            |
| *Canadian Husky Oil Co., Ltd. (Com.)              | *Peruvian Oils & Minerals Ltd. (Cap.)         |
| *Canadian Industrial Gas Ltd. (Cap.)              | *Prairie Oil Royalties Co., Ltd. (Cap.)       |
| *Canadian Petrofina Ltd. (Part. Pfd.)             | *Richwell Petroleums Ltd. (Capital)           |
| *Canadian Williston Minerals, Ltd. (Cap.)         | (Susp.)                                       |
| *Charter Oil Co. Ltd. (Capital)                   | Royalite Oil Co. Ltd. (Capital)               |
| *Devon-Palmer Oils Ltd. (Capital)                 | *Sapphire Petroleums Ltd. (Capital)           |
| *Dome Petroleum Ltd. (Common)                     | *Sarcee Petroleums Ltd. (Common)              |
| *Fargo Oils Ltd. (Common)                         | *Scurry-Rainbow Oil Ltd. (Capital)            |
|   | *Security Freehold Pet. Ltd. (Common)         |
|   | *United Canso Oil & Gas Ltd. (VTCs Com. Cap.) |
|   | *Western Leaseholds, Ltd. (Common)            |
|   | *West Canadian Oil & Gas Ltd. (Common)        |

Mr. McCORMICK. That indicates, incidentally, which are fully listed and which are not.

Mr. MACK. With respect to all of this information which we have received for our files this morning, some of which is quite voluminous, we will determine whether or not that should be included in the record.

Now, Mr. Reilly, on page 2 of your statement, you referred to the 1936 SEC study which resulted in 16 rules being promulgated by the Securities and Exchange Commission.

Could you submit the list of these 16 rules for the record?

Mr. REILLY. Mr. Chairman, the first rule promulgated was pertaining to excessive trading, that is, no member or member firm trading on the American Stock Exchange may trade in excess of the financial resources in view of the market security.

Mr. MACK. I appreciate that. Thank you very kindly, but I would just as soon you submit it for the record.

Mr. REILLY. Yes, Mr. Chairman.

(Information referred to follows:)

AMERICAN STOCK EXCHANGE—RULES FOR THE REGULATION OF TRADING ON EXCHANGES RECOMMENDED BY THE SECURITIES AND EXCHANGE COMMISSION FOR ADOPTION BY NATIONAL SECURITIES EXCHANGES

(This information is taken from appendix O-1 of the report on the feasibility and advisability of the complete segregation of the functions of dealer and broker, published by the Securities and Exchange Commission, dated June 20, 1936.)

FIRST RULE. *Excessive trading by members.*—No member, and no firm of which he is a partner, and no partner of such firm, shall effect on the exchange purchases or sales for any account in which such member, firm, or partner is directly or indirectly interested, which purchases or sales are excessive in view of the financial resources of such member, firm, or partner, or in view of the market for such security.

**SECOND RULE. Trading for joint account.**—(a) No member, while on the floor, shall, without the prior approval of the exchange, initiate the purchase or sale on the exchange of any security classified for trading as a stock by the exchange for any account in which he, or the firm of which he is a partner, or any partner of such firm, is directly or indirectly interested with any person other than such firm or partner.

(b) The provisions of this rule shall not apply to any purchase or sale (1) by any member for any joint account maintained solely for effecting bona fide domestic or foreign arbitrage transactions, or (2) by an odd-lot dealer or a specialist for any joint account in which he is expressly permitted to have an interest or participation by the 11th or 14th rules, respectively.

**THIRD RULE. Report of joint accounts.**—(a) No member, and no firm of which he is a partner, and no partner of such firm, shall, directly or indirectly, hold any interest or participation in any joint account for buying or selling any security on the exchange, unless such joint account is reported to and not disapproved by the exchange.

(b) Such report shall be filed with the exchange by any member, firm, or partner participating in such joint account before any transactions are effected on the exchange for such joint account and shall include in substance the following:

- (1) Names of persons participating in such account and their respective interests therein.
- (2) Purpose of such account.
- (3) Amount of commitments in such account.
- (4) A copy of any written agreement or instrument in writing relating to such account.

(c) Every member, the firm of which he is a partner, and every partner of such firm who is directly or indirectly interested in any substantial joint account for buying or selling any specific security on the exchange, or in any joint account which actively trades in any security on the exchange, shall file with the exchange not later than Saturday of each week with respect to every such joint account existing at the close of business on the preceding Wednesday a report containing in substance the following information, unless such information is reported to the exchange by some other member, firm, or partner:

- (1) Name and amount of each security purchased or sold during the week ending on such Wednesday on the exchange.
- (2) Amount of commitments in such account at the close of business on such Wednesday.

(3) Any change which renders no longer accurate any portion of the original statement filed under paragraph (b).

(d) Every member, the firm of which he is a partner, and every partner of such firm who has knowledge of any substantial joint account for buying or selling any specific security on the exchange or of any joint account which actively trades in any security on the exchange by reason of transactions executed by or through such member, firm or partner for such account, shall file with the exchange not later than Saturday of each week with respect to every such joint account existing at the close of business on the preceding Wednesday a report containing in substance the following information, if known, unless such information has previously been reported to the exchange:

- (1) Names of persons participating in such account and their respective interests therein.
- (2) Purpose of such account.
- (3) Name and amount of each security purchased or sold during the week ending on such Wednesday.
- (4) Amount of commitments in such account at the close of business on such Wednesday.

**FOURTH RULE. Discretionary transactions.**—(a) No member, while on the floor, shall execute or cause to be executed on the exchange any transaction for the purchase or sale of any security classified for trading as a stock by the exchange with respect to which transaction such member is vested with discretion as to (1) the choice of security to be bought or sold, (2) the total amount of any security to be bought or sold, or (3) whether any such transaction shall be one of purchase or sale.

(b) The provisions of paragraph (a) of this rule shall not apply (1) to any discretionary transactions executed by such member for any bona fide cash investment account or for the account of any person who, due to illness, ab-

sence, or similar circumstances, is actually unable to effect transactions for his own account; provided that such member shall keep available for inspection a detailed record of any such transaction and the grounds for exercising such discretion and shall file with the exchange on August 1, 1935, and quarter annually thereafter a report covering the preceding quarterly period showing the name of each account for which any such transaction was executed, the amount of such discretionary purchases or sales and the grounds for exercising such discretion with respect to each account, or (2) to any transaction permitted under the second rule for any account in which the member executing such transaction is directly or indirectly interested.

(c) No member, and no firm of which he is a partner and no partner of such firm shall execute or cause to be executed on the exchange purchases or sales of any security classified for trading as a stock by the exchange for any account with respect to which such member, firm or partner is vested with any discretionary power, which purchases or sales are excessive in size or frequency in view of the financial resources in such account.

**FIFTH RULE. *Trading by member while acting as broker.***—(a) No member shall (1) personally buy or initiate the purchase of any security on the exchange for his own account or for any account in which he, or the firm of which he is a partner or any partner of such firm, is directly or indirectly interested, while such member personally holds or has knowledge that his firm or any partner thereof holds an unexecuted market order to buy such security in the unit of trading for a customer, or (2) personally sell or initiate the sale of any security on the exchange for any such account, while he personally holds or has knowledge that his firm or any partner thereof holds an unexecuted market order to sell such security in the unit of trading for a customer.

(b) No member shall (1) personally buy or initiate the purchase of any security on the exchange for any such account, at or below the price at which he personally holds or has knowledge that his firm or any partner thereof holds an unexecuted limited price order to buy such security in the unit of trading for a customer, or (2) personally sell or initiate the sale of any security on the exchange for any such account at or above the price at which he personally holds or has knowledge that his firm or any partner thereof holds an unexecuted limited price order to sell such security in the unit of trading for a customer.

(c) The provisions of this rule shall not apply (1) to any purchase or sale of any security in an amount of less than the unit of trading made by an odd-lot dealer to offset off-lot orders of customers, or (2) to any purchase or sale of any security, delivery of which is to be upon a day other than the day of delivery provided in such unexecuted market or limited-price order.

**SIXTH RULE. *Successive transactions by members.***—No member, and no firm of which he is a partner and no partner of such firm shall execute or cause to be executed on the exchange the purchase of any security at successively higher prices or the sale of any security at successively lower prices for the purpose of creating or inducing a false, misleading, or artificial appearance of activity in such security, or for the purpose of unduly or improperly influencing the market price of such security, or for the purpose of making a price which does not reflect the true state of the market in such security.

**SEVENTH RULE. *Trading by members holding options.***—No member, while on the floor, shall initiate the purchase or sale on the exchange for his own account or for any account in which he, or the firm of which he is a partner or any partner of such firm, is directly or indirectly interested, of any security classified for trading as a stock by the exchange, in which he holds or has granted any put, call, straddle, or option, or in which he has knowledge that the firm of which he is a partner or any partner of such firm holds or has granted any put, call, straddle, or option.

**EIGHTH RULE. *Record of orders.***—(a) Every member or the firm of which he is a partner or any partner of such firm shall preserve for at least 12 months a record of every order transmitted by such member, firm, or partner to the floor of the exchange, which records shall include the name, amount, and price of the security and the time when such order was so transmitted.

(b) Every member shall preserve for at least 12 months a record of every order originating on the floor of the exchange given to such member for execution, and of every order originating off the floor, transmitted by any person other than a member, firm, or partner, to such member on the floor, which record shall include the name, amount, and price of the security and the time when such order was so given or transmitted.

**NINTH RULE. Registration of specialists.**—No member shall act as a specialist in any security unless such member is registered as a specialist in such security by the exchange.

**TENTH RULE. Trading by specialists.**—No specialist shall effect on the exchange purchases or sales of any security in which such specialist is registered, for any account in which he, or the firm of which he is a partner, or any partner of such firm, is directly or indirectly interested, unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market, or to act as an odd-lot dealer in such security.

**ELEVENTH RULE. Joint accounts of specialists.**—No specialist, and no firm of which he is a partner, and no partner of such firm, shall, directly or indirectly, acquire or hold any interest or participation in any joint account for buying or selling on the exchange any security classified for trading by the exchange as a stock in which such specialist is registered, except a joint account with a partner of such specialist, a member of the exchange, or a firm of which a member is a partner.

**TWELFTH RULE. Records of specialists.**—Every specialist shall keep a legible record of all orders placed with him in the securities in which he is registered as a specialist and of all executions, modifications, and cancellations of such orders, and shall preserve such record and all memoranda relating thereto for a period of at least 12 months.

**THIRTEENTH RULE. Registration of odd-lot dealers.**—No member of the exchange shall act as an odd-lot dealer in a security unless such member is registered as an odd-lot dealer in such security by the exchange.

**FOURTEENTH RULE. Joint accounts of odd-lot dealers.**—No odd-lot dealer, and no firm of which he is a partner, and no partner of such firm, shall, directly or indirectly, acquire or hold any interest or participation in any joint account for buying or selling on the exchange any security in which such odd-lot dealer is registered, except a joint account with a partner of such odd-lot dealer, a member of the exchange, or a firm of which a member is a partner.

**FIFTEENTH RULE. Options of specialists and odd-lot dealers.**—No specialist or odd-lot dealer, and no firm of which such specialist or odd-lot dealer is a partner and no partner of such firm, shall acquire, hold, or grant, directly or indirectly, any interest in any put, call, straddle, or option in any security classified for trading as a stock by the exchange in which such specialist or odd-lot dealer is registered.

**SIXTEENTH RULE. Short selling.**—(a) No member shall use any facility of the exchange to effect on the exchange a short sale of any security in the unit of trading at a price below the last sale price of such security on the exchange.

(b) The provisions of this rule shall not apply to any short sale (1) by an odd-lot dealer to offset odd-lot orders of customers, (2) by an odd-lot dealer to liquidate a long position which is less than the unit of trading, provided the net change in the position of such odd-lot dealer after any such short sale is not more than the unit of trading in such security, or (3) by any member, with the approval of the exchange, for the purpose of equalizing the price of a security on the exchange with the price of the same security on another national securities exchange which is the principal market for such security.

Mr. MACK. On page 5 of your statement, you refer to the six functions of a specialist laid down by the SEC, Trading and Exchange Division in 1937. We would also like to have these six functions included at this point in the record, if you can submit them.

Mr. REILLY. Yes, Mr. Chairman.

(Information referred to follows:)

1. The function of a member acting as a specialist on the floor of the exchange includes, in addition to the effective execution of commission orders entrusted to him and the performance of his obligations as an odd-lot dealer, the maintenance, insofar as reasonably practicable, of a fair and orderly market on the exchange in the stocks in which he is so acting.

2. The maintenance of a fair and orderly market implies the maintenance of price continuity and the minimizing of the effects of temporary disparity between supply and demand.

3. In connection with the maintenance of a fair and orderly market, it is commonly desirable that a member acting as specialist engage to a reasonable degree in existing circumstances in dealings in full lots for his own account when

lack of price continuity in the full-lot market or disparity between supply and demand in either the full-lot or the odd-lot market exists or is reasonably to be anticipated.

4. Transactions on the exchange for his own account effected by a member acting as specialist must constitute a course of dealings reasonably calculated to contribute to the maintenance of price continuity and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated in either the full-lot or the odd-lot market. Transactions not part of such a course of dealings are not to be effected.

5. A specialist's quotation, made for his own account, should be such that a transaction effected thereon, whether or not having the effect of reducing or increasing the specialist's position, will bear a proper relation to preceding transactions and anticipated succeeding transactions.

6. Transactions on the exchange for his own account of a member acting as specialist are to be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular stock and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the full-lot and the odd-lot market. The following types of transactions to establish or increase a position are not to be effected except when they are reasonably necessary to render the specialist's position adequate to such needs:

(a) a purchase at a price above the last sale in the same session;

(b) the purchase of all or substantially all the stock offered on the book at a price equal to the last sale, when the stock so offered represents all or substantially all the stock offered in the market;

(c) the supplying of all or substantially all the stock bid for on the book at a price equal to the last sale, when the stock so bid for represents all or substantially all the stock bid for in the market.

Transactions of these types may, nevertheless, be effected in less active markets where they are an essential part of a proper course of dealings and where the amount of stock involved and the price change, if any, are normal in relation to the market.

Mr. MACK. This concludes our hearing. I want to thank you, Mr. McCormick, for your appearance before the committee, and your associates as well.

I did not state at the outset of the meeting, but I did want the record to show that you appeared here as a voluntary witness and that you made such a request to appear before the committee.

This concludes our hearings on House Joint Resolution 438. These hearings, in my opinion, have demonstrated a serious need for a thorough study and investigation of the rules of the national exchanges and associations, and I intend to do everything in my power to secure early approval of this resolution.

This subcommittee will continue its watchfulness over the securities field for the next 18 months. Additional hearings on related subjects will be announced when our schedule permits. Among other things, this subcommittee hopes to visit each of the 13 national securities exchanges in the course of the next 12 months. I want to take this opportunity to thank you for your statement this morning.

Mr. REILLY. Thank you, Mr. Chairman.

Mr. MACK. The committee will stand adjourned.

(The following information was submitted for the record:)

LAW OFFICES OF SHIPLEY, AKERMAN & PICKETT,  
Washington, D.C., July 20, 1961.

Re House Joint Resolution 438.

HON. PETER F. MACK, JR.,

Member of Congress, Chairman, Subcommittee on Commerce and Finance,  
Committee on Interstate and Foreign Commerce, House Office Building,  
Washington, D.C.

DEAR CONGRESSMAN MACK: Our office from time to time represents persons and companies in the securities field, and we have a continuing interest in legislative proposals in this area. We do not believe that an appropriation of public moneys

for further investigations in the field of mutual funds can be justified at the present time, and would therefore recommend that the scope of House Joint Resolution 438 not be expanded beyond its originally stated purpose for the following reasons:

First. SEC Chairman Cary has recently stated that mutual funds have been the subject of an intensive study by the Commission over a period of the last 2 years, under a contract with the Wharton School of Finance at the University of Pennsylvania. That study is expected to be completed in the near future, and it should be analyzed before further investigations are launched.

Second. In December of last year the SEC circulated to investor advisers, investment companies, and distributors of securities a special questionnaire designed to elicit precise and up-to-date information on mutual fund operations.

Third. There is a widespread feeling among investors and investment companies that continuing investigations shake public confidence in mutual funds.

In looking over the transcript of testimony before your subcommittee, I was much concerned at the line of questioning developed on the amount of fees paid to investment advisers under the Investment Company Act of 1940. There seems to be a concern with the fact that the amount of fees paid by mutual funds for professional advice and management is not regulated by the Securities and Exchange Commission, apparently with the thought that such fees should be regulated as if management companies were public utilities.

This question of management and adviser fees was exhaustively considered by Congress in 1940 when the act was passed. As you know, the original bill recommended by the SEC in 1940 was drafted on the basis of a 5-year study of investment companies. Congressional hearings occupied 21 days during a period of 3 months, and reflected considerable preparation. The final bill was drafted after 5 weeks of intensive work by the SEC and investment company counsel. (Hearings on S. 3580, Senate Banking and Currency Committee, and hearings on H.R. 10065, House Committee on Interstate and Foreign Commerce, 76th Cong. 3d sess. (1940).)

After the most careful consideration the present provisions of the 1940 act were thought by Congress to be the best solution. The act is presently construed by the SEC as requiring the board of directors of a mutual fund to assure that adviser and management contracts, which must be approved annually by them or by the stockholders, are fair and equitable.

In addition, the independent directors of the mutual fund, that is directors not affiliated with the adviser or management company, are expressly charged with the duty of approving the renewal of such contracts pursuant to section 15(c) of the Investment Company Act as an alternative to a stockholder's vote.

The SEC staff has long taken the position that the directors of a mutual fund have an obligation to determine whether an adviser or management contract with an outside company is to be preferred over the direct assumption of investment operations by the investment company (mutual fund) itself.

The general consensus in the mutual fund industry has been for 20 years that the investors and the public are best served by having the highly technical and complicated management services performed by outside professional companies specializing in this kind of work. Likewise, over the years, it has become commonly accepted by the industry and investors that such professional services are best paid for on the basis of a contingent fee of one-half of 1 percent of net asset value.

The Investment Company Act of 1940 sets a very high fiduciary standard of conduct for management in the investment company structure. This statute is very elaborately drawn to protect investors in every feasible way consistent with a free enterprise society.

The declaration of policies and purposes of the Investment Act, contained in section 1(b) is in effect a codification of general fiduciary duties imposed upon directors, officers, investment advisers, and other controlling or managerial personnel of investment companies. The legislative objective is declared to be to eliminate various enumerated conditions adversely affecting the national public interest and interest of investors.

Such documents as Senate Report No. 1775, 76th Congress, 3d session, 1, and House Report No. 2639, 76th Congress, 3d session, 5 (1940), should be reviewed by your subcommittee in this connection.

Under section 14 of the Investment Company Act the SEC is presently authorized and required to make a continuing study and investigation of the size of investment companies and its effect on investment policy, on investment companies themselves, on security markets and related matters involving the protec-

tion of investors and the public interest. The SEC investigations presently underway and referred to above come under this section of the law. Additional authority is neither required nor justified at the present time.

As stated in a recent article by Nathan Lobell "mutual funds are emerging as one of the major financial institutions of our day. Their growth has been phenomenal. Nearly 5 million shareholders own the \$17 billion of mutual fund assets, and are given the benefits of investment management once available only to the rich."

This same article points out that "mutual funds have had a 35 times increase in assets in the past 20 years as against a 6½ times increase in the value of shares listed on the New York Stock Exchange. In the past 10 years the estimated number of shareholders of mutual funds has increased more than five times as against less than a two times increase in holders of shares listed on the exchange. During that 10 years, funds have been adding investors at an average rate of 1,000 per day."

SEC Chairman Cary recently testified before the Committee on Appropriations that the number of registered investment companies has increased from 432 in 1957 to 570 in 1960, and stated that he expects there will be 630 such companies in 1961, and 705 by 1962.

He further stated "it appears that the estimated aggregate net asset value of registered investment companies has increased from \$15 billion at the close of 1957 to about \$23.5 billion at the end of 1960. We estimate that these figures will reach \$27 billion and \$32 billion at the close of 1961 and 1962, respectively."

He made a special point of the rapid increases in the estimated number of shareholder accounts in registered investment companies.

He said "at the close of 1957, there were approximately 3.1 million persons owning these securities as compared with 4.6 million accounts at the close of 1960. We anticipate that this number will increase to 4.9 and 5.2 million shareholder accounts at the close of 1961 and 1962, respectively. These figures, I may say, apply only to the open-end mutual funds, whose net assets are about 75 percent of the total I have given. It does not include the very substantial closed-end companies. The total number of shareholders for whose protection the Investment Act was passed, is, therefore, substantially more than the estimates I have given."

In light of the above factors, it would appear that the mutual funds are presently as closely regulated by the SEC as investor protection and the public interest can possibly require measured by any standard of reason in a free enterprise society.

The important purposes of House Joint Resolution 438 should not be permitted to be diluted or diverted by allowing the investigation to be turned off on the scent of the mutual fund trail, which is already heavily traveled with current SEC investigations.

Very truly yours,

CARL L. SHIPLEY.

NATIONAL ASSOCIATION OF INVESTMENT COS.,  
New York, N.Y., July 14, 1961.

HON. PETER F. MACK, JR.,

Chairman, Subcommittee on Commerce and Finance, House Interstate and Foreign Commerce Committee, House of Representatives, Washington, D.C.

MY DEAR MR. MACK: At the time your subcommittee announced public hearings on H.R. 438, consideration was given by this association to an appearance in response to your invitation. A review of the resolution, however, indicated that the proposed study would be concerned with the business of the members of this association only indirectly as part of a general study of securities and securities markets.

In the light of certain testimony at the public hearings held by your subcommittee, however, we wish to file this brief statement clarifying and placing in perspective the protection afforded investors in the marketing of open-end investment company shares.

We believe some misleading impressions may have been created in the minds of some of the members of the subcommittee, and we wish to make clear the significant differences in the marketing of open-end investment company shares as compared with trading in listed or over-the-counter securities. Briefly, open-

end investment company shares are distributed subject to the protections enumerated below:

1. Open-end company shares are offered continuously by the investment company in most cases and therefore must be continuously registered as new issues for sale under the Securities Act of 1933. Every prospective shareholder must receive a prospectus which sets forth all material information about the company and its investment policies and obligations.

2. The prospectus and all supplementary sales literature must conform to the detailed requirements of the statement of policy of the SEC, governing the content and format of such literature. This statement of policy is administered by the SEC and the National Association of Securities Dealers, Inc. In addition, some State security commissioners also examine and establish further standards for such literature.

3. The Investment Company Act of 1940 regulates many functions, activities and relationships of investment companies, their directors and officers, underwriters, investment advisers, and other affiliated persons. The registration statement filed under the 1940 act contains a complete detailed description of the investment company.

4. State "blue sky" laws regulate the sale of investment company shares along with other public offerings, and certain States put particular emphasis on the regulation of investment companies because of their appeal to the smaller investor. Many State security commissioners have broad statutory powers which they have exercised.

5. Most open-end investment company shares are sold through independent broker-dealers, although important segments of the industry sell shares through affiliated retail sales organizations. All independent broker-dealers must be NASD members and are regulated in respect of their sales of open-end shares as in other aspects of their business. All dealers (whether or not NASD members) are subject to the jurisdiction of the SEC under the Securities Exchange Act of 1934 and the State blue sky laws governing dealers and salesmen.

6. The statutes referred to give investors important rights at law in addition to their common law rights and the protection of regulatory agencies.

If adopted as proposed, House Resolution 438 would include in its scope the markets and distribution systems, for investment company shares, along with all other securities. The SEC already has ample power to investigate all other aspects of investment companies, and, in fact, for nearly 3 years has been conducting a broad and intensive study of investment companies as reported to your subcommittee by Chairman Cary. In this study, which has to date required response by investment companies to two comprehensive questionnaires, this association and its members have cooperated.

We believe that investment companies perform an important service to investors of many kinds and that the industry's growth demonstrates shareholder satisfaction and confidence. We believe that the standards of the investment company industry are high and the regulatory supervision effective. We are striving to improve both, and shall continue to cooperate with all constructive governmental efforts seeking to improve the investment company industry and safeguard our shareholders.

May we respectfully request that this letter be filed with the records of your subcommittee to clarify some aspects of our business not brought out at your hearings? Copies of this letter are being sent to the other members of your subcommittee and to Mr. Cary, for their information.

Yours sincerely,

GEORGE K. WHITNEY.

(Whereupon, at 12:45 p.m., the subcommittee recessed, to reconvene subject to the call of the Chair.)

