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

EIGHTY-SEVENTH CONGRESS
SECOND SESSION

ON

H.R. 11670

A BILL TO POSTPONE BY 3 MONTHS THE DATE ON OR BEFORE WHICH THE SECURITIES AND EXCHANGE COMMISSION SHALL REPORT TO THE CONGRESS THE RESULTS OF ITS STUDY AND INVESTIGATION PURSUANT TO SECTION 19(d) OF THE SECURITIES EXCHANGE ACT OF 1934, AND FOR OTHER PURPOSES

MAY 14, 1962

Printed for the use of the
Committee on Interstate and Foreign Commerce



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EXTEND DATE OF SEC REPORT

MONDAY, MAY 14, 1962

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, New House Office Building, Hon. Peter F. Mack, Jr. (chairman of the subcommittee), presiding.

Mr. MACK. The subcommittee will come to order.

This morning the Subcommittee on Commerce and Finance has scheduled a hearing on H.R. 11670, a resolution to extend the investigation and study now being conducted by the Securities and Exchange Commission for 3 months and to provide for an additional \$200,000 to complete this investigation.

A copy of the bill, plus agency reports, will appear at this point in the record.

(A copy of H.R. 11670 and a report from the Securities and Exchange Commission follow herewith:)

[H.R. 11670, 87th Cong., 2d sess.]

A BILL To postpone by three months the date on or before which the Securities and Exchange Commission shall report to the Congress the results of its study and investigation pursuant to section 19(d) of the Securities Exchange Act of 1934, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the second sentence of subsection (d) of section 19 of the Securities Exchange Act of 1934 (15 U.S.C. 78s(d)) is amended by striking out "January 3, 1963" and inserting "April 3, 1963" in lieu thereof. The last sentence of such subsection is amended by striking out "\$750,000" and inserting "\$950,000" in lieu thereof.

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., May 14, 1962.

HON. OREN HARRIS,
Chairman, Committee on Interstate and Foreign Commerce,
House of Representatives, Washington, D.C.

DEAR MR. HARRIS: In answer to your request of May 12 for comments on H.R. 11670, I am enclosing three copies of a statement which I presented this morning to the Subcommittee on Commerce and Finance of your full committee.

Sincerely yours,

WILLIAM L. CARY, Chairman.

Mr. MACK. Last June I introduced a resolution, House Joint Resolution 438, which directed 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 Security Dealers. This resolution provided for a study which was to terminate on January 3.

The resolution I introduced on last Wednesday simply extends this time for 3 months and provides an additional \$200,000. I made quite an extensive statement on this subject on Wednesday of last week on the floor of the House, and it is my intention to include this statement at this point in the record.

(The statement which appeared in the Congressional Record of May 9, 1962, on pp. 7424 and 7425, follows herewith:)

EXTENSION OF STOCK MARKET INVESTIGATION

The Speaker pro tempore (Mr. Libonati). Under previous order of the House, the gentleman from Illinois [Mr. Mack] is recognized for 30 minutes.

(Mr. Mack asked and was given permission to revise and extend his remarks.)

MR. MACK. Mr. Speaker, I have today introduced a resolution which would provide for a 3-month extension of the stock market investigation.

My resolution would also authorize the Securities and Exchange Commission to spend an additional \$200,000 on its special study of the Nation's security exchanges and over-the-counter market.

On June 1, 1961, I introduced House Joint Resolution 438 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, and authorizing the appropriation of \$750,000 for such study and investigation. Last summer I presided at hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce at which the Chairman of the Commission and representatives of the securities industry testified. No one appeared in opposition to the resolution.

The resolution was subsequently passed by the House and Senate and approved by the President on September 5, 1961. The sum of \$412,500 was appropriated for fiscal 1962 and \$337,500 has been requested for fiscal 1963. Pursuant to this resolution the Securities and Exchange Commission has initiated what I believe will be the broadest and most penetrating investigation of the securities markets since the early 1930's.

Starting with a small nucleus transferred from the regular staff, a special staff of about 60 attorneys, economists, statisticians, and other necessary personnel has been organized; study plans have been developed; and various studies and investigations are now well underway by the study group, which has been designated by the Commission as the Special Study of Securities Markets. During the course of the study, I have been continuously informed by the Chairman of the Commission and the director of the special study with regard to the study plans and the progress of the investigation. I have been impressed by the manner in which the Commission and its staff have exercised the responsibilities entrusted to them by the resolution. The Congress has directed the Commission to study a complex and intricate segment of our economy where an investigation must be conducted with extreme care and responsibility so as not to destroy the confidence of millions of investors in our securities markets. I have every reason to believe that the Commission is conducting its study and investigation in a very serious, diligent, and responsible manner.

Although the study has been underway for only about 6 months, I think there are a number of important and positive accomplishments that can already be reported to the Congress. One of the factors which prompted my introduction of the resolution was the rather alarming revelations of misconduct on the American Stock Exchange, which—together with a number of other conditions—indicated an erosion of standards in certain segments of the securities business. At this time 1 year ago the Commission reported a rising number of enforcement actions involving fraud and manipulation. The president of the New York Stock Exchange had issued two strong warnings against speculation in the stock market. There was an increasing tide of so-called hot issues. Since the initiation of the study and investigation pursuant to the resolution, there have been a number of significant developments, directly or indirectly stimulated by the special study, which have helped to create a more salutary climate in the securities markets.

First, the Commission on January 6, 1962, authorized the public release of a staff report with respect to the organization, management, and regulation of the conduct of members on the American Stock Exchange. The report revealed a general deficiency of standards and a fundamental failure of controls on that

exchange. The failure of an important segment of the financial community to exercise its share of responsibility for self-regulation of the exchange; the resulting concentration of power in the hands of a small self-perpetuating group dominated by specialists; the disproportionate emphasis by responsible exchange officials upon pursuit of new listings; the lack of member supervision by the exchange—all contributed to a general breakdown of the regulatory machinery. As a result of the Commission's investigation of the American Stock Exchange, a thoroughgoing reform and reorganization of the exchange is now underway. The previous dominant group in the management of the exchange has been replaced; a new president has been appointed; the constitution is being amended; the staff is being enlarged and strengthened; new controls and surveillance procedures are being instituted; and the exchange is proceeding with various disciplinary actions. The Commission's approach to this problem has been within the statutory framework of self-regulation. It is hoped that, under the active supervision of the Commission, the exchange will be so reconstituted that it will be capable of governing itself in the manner originally envisioned by the Congress.

Since the initiation of the special study, there have been a number of other developments indicating that the securities industry is aware of the importance of putting its own house in order. Certain of the regional exchanges have tightened their listing requirements; others are revamping their supervisory procedures and controls. The New York Stock Exchange has recently adopted a rule which requires that specialists on that exchange report all transactions made by their public customers in stocks in which the specialist is registered. In its report on the American Stock Exchange, the special study had pointed to some of the potential abuses of a system wherein specialists are permitted to handle orders on behalf of public customers.

In the over-the-counter market, the National Association of Securities Dealers has stepped up its disciplinary actions involving violations of its rules by members. The "hot issue" phenomenon has very noticeably cooled off since this study and investigation was undertaken.

The salutary effect of the study and investigation in generating reform from within the industry was noted in a recent article—April 15, 1962—in the New York Times:

"Another reason, for reform of the American Stock Exchange, is the presence of the Securities and Exchange Commission, studying all of Wall Street and particularly the American Exchange under congressional mandate. This presence has been ubiquitous—from the trading floor of the American Exchange, where investigators have stood side by side with the specialists, to the over-the-counter houses and the big board itself.

"Wall Street fears restrictive new legislation. A clean house, it is hoped, will make the legislation less severe. Naturally, there is also a sincere desire to correct abuses."

In the report to the House which I submitted on the resolution, it was stated that while the language of the resolution is specific, the scope of the resolution was intended to be broad inasmuch as the subject matter encompassed or not encompassed by the rules of securities exchanges and securities associations is extremely wide in breadth. Consonant with this directive of the Congress, the Commission has embarked upon an inquiry which is impressive in its scope and comprehensiveness. I have been advised that the Commission is studying the following subjects, among others:

First. Qualification and supervision of persons in the securities business; the financial responsibility of broker-dealers.

Second. The stock exchanges and their rules and practices, including the role of specialists, floor traders, and odd-lot dealers.

Third. Public offerings of securities: Underwriting and distributing practices and the aftermarket.

Fourth. The operation and structure of the over-the-counter market; the quotations systems.

Fifth. Comparative regulation in the exchange and over-the-counter markets.

Sixth. Security credit and margin requirements.

Seventh. Selling practices, investment advice, and financial public relations.

Eighth. Industry self-regulation.

Ninth. Selected aspects of mutual funds.

The Commission has embarked upon an ambitious and far-reaching inquiry into the securities markets. I am informed that practically all projects are in the interim stage—data are being gathered through interviews and question-

naires, and are now being reviewed and assembled. Public hearings have been scheduled and the first series has commenced this week.

The Chairman of the Commission has informed me that the study is being pursued with vigor and diligence and that some of the study projects will be completed by the reporting date of January 3, 1963. However, complete execution of the study plan and adequate fulfillment of the purpose of the resolution will depend to some extent upon whether or not the reporting date of the study is extended and additional funds are authorized. The Chairman has indicated to me that an extension of the reporting date to March 31, 1963, with an additional authorization of \$200,000 will be sufficient to complete substantially the factfinding phase of the inquiry, together with a report and recommendations to the Congress.

In view of the importance of this inquiry to the investing public, I have today introduced a resolution which would extend the date of the report of the Commission from January 3, 1963, to March 31, 1963, and would authorize the appropriation of an additional \$200,000 to continue the study and investigation. I believe that the proposal of the Commission is a completely reasonable one. Although the resolution was introduced by me in June 1961, it was not adopted by the Congress until August 25 and approved by the President on September 5, 1961. Subsequently the Commission was engaged for a few months in staffing and organizing the study unit. Preliminary inquiries and analyses had to be made before final study plans could be definitely formed. Moreover, investigatory techniques had to be varied according to the subject matter. These preliminary steps indicated the breadth and complexity of such an undertaking. Extension of the study to March 31, 1963, would provide a total of 18 months to complete the study, the period originally contemplated when the resolution was introduced.

A more important consideration in favor of the extension is the importance of this study and investigation to the investing public. The dramatic increase in public participation in the securities markets, particularly among persons having slight acquaintance with the intricacies of corporate finance and stock market operations, requires that these markets be fair and orderly. Practices which impinge upon the integrity and orderly functioning of the market cannot be tolerated.

The Commission should be permitted to complete the undertaking which the Congress has entrusted to it in order to maintain full investor confidence in the securities markets.

Mr. MACK. Mr. Chairman, we are very happy to have you before our committee again and we are quite anxious to have your testimony concerning the progress that you made and the justification for the extension of this investigation.

Mr. Chairman, you may proceed.

STATEMENT OF HON. WILLIAM L. CARY, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY HON. MANUEL F. COHEN, MEMBER, SECURITIES AND EXCHANGE COMMISSION; MILTON H. COHEN, DIRECTOR, SPECIAL STUDY OF SECURITIES MARKETS; PHILLIP A. LOOMIS, DIRECTOR, DIVISION OF TRADING AND EXCHANGES; ALLAN F. CONWILL, DIRECTOR, DIVISION OF CORPORATE REGULATION; FRANK J. DONATY, COMPTROLLER; AND ARTHUR FLEISCHER, JR., LEGAL ASSISTANT TO THE CHAIRMAN

Mr. CARY. Mr. Chairman and Congressman Keith, I am William L. Cary, Chairman of the Securities and Exchange Commission.

I have a prepared statement from which I may on occasion deviate, but which will be the basis of my testimony. And in the event that I do so deviate, I would like to have this prepared statement a part of the record.

Mr. MACK. Without objection, your entire statement will be included in the record.

Mr. CARY. My appearance today is to testify on H.R. 11670. This resolution extends the completion date of the Commission's special study of the securities markets from January 3, 1963, until April 3, 1963, and as you have indicated already, authorizes an additional \$200,000 for the 65 positions of the special study to operate as a unit until the latter date. The approval of this proposal would increase the authorization of the study from \$750,000 to \$950,000. The Commission strongly supports this proposal.

The special study is a result of a resolution introduced by Congressman Mack authorizing and directing the Commission to make a study and investigation of the adequacy, for the protection of investors, of the rules of stock exchanges and of national securities associations. It was the firm belief of the Commission then that such a study was most essential and desirable.

There had been no broad study of the securities markets in over 25 years. During that period, important changes had occurred in the structure of the markets, as demonstrated by increases in the number of shareholders, in the number of issuers, in the number of broker-dealers, and in the volume of trading.

Moreover, changes in the methods of distributing and marketing securities had become evident, such as the spread of branch offices, the employment of part-time salesmen and door-to-door selling. At the same time, and perhaps resulting from this great expansion and these changes, there appeared to be an increasing inadequacy, and even a breakdown, of controls in certain areas of the securities markets. Involved in the daily administration of the securities acts, the Commission had not had an opportunity for a reassessment in the light of all these developments. The progress of the study so far confirms the Commission's belief in its importance and necessity.

The Commission believes that enactment of H.R. 11670 is a requisite for it to satisfy the purposes and intent of Public Law 87-196. The Commission expects to be able to report to the Congress on certain subjects by January 3, 1963, the scheduled termination date.

Virtually all projects are in various interim stages; data are constantly being acquired through interviews and questionnaires, and then subjected to distillation and analysis. However, complete execution of the study and adequate fulfillment of the broad purposes of the resolution will depend upon the extension of the study date and the authorization of additional funds.

The Commission most strongly desires to achieve the breadth of approach to the study which is clearly the intention of the Congress, as expressed when the Mack resolution was adopted. The House committee report on the resolution stated:

It should be noted that while the language of the resolution is specific, the scope of the resolution which is telescoped in this succinct language is very broad inasmuch as the subject matter encompassed or not encompassed by the rules of the securities exchanges and securities associations is extremely wide in breadth.

Moreover, Senator Williams of New Jersey said on the Senate floor:

It is intended that the study and investigation be wide in scope; otherwise the resulting information will not enable Congress to examine the broad spectrum of the securities industry.

The organization of the study group had to await appropriation of funds and entailed a certain amount of time for its staffing. The extension of the study would provide a total of about 17 working months for completion. House Joint Resolution 438 was introduced by Congressman Mack in June 1961; it was not adopted by the Congress until August 25, 1961, and was approved by the President on September 5, 1961.

The initial funds for the study, \$412,500, were appropriated on September 30, 1961. Subsequently, the Commission required until early November to staff and organize the special study unit. Further time was necessarily consumed in preliminary analyses before formulating any final study plans. In the same vein, the techniques of investigation had to be developed.

At the time of the introduction of the Mack resolution, the Commission could not definitively report to the Congress on the exact time required to complete the study. I do not venture to assert that even now we can speak with ultimate precision. But we do believe that the extension will provide the time necessary to complete substantially the factfinding phase of the inquiry, together with a report and recommendations to the Congress.

The time and manpower needed to complete an analysis and report on all the subjects which the Commission considers basic and vital, and which must be studied to satisfy the congressional intent, became apparent only after numerous preliminary inquiries. These inquiries pointedly demonstrated the breadth and complexity of our undertaking and further led us to the conclusion that, without an additional authorization, we shall have to exclude consideration of certain fundamental areas from the scope of the study.

Any attempt at exclusion raises very difficult issues. Many problems are interrelated. What at first blush might be selected as being separate and distinct topics are frequently found to be so intertwined with other topics that any attempt at separation would be artificial and might well lead to arbitrary conclusions.

I know in connection with this question of our need for additional funds and additional time you perhaps would like some concrete examples. One of them is in the statement. Another I might allude to is not described in this statement.

The first example involves the American Stock Exchange report. Although only a limited and interim report on the organization and government of that exchange, it necessarily touched on certain problem areas in relation to specialists and floor traders. But can one draw any final conclusions as to these aspects of the exchange without considering similar aspects of the New York Stock Exchange and other exchanges?

And even though the New York and American Stock Exchanges overshadow all the other exchanges, can we ignore these others either in their capacity as dual or even competitive markets for securities listed on the two larger exchanges, or in their capacity as primary markets for many local issues and many investors?

In other words, when you get into one facet, e.g., one major exchange, you are of necessity drawn into an examination and comparison of the other exchanges. By the same token, when we get into this question of the distribution of securities, with respect to which we have sent out a questionnaire, we find that we simply

cannot stop with the distribution the day that the stock is sold, in effect.

We have to study the aftermarket with respect to securities. As you know, in some cases we have found instances in which a security is offered and sold on the first day at 10, and then it moves up on the market to 20 or higher, so that you have to study the process of the aftermarket as a part of the distribution process itself.

When you get into this question of the aftermarket, you have to look into another very complicated issue—"sponsorship," namely, the underwriter who is involved in the original distribution taking the responsibility for making a market in the security at a subsequent time. The question arises whether the relationship between the trading and distribution rules are either too strict, on the one hand, or lax, on the other.

The underwriter might go on the board of directors. Should an underwriter who is on the board be engaged in trading activities? This raises the issue of the applicability of section 16(b) to securities which at the present time are not listed on any of the exchanges and to which reporting requirements, proxy rules, and section 16(b) dealing with short-swing profits are presently not applicable.

And then you get into questions of investment advice, what advice is being given at the time with respect to the security, and also whether or not there are any public relations activities involving that security or that issuer.

As a consequence, we find that we start with one area which in itself is quite broad; namely, the process of distribution. Then we are led into a variety of other areas, all of which have to be explored in order to understand the interrelationships and thus the problem as a whole rather than as a separate compartment.

And I think that illustration, together with the American Stock Exchange report, may demonstrate why we find our study as it develops requiring more time, although a very limited amount of additional time, and a relatively limited additional amount of money.

Going back to the statement, the Commission believes that the importance of the study to the investing public requires its complete execution which can only be effected pursuant to an extension of the study. There has occurred a dramatic increase in public participation in the securities markets, particularly among persons having but slight acquaintance with the intricacies of corporate finance and stock market operations. This development demands that the selling of securities be conducted in a more professional manner; that financial information constantly flow to investors; and that practices which encourage irresponsible speculation be curtailed.

Our economic development depends to a large extent on the orderly and fair operation of our capital markets. Practices which impinge upon the integrity of these markets can only be harmful to our economic growth and to the investors who furnish the funds for that growth. The Commission believes that this study will assist in raising standards generally in the securities markets and in maintaining full investor confidence in those markets.

At the same time we do not want more than 3 extra months. This is not an academic study; it should result in action. Once the study is completed, our present regular staff and additional manpower from the special study will undoubtedly be assigned to remedy any weaknesses disclosed and execute any recommendations made.

I believe that the study, although only about 6 months old, has already demonstrated its importance and value. The special study has apparently stimulated a number of significant developments in the form of rule changes, internal control procedures, and disciplinary actions. These are reflective of an increased awareness by the financial community of their responsibilities and further have assisted in establishing a more salutary climate in the securities markets.

The most dramatic illustration of this new climate is the reorganization of the American Stock Exchange. The Commission authorized an investigation of the exchange on May 12, 1961, immediately after the expulsion of a firm of exchange specialists charged with wholesale violations of the Securities Act of 1933 and the Securities Exchange Act of 1934.

After the establishment of the special study, personnel from that group joined with the staff of the Division of Trading and Exchanges to complete the study and write a report, released by the Commission on January 6, 1962. In that report the staff concluded that, in the case of the American Stock Exchange, the statutory scheme of self-regulation in the public interest had not worked in the manner originally envisioned by the Congress.

This deterioration of self-regulation, first of all, was illustrated by detailing the general failure of the exchange to regulate its members properly; secondly, the domination of the exchange by a small group, predominantly specialists; thirdly, the disproportionate emphasis placed on securing new listings; and, fourthly, the inadequacy of the administrative structure and staff.

Since the investigation and subsequent report on the American Stock Exchange, substantial changes have occurred in its staff, organization and constitutional structure. This reorganization has been effected by the party with the primary responsibility, the exchange itself. The belief that self-regulation could be revitalized on a realistic basis has been a guiding principle in the Commission's relations with the American Stock Exchange.

The view that the exchange should rehabilitate itself has not contemplated abdication by the Commission of its responsibilities. Close coordination between the Commission and the exchange has been evident throughout the process of reorganization.

One important area intended to be covered by the study is the effectiveness of disciplinary actions by the National Association of Securities Dealers and the exchanges. The number of disciplinary proceedings instituted by the NASD for the 9-month period commencing on July 1, 1961, is more than twice that for the comparable period starting on July 1, 1960. Moreover, the recent actions, on successive days, by the New York Stock Exchange in suspending partners of two member firms for 1 year is apparently unprecedented in recent times.

I do not mean to imply that the presence of the study caused the institution of any particular proceeding or generated a particular penalty. However, it does appear that the study has created an environment generally conducive to raising standards.

The study also seems to have had a beneficial effect on the procedures for training and supervision of salesmen. There have been announcements of new, or augmented, training programs established by broker-dealers.

Moreover, a recent newspaper report indicated a growing number of securities firms are hiring training directors to oversee classroom

instruction on the intricacies of securities trading. Reportedly there are now 25 of these directors among New York Stock Exchange firms as compared with 6 at the start of 1961. In fact I understand these directors have formed an association to meet and discuss common problems.

There has been a continuing flow of rule changes since the initiation of the study. Here again the American Stock Exchange has been active, with amendments to various of its rules affecting floor trading, specialists' functions, and members' transactions. The New York Stock Exchange has recently required that specialists report all transactions made by their public customers in stocks in which the specialist is registered. This mirrors the staff report on the American Stock Exchange, which had pointed to some of the potential abuses inherent in a system in which specialists are permitted to handle orders on behalf of public customers.

Moreover, as the staff report stimulated a tightening of listing standards and a revamping of supervisory procedures and controls on the American Stock Exchange, the present environment appears to have caused similar changes on certain of the regional exchanges.

The Commission welcomes these industry actions. They are demonstrative of a self-reevaluation of procedures and practices, which representatives of the financial community have expressed as necessary at this time. As I have stated, these various steps indicate the study has already had a beneficial effect. But the Commission believes that the study can only achieve its maximum utility if extended so that the broadest examination of the securities markets is possible.

I should now like to discuss briefly some of the major topics of the study.

As I stated, one important reason for a study was an increasing evidence of a general lowering of standards in the securities business. The growth of the industry in terms of number of issuers, transactions, firms, branch offices and salesmen, with the consequent difficulties in maintaining adequate surveillance and supervision, appears to have been partly responsible for this decline. Moreover, the relatively easy standards of qualification for entrance into the securities business do not appear conducive to the maintenance, and elevation, of high standards.

There is clearly a need for greater professionalism on all levels of the securities industry. All professional groups operate on the assumption that professionalism begins at the port of entry. Moreover, training and responsible supervision are necessary to maintain standards. The market study, accordingly, is determining the extent to which, and the manner in which, present requirements of the securities laws implement the goals of professionalism.

Public hearings on this subject commenced last week. It is anticipated that these hearings will develop facts and opinions relating to current industry practices and programs and also relating to problem areas revealed by preliminary investigations.

Moreover, the special study has sent questionnaires to approximately 300 broker-dealer firms requesting information on their practices in hiring, training, compensating, and supervising persons engaged in selling securities to the public. The resulting information should clearly inform the Commission of the extent to which existing legislation, rules and practices conflict with the continuing and necessary development of professional standards in the securities business.

The special study has initiated an investigation into the entire process by which corporations distribute their securities to the public and into the over-the-counter trading in these securities after distribution. This, I might say, is a point to which I earlier adverted.

The continuing growth of so-called "hot issues," where the first trading price of a security represented a substantial premium over its offering price, inevitably focused attention on this problem. In connection with this project, the Commission is giving particular attention to the amount and forms of underwriters' compensation, the use of the prospectus, and the effect and propriety of restrictive arrangements concerning the disposition of the security in the after-market.

Fundamental questions must be answered here: What is the underwriter's duty of investigation into the affairs of the issuer? What is the relationship between the distribution and trading process? What restrictions are reasonably necessary to facilitate an underwriting and yet do not conflict with the basic desire for a free market? We hope that our study will provide insight into these problems.

A broad inquiry is also being conducted into the rules and practices of the stock exchanges with particular attention to the role of specialists, floor traders, and odd-lot dealers on the New York Stock Exchange; the handling of block transactions; and controls over members' activities.

For example, the specialist phase of this inquiry seeks to obtain basic information about such matters as the performance of specialists in maintaining a fair and orderly market; relations of specialists with issuers, customers, and members; and various business practices of specialist firms. In general the study is engaged in gathering information which will enable the Commission to evaluate specialist performance in their unique role in the functioning of the auction market.

In the hearings on House Joint Resolution 438, I pointed to the lack of fundamental information concerning the over-the-counter market with respect to both securities traded in that market and the issuers of those securities. The special study has launched broad inquiries covering each of these areas.

The structure of the over-the-counter market is being analyzed through, among other things, a questionnaire which the Commission has sent to all registered broker-dealers. This questionnaire, and other inquiries, should produce basic, and needed, data on the size of the over-the-counter market, pricing of securities, the relationship between principal and agency transactions and the significance and effect of "sponsorship"—the maintenance of a trading market by a broker-dealer in securities which he has underwritten.

Information is being gathered on issuers having securities traded in the over-the-counter market. Under the present law a large number of issuers in whose securities there is substantial public interest are not subject to any reporting requirements. Thus, the investing public is deprived of material financial information with respect to these companies.

This absence of data is particularly unfortunate in the over-the-counter market in which are traded a substantial number of companies carrying on speculative or unseasoned ventures.

On the basis of this inquiry, the Commission expects to determine the appropriateness of existing distinctions in the regulation of issuers with listed securities and unlisted securities, particularly with respect

to publication of reports, solicitation of proxies and insiders' transactions.

The special study is also examining the techniques and uses of financial publicity. In its best form, financial public relations can be considered a desirable extension of the disclosure philosophy contemplated by the Federal securities laws. At its worst, it can be a subtle manipulative technique intended primarily to affect security prices. The study will attempt to delineate between legitimate and improper public relations.

Similar analysis will be pursued in our study of research and advisory activities of broker-dealers and investment advisers. Here we shall attempt to ascertain the differences between proper advisory practices and those involving potential manipulation or conflicts of interest.

Finally, I should like to comment on the Commission's study of investment companies. At present, the special study and the Division of Corporate Regulation are examining various problems in the mutual fund area. Fifty-odd lawsuits involving mutual funds and their affiliates inevitably so direct our attention.

Moreover, under section 14(b) of the Investment Company Act of 1940, which generally authorizes the Commission to study investment companies, the Commission 3 years ago requested the Wharton School of Finance of the University of Pennsylvania to do a study of the investment company industry. Final disposition of this study can be expected in the near future.

We expect the market study and the Division of Corporate Regulation will analyze and report to the Commission on the following problems among others:

- (1) Sales practices of mutual funds.
- (2) Investment company relationships with their investment advisers, brokers, and underwriters. Sometimes one group may perform all three functions.
- (3) The participation by underwriters and dealers in investment advisory fees.
- (4) Joint transactions by the investment companies and affiliated persons.
- (5) Industry practices, such as "reciprocal business." This recitation of only certain of the projects undertaken by the study indicated the scope and ambitiousness of our undertaking. I have omitted discussion of some very basic projects, such as industry self-regulation through the registered exchanges and the NASD, which will entail considerable examination and analysis. I am hopeful that practically all of our projects can be completed in a meaningful manner.

Otherwise, I do not believe that the study will achieve the purpose for which it was intended, a thorough reexamination of the securities markets to determine the present adequacy of investor protection. This thorough reexamination can only be achieved if the completion date of the study is extended and additional funds authorized.

Accordingly, we strongly urge that the Congress adopt H.R. 1170.

Finally, I should like to bring to this committee's attention the fact that the Commission will subsequently request from the Appropriations Committee \$100,000 for approximately 40 positions to be transferred from the special study group on April 4 to operating

divisions. This will cover the last 3 months of fiscal year 1963, that is from April 4 to July 1. We believe that this step will be necessary in order to implement the recommendations and findings of the special study.

As the Commission has learned from its experience with respect to the American Stock Exchange, the publication of a report is not necessarily the end of a problem but may be the beginning of one. Implementation of such a report requires the services of experienced personnel and a tremendous amount of energy and thought to resolve all problems.

That, Mr. Chairman, concludes my opening statement and I am available for questions.

Mr. MACK. I was particularly interested in the \$100,000 that you will request from the appropriations committee. For 40 positions, and this will be for the purpose of assisting you in preparation of legislation and justify supporting that legislation before congressional committees?

Mr. CARY. That is precisely correct, sir. I think there may not only be legislative recommendations, but also rulemaking proposals which can be exceedingly complex. Therefore, we need the experience of some of these people, and the more of them we can persuade to stay the better, for the purpose of working through this rulemaking and appearing before congressional committees. These people will be needed in connection with what should be done in the light of the study, and proposing legislation as a result of the report that we have made.

Mr. MACK. In other words, your plan is to continue the work following the final report. Instead of facing an abrupt termination of the investigation when this report is submitted, it is your plan to pick up at that point and propose the legislative recommendations with the hope that they are implemented and adopted by the Congress?

Mr. CARY. That is correct, sir. We feel that the study as such, the investigation phase, pursuant to this request, will have ended and we will have a full report available to this committee and to Congress by April 5.

After that point, however, we will have to consider the report itself, which undoubtedly will be a massive document and cover a wide variety of subjects for legislative recommendations and rule-making proposals. We will need to appear before congressional committees and also preparing legislation on the basis of the material already available through the study.

Mr. MACK. Would this staff also have the responsibility of making recommendations within the Commission for rule changes or would it be basically for legislative purposes?

Mr. CARY. It will be for both, and the staff will not remain in that form.

In other words, at the moment it is a separate special study group. Upon the termination of the study, or shortly thereafter—I don't know exactly at what time you shift over—they would undoubtedly become, I would assume, a part of an operating division. The operating division normally charged with this area of activity is the Trading and Exchanges—to some extent the Division of Corporate Finance is involved in view of the study touching upon registration

problems and the distribution process. In the field of mutual funds, the Division of Corporate Relation is concerned. Therefore there would be some division of the study personnel with all their experience in these various areas into operating divisions. The study as a whole would perhaps not, therefore, remain as a separate group after the April 3 date.

Mr. MACK. You envision the utilization of your personnel who have been associated with the special study in other areas of the Commission to assist in carrying out the recommendations?

Mr. CARY. Precisely, yes. That is our intention.

Mr. MACK. I think that is very good planning, and needless to say, we in Congress are quite anxious to support legislation which will solve the problems in the securities industry. It seems to me that it would be very helpful to us to have people on your staff available for that purpose.

Mr. CARY. We hope they will be available.

Mr. MACK. Mr. Keith, do you have some questions?

Mr. KEITH. One or two observations and a question, perhaps.

I just would like to reassure myself that most of the extenuating circumstances that you pointed out as causing a greater study in depth have been, in effect, realized by you prior to undertaking the study, and that was one of the reasons for the study. It is just that it is really working out to be more of a task than you originally anticipated?

Mr. CARY. That is correct, sir. When we came before this committee in connection with the original authorization, we had a pretty good idea of the areas in which we were going to be engaged. On the other hand, one never knows until you put a group together and until you get down into the concrete details just how much time will be involved. It is really, I suppose, even now hard to give a precise estimate. However, we do believe that to take this group of subjects to go into them with any depth and thoroughness, and also to put them together—in view of this interrelationship that I mentioned earlier—it would take longer than the date of January 3. Although we are not asking for a very extended and large amount of time, we thought another 3 months would be satisfactory, particularly since we got started later than we originally anticipated.

As you recall, the resolution was not passed until September and we didn't get the funds until the end of that month. All of these circumstances together make us come to the conclusion that another 3 months would be necessary and a small amount of additional funds.

Mr. KEITH. I would like to point out, Mr. Cary, that actually you did very well with reference to the timing and implementation of the resolution. For somebody to introduce a resolution in June of 1961 and have it acted upon by the Congress in August of the same year and approved by the President, is a great tribute to you in the presentation of your case and to the power and prestige of our subcommittee chairman, because that is a remarkably fine record. Many of us file resolutions that don't every get a hearing and if they do get a hearing they don't get acted upon by the subcommittee perhaps, and seldom do we have the success that you have had.

Mr. CARY. I am not complaining, sir. I am intensely grateful. I agree with you.

Mr. KEITH. Inasmuch as you have not thus far submitted any legislative recommendations for this year, and, further, that you haven't highlighted any abuses thus far in your study, I am led to believe that there is no real urgency in connection with any of the facts that you have thus far uncovered.

Mr. CARY. Sir, I have two answers to that question. First, if you take the one area in which we have gone into most exhaustively thus far—the American Stock Exchange, primarily the practice of specialists on that exchange—it was our belief that we ought to stick to the philosophy of Congress and our own philosophy that there should be self-regulation and what was needed was revitalization.

In that area, therefore, we decided that it was not a matter on which we should come to Congress for further legislation, for instance, to ask for more powers. I think we have a very substantial number of powers granted by Congress in connection with exchanges. We haven't exercised these powers fully because we believe that our whole effort in that direction should be to get them to revitalize themselves, to pick new people, and begin to accept the responsibility which should ultimately be theirs.

Now, the American Stock Exchange is really the area in which I suppose we have had the most concrete analysis made and a full report out. As I have stated, we did not believe that or required legislative action.

Now, we are beginning to get into other areas. Although we think there are very substantial problems in certain areas, there are definite interrelationships between others which we have not fully investigated. As a consequence we just do not feel that we are yet in a position responsibly to come before this Congress for legislation.

Mr. KEITH. The market has fallen off in recent weeks rather decisively. Do you see any direct or indirect relationship between that retreat and your revelations pertaining to your hearings of last week and this week?

Mr. CARY. Obviously, I am not a market expert and the Commission really is not an expert in the way the market moves up and down. But I would answer you in general that I do not believe there is any relationship. I think that the activities of the SEC, if anything, really should establish in the public mind confidence in the fact that there is a free and orderly market being maintained. We are attempting to achieve that goal as much as possible. Indeed, I have noticed that by and large the press has not attributed any action in the market to the work which we are doing and I would tend to believe that is true.

Mr. KEITH. In your testimony you talk about filing of some suits which in effect protest certain phases of the mutual fund business activities, and I believe that Mr. Glenn has filed some legislation which would, in effect, cause those who are seeking redress to first of all attempt to get administrative relief through the SEC. Has your Commission had any of these problems that have taken the form of suits? Have they been first brought to the attention of the Commission before the suits have been filed?

Mr. CARY. I may ask the Director of the Division of Corporate Regulation to amplify my remarks, but I would like to start off in answer to that. We have not yet, I believe, replied to the proposal of Congressman Glenn. I might say, however, that our basic phi-

losophy in all the securities acts, including the Investment Company Act of 1940, is that a private remedy should be available. In other words, private individuals should clearly be allowed to assert rights which they have and not be required to proceed through the Securities and Exchange Commission. I think that it has been a general philosophy of Congress not to vest all of the total regulatory power in us and to provide for private remedies.

Let us move now from the general philosophy that we have with respect to the Securities Exchange Act of 1934 and the Securities Act on to the Investment Company Act.

We have taken a specific and concrete position as *amicus curiae* in 2 of the 50 cases which you have referred to involving an alleged excessive advisory fees and other collateral matters. The extent to which we have participated at this time concretely in those cases is that we took a position at the appellate level in strong support of the proposition that I have just mentioned—that private individuals as well as the Commission have the right to bring lawsuits under various provisions of the Investment Company Act, just as we believe they have the right to bring them under various provisions of the other securities acts. We believe the philosophy of Congress is to provide an individual remedy as well as action by the Securities and Exchange Commission in those instances in which a gross abuse of trust or other dereliction may exist.

Mr. KEITH. I still do not know whether or not these individuals who filed suit did seek relief through the SEC.

Mr. CARY. In my opinion, they did not and should not have to, but I would like to ask the Director of the Division of Corporate Regulation to check my views. Mr. Conwill.

Mr. CONWILL. The answer to that is "No," sir.

Mr. KEITH. Thank you. That is all, Mr. Chairman.

Mr. MACK. Mr. Dingell.

Mr. DINGELL. Thank you, Mr. Chairman.

Mr. Cary, I want to commend you for the fine job you are doing and also commend you for the visible fruits of the investigation which you have conducted, I think in a very careful and very scholarly way. It has been a pleasure for me to observe the SEC as being one of the Federal regulatory agencies which has been really vigorous in protecting the public interest.

I have a number of questions I would like to ask you about the conduct of this investigation and the first of which is this: You indicate that you will have some tentative recommendations at a relatively immediate future time to the Congress but that these are in a sense preliminary and tentative in nature. Am I correct in this?

Mr. CARY. I have said in previous appearances, Congressman Dingell, that as we go along in this study we will furnish reports to Congress whenever they are concluded. So far as I know, I haven't indicated that we would have anything in the immediate future, and I do not have any proposal in the offing at this moment. I do hope, however, that we will have some certainly even before the January 3 date and clearly before the April 3 date which is the extended period that we ask for.

Mr. DINGELL. I was referring to the January 3 date in my question. You in a way answered the next question I proposed to ask and that was this: You do propose to send up legislative recom-

recommendations to the Congress as soon as you are able to finalize those recommendations and when you determine conclusively that they are in the public interest as to form and content and as to objective need. Am I correct?

Mr. CARY. That is correct, sir; yes.

Mr. DINGELL. I am particularly concerned with this because it appears to me it would be useful to have the recommendations as fast as possible because, as you are aware, the securities market is a living organism which requires constant scrutiny and supervision. You indicated here that you were making a whole, broad study of the market. As you recall, when you were before this committee, I believe at the time we were first considering the investigation by your agency, I expressed considerable interest in the problem of mutual funds and in the problem of loads, and so forth, on mutual funds, and you indicated at that time that you intended to go into this area of the market. Am I correct?

Mr. CARY. That is correct, sir.

Mr. DINGELL. Have you done so?

Mr. CARY. Yes, sir. As I indicated in the statement, we are approaching the problems of the mutual fund industry in two directions. One part of it is being done by the special study group and another is being done as sort of a consistent responsibility of the Division of Corporate Regulation.

A part of our mutual fund study has been taken up in public hearings which have been conducted in the last week and which will be continued this week. The area that we are concentrating upon in this first series of public hearings relates to the training, supervision, and activities of salesmen and of selling practices generally.

Mr. DINGELL. You mean with regard to these door-to-door salesmen that operate in the mutual fund field and the people who have been specializing in sales to the military and things of this sort?

Mr. CARY. That is part of the problem, and of course we are looking into the whole area of salesmen, not only of mutual funds, but of all types of securities. Mutual funds are one of the major areas in view of their phenomenal growth. There has been a substantial amount of testimony taken during the past week with respect to mutual fund selling activities.

Mr. DINGELL. Do you expect to go into load charge fees and other charges that are placed by the managers and the financial advisers of these funds against the funds?

Mr. CARY. One of the areas covered in the public hearings last week involves the so-called front-end load. This involves contractual plans in respect of which persons undertake to purchase, in effect on a downpayment basis, shares in mutual funds. This area has been growing immensely. Of course it is particularly attractive in that a very substantial amount of the first year's commission—a maximum of 50 percent—is taken down by the salesman. This poses problems and we are analyzing this question at the present time.

Mr. DINGELL. It always struck me that this was a highly improper way to finance a sale of any security and that it was particularly against the interest of the small investor with both limited means and limited knowledge of the market and limited understanding of what he was getting into. I was wondering if the Commission and yourself had any additional feelings on that that you would care to comment on at this time.

Mr. CARY. It is premature for us to really arrive at any conclusions in this area. We simply believe, as is demonstrated by the public hearings that we are holding at the present time, this is something that should be analyzed and investigated. We are looking into it.

Mr. DINGELL. Are you looking into the possibility of action by the SEC and also possible legislative recommendations to the Congress?

Mr. CARY. If the testimony and the facts demonstrate this need we would definitely be coming to Congress. This is an area which we could not resolve simply under our rulemaking power, but would have to come back to Congress.

Mr. DINGELL. With regard to the management of the fees of the managers and financial advisers to the fund, are you scrutinizing those, because those are also substantial charges against the investors?

Mr. CARY. As you have indicated in the earlier questioning, when I was before this committee on the House Joint Resolution 438, there were and are 50 lawsuits involving primarily this question of excessive advisory fees. This is a continuing area of our study. We have not specifically got into the particular lawsuits which are involved, but we believe that this is an area which deserves study and is being studied. It is not a matter which is subject to public hearings at the moment, for example, unlike the selling practices that I have just referred to.

Mr. DINGELL. I am not concerned so much with whether you are having public hearings at this time, but as to whether or not you are scrutinizing and intend to go into it.

Mr. CARY. This is a problem that we think we must study and we are going into it, yes, sir.

Mr. DINGELL. Have you also been scrutinizing the matter of attorneys' fees in the stockholder suits?

I have had the feeling that not infrequently these attorneys were excessive and also were unfair and an undue burden on the investor and on the corpus of the fund. Are you scrutinizing them?

Mr. CARY. We are aware of the fact that some of those suits have been settled and that there have been attorney fees paid. Whether or not we get specifically into the question of those attorneys' fees as a basic problem in the mutual fund industry is a question. I might say, Congressman Dingell, I tried to think through the question that I assumed that your committee would ask with respect to this litigation generally and I would like to make a general statement on this problem if I may.

Mr. DINGELL. I would be happy to have it.

Mr. Chairman, I have to remember that I have other colleagues and I think perhaps maybe at this point I ought to yield to one of my other colleagues and perhaps renew my questioning later if I may, and I will discuss this next, because I want to respect the rights of my colleagues and also the chairman.

Mr. MACK. Mr. Curtin.

Mr. CURTIN. Yes, Mr. Chairman.

I have one or two questions, Mr. Cary. I have read your statement with much interest, and I think it is very well done. I note, however, in the latter part of the statement that you say you are seeking an additional \$100,000 from the appropriations committee. Is that money over and above the \$200,000 that is provided for in H.R. 11670?

Mr. CARY. The answer to you is "Yes," but may I explain it further?

The \$200,000, Congressman Curtin, that we are asking for at the present time will be with respect to the extension of study and work upon it from January until April 3. There will be a gap of the following 3 months until the next fiscal year. In that connection we feel, as I have indicated earlier in my testimony, that we will need to take some of the manpower that we have happily gathered together on this special project for the purpose of considering rulemaking, appearances before Congress to explain it, and also legislative recommendations. Therefore, this request for \$100,000 will be utilized after the study as such is formally completed, but because there will be further work, further discussion, and rulemaking and legislation possibilities, we feel that we need the additional funds in order to retain some of that valuable personnel and some of that valuable experience that has been accumulated during the study.

Mr. CURTIN. I take it, then, however, that it is a direct result of this study.

Mr. CARY. It is a direct result; that is correct. Additional manpower in our opinion will be useful, indeed necessary, in order to carry out, to implement, the study as we have developed it and finished it, we hope, by April 3.

Mr. CURTIN. Don't you think then that it would be better if this \$100,000 was added to the \$200,000 asked for in this piece of legislation so you could wrap it all up in one package?

Mr. CARY. I don't claim to be a budgetary expert. As I understand it, we ask this committee for a continued authorization with respect to the study. The study as such, sir, will be finished on April 3. From then on the personnel will be assigned to the working divisions of the Commission. The study as such will no longer be in existence. These people will be divided and go into the operating divisions in the areas in which the study has developed conclusions.

For instance, some will go into the Division of Corporate Regulation and some into the Division of Trading and Exchanges. Therefore, in the \$100,000 request we are basically asking for money to pay for that manpower rather than for authorization with respect to the study which this resolution involves.

As a consequence, although, as I say, I don't claim to be a budgetary expert and my comptroller is here and might go into this further if you wish, we felt that we wanted to tell the Congress now what we intend to do. But the further request for \$100,000 will not be part of the study itself. It will take the form of a supplemental before the Appropriations Committee.

Mr. CURTIN. One other thing, Mr. Chairman. I see that this study is going down several avenues, which I think is very fine, but I am wondering if they have all actually been launched—or are many of them still in the discussion state?

Mr. CARY. Every one of these to my knowledge has been launched through discussions with individuals, questionnaires already sent out, or taking of testimony.

Mr. CURTIN. Have you actually concluded any portion of your study?

Mr. CARY. The only one which we have formally concluded is the first phase of the analysis of the American Stock Exchange, primarily the work of the specialists. That came out, sir, in the form of a staff report which I would like to make available to each of you.

Mr. CURTIN. Are you convinced that this additional 3 months will give you a sufficient time to complete this work?

Mr. CARY. Ideally, if we wanted to do an academic type of study, I suppose it wouldn't be. But I feel that times change, markets change, and the like, and as a practical matter we can get it done by April 3. We do need that little extra time in order to do the thorough job that we plan.

Mr. CURTIN. And you presently have no intention of asking for a further extension of time?

Mr. CARY. We have no intention of asking for a longer time and I would have trouble prevailing upon some of the very excellent people I have persuaded to come on a year's commitment to stay much longer than that. So I can assure you that the whole motivation will be to complete the study by April 3.

Mr. CURTIN. Thank you.

Thank you, Mr. Chairman.

Mr. MACK. Mr. Dingell, you may proceed. I do think that we should permit the chairman to make his general statement.

Mr. DINGELL. I would be happy to have it at this time, Mr. Chairman. I just don't want to interfere with Mr. Curtin.

Mr. MACK. If you desire, Mr. Chairman.

Mr. CARY. I did not plan to make this statement unless I was asked these questions. I know that several of you have asked questions in this area of fee litigation. I wanted to present an integrated statement of what positions we have thus far taken.

As I stated earlier, we have not taken a position on the merits in any of the approximately 50 lawsuits alleging excessive advisory fees and other collateral matters. We have, however, appeared amicus curiae in two of the cases which reached the appellate level—and this I have mentioned already in answer to Congressman Keith's question—strong support of the proposition that private individuals as well as the Commission have the right to bring lawsuits under various provisions of the investment company act. We have not got into the factual merits of these cases for several reasons:

First of all, the focus of these suits is in large part upon the question of the fee scale, which is a subject of a broad study of the industry that we have been undertaking, as I mentioned before. The thrust of these suits goes to the structure and organization of mutual funds and the related responsibilities and duties of directors and other affiliated persons. These matters warrant and are receiving careful study by the Commission in a far more comprehensive way than would be possible to develop from the evidence in individual lawsuits. In other words, if we got in one lawsuit we would get into the individual problems there rather than looking at it as a whole.

Secondly, the act with exceptions not relevant to the existing lawsuits, confers no specific authority upon the Commission to regulate directly the size of advisory fees or to superimpose the Commission's judgment upon that of management. We do not really have that direct power.

Thirdly, as to intervening on the factual issues, the Commission cannot possibly participate effectively in 50 more lawsuits. There are obvious limitations on our available legal personnel. If we attempted to get into them, our own direct litigation and our general endorsement program would be seriously impaired. This is not to

say that we are ignoring the fee litigation. To the contrary, we are actively and carefully watching the progress of each case. In recent weeks we have been concerned with and studied the terms of settlement of three of the lawsuits prior to trial of factual issues. Particularly arresting our attention is the fact that several have already resulted in modification of future fee schedules but counsel's fees for plaintiffs attorneys are to be paid by the mutual fund rather than by the active defendants.

Finally, it is clear to us that the prevailing contractual investment advisory arrangements and the payment of fees based upon a percentage of assets are an inherent part of the investment company structure contemplated at the time of the adoption of the act. It is possible that this and other elements of the industry structure, which may have been reasonable in the context of conditions 20 years ago, require reexamination. Consequently, we are conducting a thorough study of the entire structure to determine what is realistic and reasonable in the light of present conditions. The Wharton School study, soon to be available, will afford a general picture of mutual funds and further case study will supplement that by concrete example. I think that states generally the posture of our work and the general approach which we are taking to this as a problem—arrested to our attention, in substantial part by the existence of these 50-odd lawsuits.

Mr. DINGELL. I think that is a very wholesome thing and very wholesome statement. There are two other questions I would like to pursue with you, Mr. Chairman.

The first has to do with the general condition and appropriations staffwise of the Commission over the past years and with regard to caseload. I believe it would be fair to say that the caseload has increased enormously since the Commission was originally established by any yardstick we would care to use. Am I correct?

Mr. CARY. That is correct, sir.

Mr. DINGELL. With regard to the volume of work, with regard to the number of staff people you have, and with regard to the dollars of appropriations which you receive from the Congress. Am I correct?

Mr. CARY. That is correct.

Mr. DINGELL. Rather than questioning to any substantial length, I wonder if you would mind submitting to this committee a brief analysis of the workload with regard to the amount of appropriations and with regard to the amount of staff over the years, because I think that a summary of this kind will reveal a rather substantial deterioration of the Commission's position and also of its ability to protect the consuming public. I think this would be a very helpful thing if you could give it to us.

Mr. CARY. I would be very happy to.
(The information requested follows:)

SECURITIES AND EXCHANGE COMMISSION

Statement of selected workload items and appropriations and authorized strength, fiscal years 1955-62

	Estimate, 1962	Actual									
		1961	1960	1959	1958	1957	1956	1955	1954	1953	
Appropriation, actual.....	\$11,412,500	\$9,517,500	\$8,100,000	\$7,705,000	\$6,935,000	\$5,749,000	\$5,278,000	\$4,843,180	\$5,000,000	\$5,245,828	
Authorized strength.....	1,320	1,095	1,000	963	886	810	739	713	756	828	
1. Examination of registration statements:											
Pending, beginning of year.....	515	335	252	145	105	115	103	68	73	72	
Filed.....	2,400	1,850	1,626	1,226	913	943	681	849	649	621	
Subtotal.....	2,915	2,165	1,880	1,371	1,018	1,058	1,084	917	722	693	
Examined.....	2,100	1,550	1,119	873	653	969	814	654	620	620	
Pending, end of year.....	815	515	335	252	145	105	115	103	68	73	
2. Examination of other filings and applications.....	770	670	564	475	501	525	461	410	324	940	
3. Regulation A filings.....	1,150	1,057	1,049	854	732	919	1,463	1,628	1,175	1,528	
4. Annual and periodic reports (forms 10-K, 9-K, and 8-K):											
Pending, beginning of year.....	9,947	8,865	7,154	5,833	5,338	4,001	3,427	1,866	9,260	13,375	
Filed.....	12,975	12,404	11,698	11,094	10,810	9,937	9,323	6,712	7,097	15,537	
Subtotal.....	22,922	21,269	18,852	16,927	16,148	13,938	12,750	8,578	16,357	28,912	
Examined.....	14,422	11,322	9,987	9,773	10,315	8,000	8,749	5,151	14,491	11,090	
Pending, end of year.....	8,500	9,947	8,865	7,154	5,833	5,338	4,001	3,427	1,866	17,822	
5. Investigations relating to possible administrative, civil, and criminal proceedings:											
Pending, beginning of year.....	1,126	960	977	937	978	813	644	725	968	1,072	
Opened.....	575	567	510	523	447	512	362	392	343	462	
Subtotal.....	1,701	1,527	1,486	1,460	1,425	1,325	1,006	1,117	1,311	1,534	
Closed.....	561	401	536	483	488	347	193	473	586	566	
Pending, end of year.....	1,140	1,126	960	977	937	978	813	644	725	968	

1 Includes 65 positions and an allocation of \$412,500 for the special study of securities markets.
 2 Includes a supplemental appropriation for statutory pay increases.
 3 The Commission adopted form 9-K effective Jan. 1, 1960. Form 9-K replaced item 11 of form 8-K for reporting gross sales and operating revenues on a quarterly basis. This form 9-K was rescinded in October 1958. A new form 9-K, semiannual earnings report, was adopted on June 23, 1956.

EXTEND DATE OF SEC REPORT

Statement of selected workload items and appropriations and authorized strength, fiscal years 1953-62—Continued

	Estimate, 1962	Actual									
		1961	1960	1959	1958	1957	1956	1955	1954	1953	
6. Criminal cases referred to the Department of Justice.....	45	42	53	45	15	26	17	8	10	18	
7. Applications for broker-dealer registration:											
Pending, beginning of year.....	128	61	87	60	69	53	40	47	57	35	
Received.....	1,150	1,065	1,077	944	704	776	764	715	684	532	
Subtotal.....	1,278	1,126	1,164	1,004	773	829	813	762	641	567	
Processed.....	1,200	1,000	1,103	917	713	700	700	713	594	510	
Pending, end of year.....	76	126	61	87	60	60	53	49	47	57	
8. Number of registered broker-dealers.....	5,750	5,500	5,288	4,907	4,752	4,771	4,591	4,334	4,132	4,053	
9. Broker-dealer inspections made.....	1,070	1,627	1,499	1,471	1,452	1,214	952	822	788	686	
10. Annual financial report of brokers and dealers (form X-17A-5).....	5,300	5,060	4,569	4,560	4,473	4,328	3,968	3,945	3,950	3,936	
11. Number of investment advisers registered at the close of the fiscal year.....	2,000	1,885	1,867	1,671	1,562	1,431	1,309	1,203	1,134	1,063	
12. Applications for registration of investment advisers:											
Pending, beginning of year.....	24	95	30	22	19	20	14	11	9	16	
Received.....	340	313	305	275	212	217	207	199	124	122	
Subtotal.....	364	339	335	300	231	237	221	210	133	138	
Processed.....	325	315	309	270	209	218	201	196	122	129	
Pending, end of year.....	39	24	26	30	22	19	20	14	11	9	
13. Registered investment companies:											
Number at beginning of year.....	663	570	512	453	432	390	387	384	369	367	
Number of registrations during year.....	120	118	67	70	42	49	46	37	20	17	
Subtotal.....	783	688	579	523	474	448	433	421	389	384	
Number of registrations terminated during year.....	48	25	9	11	21	16	34	34	5	15	
Number of registrations, end of year.....	735	663	570	512	453	432	399	387	384	369	
14. Market value of assets of investment companies (billions).....	\$32	\$29	\$23.5	\$20	\$17	\$15	\$14	\$12	\$8	\$7	
15. Investment company inspections.....	91	56	27	14	7	6					

Mr. CARY. I would not say that we have deteriorated in quality. I would like to believe that we are improving. But I would say that, as Mr. Loomis said in testimony last week, we are having to run a lot harder just to keep up, you might say—to keep up with the old types of cases rather than grasping for all these new problems that we have been faced with. The net result is that I am increasingly convinced that we will have to ask for a larger percentage increase in appropriations in the coming year than we have in the past years. It is hard to retain excellent men. Industry itself is extremely anxious to take them away from us, good young lawyers after about a year and a half or a year and eight months. We have that problem; although it is very difficult to hire excellent people swiftly, we nevertheless feel that we ought to have the authority to do so and will need it in the future in order to meet the problems as I see them.

Mr. MACK. May I interrupt there at this point?

Mr. DINGELL. Yes, be happy to yield.

Mr. MACK. Mr. Chairman, you have a program for hiring young attorneys or young law students, I believe, for summer work. Is that program still being carried out?

Mr. CARY. That is being carried out, Mr. Chairman. I do not know the exact number we bring in each summer. I think Mr. Donaty, our Comptroller, will be able to give you that figure. It has been working out. Through this method we hope to interest excellent young men in coming to the Commission after they finish law school. I know several young men I have personally interviewed of the highest quality who are coming this summer and I believe, if we can get them to come on a long-term basis, it will be most beneficial.

Mr. MACK. Is this a new program, or has this been under way for several years?

Mr. CARY. I think it is several years, but I cannot tell how long. I would like to ask Mr. Donaty, our comptroller, to speak to those to those two points.

Mr. DONATY. The program has been in effect approximately the last 5 years, sir, and this coming summer we are taking on approximately 10 to 15 of these students who are in their junior or senior level of college.

Mr. CARY. And in some cases in law school.

Mr. MACK. The reason I was interested was I was wondering has your experience been that many of these young attorneys do come back and go to work for the Commission after they graduate from law school?

Mr. CARY. I know that some of them do. We don't have 100 percent effective rate, but I know it has been an inducement and has interested them enough so that they do come. As to whether or not we can give a percentage on that, I do not know.

Mr. DONATY. I don't have an exact percentage, but I know that generally there are several that come back.

Mr. MACK. Thank you.

Mr. DINGELL. I would like to pursue another point with you, if I may, Mr. Chairman, and that is this: As you recall, I supported the initial resolution we were discussing for the investigation of the market and I also support the resolution which is before us in the committee today. I feel that it is very wholesome, but I have the feeling that a large part of the need for this special investigation is occasioned

by the fact that the Commission over the past years has not been able to keep up with the changing conditions in the market which, because of diminished appropriations, and diminished staff in relation to responsibilities, that the Commission was not able to keep up with and actually keep ahead of this. Am I correct in this?

Mr. CARY. I think that every regulatory commission really ought to be having every few years a special study. In other words, it is a way of reexamining where you are and what has happened to the industry in relationship to what you are doing. Normally, we have not had the personnel for this type of study and at the same time meet all these ad hoc problems that are coming up. Therefore, the type of special study or, in other words, long-range planning, gets secondary treatment. For that reason, I would suppose our basic answer to you is in the affirmative that a study is overdue. The industry has stated a reexamination ought to be done. We welcome the study as a vehicle to perform that role when in fact we have had so many day-to-day problems that we really haven't had the manpower to think things through independently of day-to-day administration.

Mr. DINGELL. That leads to the next question I want to examine with you, and that is this: Under these circumstances, doesn't it appear that there needs to be a general reexamination of your staffing structure, your appropriations structure, with regard to their adequacy for the SEC to carry out its assigned chore and its responsibility under the statutes?

Mr. CARY. We believe that with the growth in the markets and with the growth of our problems, in part due to that growth in the markets, we will have to ask for additional support.

Mr. DINGELL. The next thing is this: I would like to mention briefly the theory of the basic statutes under which the SEC operates. As I recall, back when the statutes were initially enacted, and I was a very young boy then, there was a decision which was made by the Congress with regard to regulation of the market. As I recall it, the Congress contemplated that the market would be left to self-regulation under expert supervision by the SEC, largely limited to a guarantee by the SEC that there would be full and complete and correct disclosure. Am I correct in this regard?

Mr. CARY. That is correct, sir.

Mr. DINGELL. The market has operated under this, I would say, for something approximating 30 years now. As I note what I have seen in the papers with regard to your scrutiny of the market, it has appeared to me that perhaps this self-regulation has not been working as well as we might have liked it. Am I correct in that regard?

Mr. CARY. We have already had one demonstration of that, a breakdown in controls in the American Stock Exchange, particularly in relation to the activities of the specialists. In that one area at least we have some evidence of it.

Mr. DINGELL. As a matter of fact, on page 7 of your very excellent statement, you say:

In that report the staff concluded that, in the case of the American Stock Exchange, the statutory scheme of self-regulation in the public interest had not worked in the manner originally envisioned by the Congress.

This refers to a report made by the special study group operating with the staff of the Division of Trading and Exchanges. Do you endorse that statement as being your statement today, sir?

Mr. CARY. That is correct. I made it and I will stand by it.

Mr. DINGELL. You referred specifically to the American Stock Exchange. Have you found this to be true with regard to other exchanges, either national or local?

Mr. CARY. We are at the present time looking over the other exchanges and I would say that as of this moment we are not in a position to comment so precisely as we have with respect to the American Stock Exchange. I do not want to give an impression one way or the other with respect to all the exchanges. As you know, there are a variety of them, regional types as well as of course the leader in the field, the New York Stock Exchange.

Mr. DINGELL. On the following page you go so far as to indicate that the number of disciplinary proceedings instituted by the National Association of Securities Dealers for the 9-month period ending July 1, 1961 is more than twice that for the comparable period starting July 1, 1960. You go on to say in following sentences:

Moreover, the recent answers—on successive days—by the New York Stock Exchange in suspending partners of two member firms for 1 year is apparently unprecedented in recent times.

On page 9 you go on to indicate that the New York Stock Exchange has recently required specialists to report all transactions made by their public customers in stocks in which the specialists are registered.

This mirrors the staff report on the American Stock Exchange, which had pointed to some of the potential abuses inherent in a system in which specialists are permitted to handle orders on behalf of public customers.

Then:

Moreover, as the staff report stimulated a tightening of listing standards and a revamping of supervisory procedures and controls on the American Stock Exchange, the present environment appears to have caused similar changes on certain of the regional exchanges.

I am sure you are aware of the fact that the newspapers have periodically reported actions which have taken place in the exchanges, in the NASD, as a result of the scrutiny which is going on now by your agency. The question is this: Would I be fair in inferring that this indicates that as a result of your scrutiny there has been a tremendous flurry of activity on the part of the various self-regulating instruments in the securities market?

Mr. CARY. I do not want to say that we have been totally responsible for this increase because the market itself has been more active; there are more and more salesmen; and there are more and more persons in effect to discipline.

Mr. DINGELL. I was rather curious that these things should coincide with the scrutiny of the SEC.

Mr. CARY. I would say, and I do believe that this Congress itself, and this committee, and the study by the SEC have all had a very definite effect on raising standards.

Mr. DINGELL. And also a definite effect on the increasing of the self-policing activity?

Mr. CARY. Precisely, through that medium; that is correct, through self-regulation.

Mr. DINGELL. This would indicate that there has been a period of somewhat inactivity in the exchanges and self-regulatory mediums previous to this investigation. Am I correct?

Mr. CARY. That has certainly been true with respect to the American Stock Exchange. We can demonstrate that. I think that it is premature for us to speak with respect to the others at this time. We haven't made a responsible study yet and therefore are not in a position to generalize beyond the statements we have made at this time.

Mr. DINGELL. Then would it be fair to say at least in the case of the one exchange, the American Stock Exchange previous to this investigation there had been a demonstrable breakdown in the self-regulatory process. Am I correct?

Mr. CARY. There was very definite evidence of some breakdown which I think at the present time they are definitely attempting to improve and regulate. In other words, responsible individuals there have brought very substantial changes already. The president has resigned. The Old Guard resigned. There were a small group of persons who were sort of perpetuating themselves in power as a committee. Those are no longer at the helm. There has been appointment of new officers and a constitution is currently being proposed which will vest responsibility not in committees any more, but primarily in a paid staff. There is disciplinary action being taken on a broad scale by the American Stock Exchange with respect to the persons referred to in our report. There have been a very substantial number of rule changes and a tightening of the listing requirements. So I think that on a variety of levels we find now that responsible persons are recognizing the needs to reinvigorate themselves and to carry out self-regulation in the form it should be carried out.

Mr. DINGELL. This would next indicate to us that it is incumbent upon the Commission to act with great vigor to protect the public interest in this area. Am I correct?

Mr. CARY. We believe that to be true, yes, sir.

Mr. DINGELL. And that that action had not been forthcoming previous to this special investigation. Am I correct?

Mr. CARY. I do not want to throw everything on this special study in this sense, Congressman Dingell. In respect of the American Stock Exchange, that problem had been building up over a period of time. About a year and a half ago it culminated in the *Re* case, which involved two specialists, as you may recall. That had been carefully pursued and developed by the SEC over a substantial period of time and it was a tough case to develop. The facts in that case clearly pointed to evidences of some breakdown.

As a consequence then we pursued the special study. But I don't want to say that it was all due to one thing. It had been building up and it culminated in the staff report.

Mr. DINGELL. But one of the bits of information that we derive from this is that the self-regulatory process had not been working during that period of time.

Mr. CARY. That is correct. There has been a breakdown of it.

Mr. DINGELL. And if it is now working it has taken extraordinary outside pressures to make it do so because this special study is extraordinary outside pressure; is it not?

Mr. CARY. It is in one way. The answer is that, even if the special study had not been created, we undoubtedly with our limited personnel would have worked toward a report with respect to the American Stock Exchange.

Mr. DINGELL. There would have been some delay.

Mr. CARY. It would probably have been delayed just because of the manpower, but undoubtedly we would have worked toward this same conclusion.

Mr. DINGELL. The point I am leading up to has been this: It is my feeling that this self-regulatory process has not been working and I would like to ask you now whether you don't feel that perhaps some change in this basic concept of the securities law be changed so that we go to additional external regulation by the Commission as opposed to just internal self-regulation within the market itself?

Mr. CARY. I cannot speak to the whole spectrum of problems with which we deal until the study itself is completed. Speaking explicitly to that one which we have worked upon already, we felt that it was possible to preserve the theory of self-regulation by invigoration of that exchange. Responsible members of the American Stock Exchange have worked on the problems raised by our report. A special committee was appointed known as the Levy committee, and issued a series of reports with respect to this. We believe that we should adhere to the basic principle of self-regulation. That, however, doesn't mean that we can abdicate our responsibilities; we have to take the role of seeing that persons self-regulate themselves properly, and in this case I think we will see very definite evidences of revitalization on a self-regulatory basis.

Mr. DINGELL. You say this even though you have told us previously in your testimony that you don't feel that the self-regulatory process has worked in the case of one of the major exchanges?

Mr. CARY. It wasn't working at that time. It doesn't mean that necessarily this doesn't have hope of revitalization.

Mr. DINGELL. Are you scrutinizing the possibility of changes that would result in what, in my opinion, would be a more wholesome climate, that is, some external regulation to make sure that this self-regulatory process does work?

Mr. CARY. We have, Congressman Dingell, power under section 19 of the Securities Exchange Act to take vigorous action with respect to an exchange itself. Though we have this power, if we feel that self-regulation can be revitalized, we feel that is the best way to approach it.

Mr. DINGELL. But it might be useful for the Commission to have some lesser tool rather than the remedies they have to take action against the whole exchange. Am I correct?

Mr. CARY. We have a very substantial number of powers with respect to exchanges and persons on the exchange. I think before we are done we may want to reexamine whether any of those powers should be altered, but at the moment I would say that we are not lacking in power under the Securities Exchange Act of 1934.

Mr. DINGELL. Thank you very much, Mr. Chairman.

Mr. MACK. Any other questions?

Mr. KEITH. No further questions.

Mr. MACK. Mr. Chairman, your study has been underway now, would you say, in full swing for approximately 6 months?

Mr. CARY. That is correct, sir.

Mr. MACK. You indicated that you thought you should not have more than 3 additional months to complete your study. Do you feel that you could do justice to the study and investigate this in less time than the additional 3 months?

Mr. CARY. We do not feel so, sir. We must examine major problems, many of which are interrelated, so as to give breadth to the study; our examination must also have depth so that we may arrive at responsible conclusions. This task will take more than the January deadline and as a consequence we think that an additional 3 months—obviously we could use more—as a practical matter is really all that we wish and would expect to have.

Mr. MACK. I would like to point out that the January 3 deadline could be extended. There is no problem and it is not a massive feat, but I selected the January 3 date originally because that would have been the date that the Congress would have been required to make a report if the Congress were undertaking this investigation itself. Therefore, we could certainly extend it to January 31 or, as you have suggested, April 3. I would also like to inquire about the additional funds. Would it be possible for you to complete your study for less than the additional \$200,000?

Mr. CARY. To do the kind of study we contemplate, the depth of study, and to cover all these subjects, we feel we do need these additional funds. Otherwise, we would have to cut out an area, or maybe two or more. If we didn't cut any one of them, we would have to simply make a much more superficial study of the kind that I don't think we would like to stand behind nor send to Congress as a basis for legislative action.

Mr. MACK. In other words, if you had less than 3 months and less than the \$200,000 additional you would have to, perhaps, exclude some phase of your study; is that correct?

Mr. CARY. That is correct, sir.

Mr. MACK. However, with the 3 months and the \$200,000 you feel that you can do a complete job?

Mr. CARY. We will do our best; yes, sir.

Mr. MACK. And come to the Congress with certain recommendations at that time?

I would like to ask, What plans you have for making reports to the Congress? It is my understanding that you feel it would be premature to make legislative recommendations this year in time to enact legislation before the Congress adjourns.

Mr. CARY. That is correct; yes, sir.

Mr. MACK. Then may I ask if you have in mind making a report prior to the January report that you referred to today?

Mr. CARY. We have two things in mind. Or course we would anticipate reporting to you as a committee on a periodic basis just to advise you as to where we are going. Secondly, I don't have any concrete single project in mind, but I do hope that even between now and January we will have a report on one phase which we could make available to this committee in order to advise them that we are that far along with respect to one phase of the study.

Mr. MACK. Is that prior to the January date?

Mr. CARY. We would hope to have one or several prior to that time. I won't guarantee it because we may find that it is intertwined with another problem and therefore we should not come out with that until we have examined all other implications.

Mr. MACK. Do you think that you could arrange to make a report to the Congress prior to the adjournment of Congress this year with regard to the progress that you have made up to that time?

Mr. CARY. If you wish us to do so, we certainly shall. It depends on the date of adjournment of Congress, but this being May it would be somewhat along the lines of the statements I have made today, plus those things that have transpired between now and the date of adjournment.

Mr. MACK. You think you would be in a position to make such a program report to us, say, about July 15 or the first of August?

Mr. CARY. We shall do so if you wish; yes, sir.

Mr. MACK. One of the problems that was discussed at the time that the original resolution was introduced was the problem of manipulation. I presume that by this time your group has had an opportunity to look into the problem of manipulation.

I understand you have also had an opportunity to do some work with regard to the public relations activity which you referred to in your statement this morning. Would it be fair to ask at this time whether or not your study had revealed that some of the public relations activity has had the effect of manipulating the price of stock?

Mr. CARY. I would like to start off that question and then ask the director of our special study, Milton Cohen, to speak further. We did in respect to public relations, Mr. Chairman, send a letter to selected issuers regarding the extent of their public relations activities. It was to obtain more or less a complete picture of financial public relations performed on behalf of selected issuers during the period of the last 2 or 3 years. The letter requested certain information as to the purpose for which the public relations firm was retained, whether any of the company's securities were sold to any public relations firm, and inquired about certain types of public relations activities by the employees. We asked for sample copies of annual reports, and press releases, and also speeches that are made by management.

As I indicated earlier, public relations, if it is handled properly, can be a very useful device really to carry out the very disclosure philosophy which the securities acts are intended for. But in some cases it can also be a tool for touting a security. I think I can only speak as far as saying what letter has been sent out and the kind of inquiry we are making. I think if there is anything further that can be added to that, perhaps it could be done by Mr. Cohen.

Mr. MACK. Then this is in its very elementary stages?

Mr. CARY. I would believe so; yes, sir.

Mr. MACK. Mr. Cohen, would you have anything further to add?

Mr. COHEN. I think it is beyond the elementary stages, sir, but not at the stage where I want to express my conclusions. We have in this and many other areas been working on a sampling basis, but a very broad sampling basis. We have brought in a great deal of material which is in the process of examination, analysis, and so on. I think we are going to have some interesting conclusions in all of the areas we are working on, but at this time I would not want to talk about any conclusions either on the subject of public relations or the other one you mentioned, manipulation. You say the over-the-counter market. I think it has been mentioned frequently that the scope of that market has certainly increased, but the extent of its increase has been somewhat mysterious, and there was an article in the Wall Street Journal a couple of weeks ago pointing out that one firm, a major firm, had increased its over-the-counter volume about 33 times in 12 years. I have another example I just looked at last

week of a firm that had \$5 million of volume 12 years ago and \$266 million last year. This means there is a big area to look at, and while we are attempting to study the problem broadly and thoroughly, we just haven't gotten far enough that I would want to express my conclusions at this time, sir.

Mr. MACK. Mr. Cohen, I have one other question: Your study has concentrated, I think, to a certain extent on the highly speculative stocks, so-called hot issues. Is that true? That you have concentrated in that area?

Mr. COHEN. I would not say so, sir. We certainly are studying the new issues, including some speculative ones, but we are trying to do a broad study of all aspects of the market and all the markets, all types of issuers, all types of firms, so I would not want to say we are concentrating on those heavily.

Mr. CARY. I think one of the first questionnaires we sent out was on new issues and therefore it received a very substantial amount of publicity. But Mr. Cohen has later sent other questionnaires out covering the whole over-the-counter market.

Mr. MACK. As I understand it, you are trying to cover the entire field rather than specialize in certain areas during certain periods of the study. Is that correct?

Mr. COHEN. As you pointed out when this legislation was first introduced and subsequently, the task you have given us is a very broad one and we are trying to cover the whole broad area. We have, by and large, not planned it on a basis of concentrating our whole staff on one or two subjects, finishing that and going on to another. We have tried to plan the whole thing and then allocate our manpower so that we can reasonably cover the whole area within the allotted time and money.

Mr. MACK. In other words, you are not following the same procedure that was employed in the case of the American Stock Exchange, which, of course, was started prior to the time your group was organized, whereby you make an investigation of the American Stock Exchange and file that report? At the present time you don't envision making an investigation of the New York Stock Exchange and making a report on that subject?

Mr. COHEN. The American Stock Exchange, sir, was a somewhat special case because it had started earlier, as you pointed out. We are studying the whole self-regulatory process for the other exchanges, the NASD, and so on. Naturally some things are a little further advanced in our work than others, either because we got moving on them a little faster or because they don't take quite as long to complete. Hopefully we will bring some subjects to a conclusion earlier than others and can report on them earlier than others.

On the other hand, because of the interrelationship of many of these topics—and they are very closely and deeply interrelated in many instances—even though we have brought one particular study to a tentative conclusion, it may be premature to put out a report simply because we have to bring up to that level of completion some other related subject before we can responsibly talk on the first one.

Mr. MACK. Then as an example, referring to the New York Stock Exchange, rather than have an investigation of the New York Stock Exchange as such, you might investigate the role of the specialist in the New York Stock Exchange as well as other stock exchanges rather than to go on into any particular exchange.

Mr. COHEN. We may be doing both, sir. That is, a good many of these things we look at in some kind of horizontal pattern and some kind of vertical pattern and at the points of intersection. We will be looking at such things as the handling of specialist transactions, and so on, not just on one exchange, but on a good many. However, on the other hand, we will take each separate exchange as an institution, including its role as a self-regulatory or disciplinary institution and examine it vertically as an institution. Those studies are all underway and each will lead to some discussion of each separate exchange as an institution.

Mr. MACK. And the same would be true with regard to the over-the-counter market, is that correct?

Mr. COHEN. Yes, sir. The over-the-counter market is the subject of two major questionnaires that I think are going to provide some data not only about the scope but also about the functioning of the over-the-counter market, of a kind that has never been available, certainly not available in relation to the modern conditions in that market. The over-the-counter market by its nature is extremely heterogeneous, extremely broad. We are trying to get the full picture of that market plus a picture of many of its specific functions and activities.

Mr. MACK. I know you have mailed thousands of questionnaires since the investigation has gotten underway and I presume that you are in the process of analyzing those questionnaires at the present time. In addition to this, do you have investigators who check the questionnaires at the source to determine whether or not the information is accurate?

Mr. COHEN. We don't do the latter in full scope, sir. By the nature of the problems we can't check every answer. But there are various internal checks available and in many, many instances we are taking the data from a questionnaire and following that up through interviews, and private hearings, and so on to get the explanatory material necessary.

Mr. MACK. Thank you very much.

Are there any further questions?

Mr. Keith.

Mr. KEITH. Just one brief question. It would appear to me that in view of the nature and scope of your study it will not result in any legislation next year being enacted by the Congress if we don't get it until April 3. Because of the schedule of hearings which would have to follow your report and then the consideration of proposals by the committee it is very unlikely that we would have any legislation next year and that therefore there is, as I stated earlier, no outstanding abuse that needs immediate attention because perhaps of the nature of the problem.

Mr. CARY. I would not want to say, Congressman Keith, that next year we would not have proposals of legislation because of the fact that even before April 3 we may have some reports available to this Congress. Furthermore, Congress itself probably would not be in a position to want to act on it, let us say, in the first month or two of a new session. I really don't think we are in a position yet to say one way or another with respect to legislation next year. I think we can say that this year we are not contemplating asking for any immediate legislation.

Mr. KEITH. The very thing that makes it difficult for you to come up with an isolated proposal this year will make it similarly difficult for us to take action on any single recommendation that you might file earlier in the session next year. We would have to wait and consider the whole picture which would be revealed when you furnish your report on April 3.

Mr. CARY. This might be. Although I hope that any report will be thorough enough so that Congress would be satisfied that we have achieved a responsible coverage and therefore placed a particular proposal in context.

Mr. KEITH. Thank you, Mr. Chairman.

Mr. MACK. I would like to say that this problem has bothered me as well to a degree. Shortly after this Congress convened I made a statement that this subcommittee on Commerce and Finance would give top priority to problems of the securities field, which we have done. I did hope that legislative recommendations would be made this year in time for congressional action prior to the adjournment of Congress. Obviously, it cannot be done and I am of the opinion that it would be unwise for us to proceed to legislate without having the benefit of the study and investigation, and for that reason I would want to wait until the proper time so that we can do the right kind of a job. I would also like to say that there are other corrective actions that might be taken other than legislative to solve some of our problems through the rules of the exchanges and associations, and of the commission itself, so that the legislation is only one part of the overall problem. I would like to inquire as to whether or not you feel that you would be in a position to make some legislative recommendations as early as January of next year.

Mr. CARY. It is hard to speak to that and be sure that I am correct. I would hope that in some areas we would have thought through the problem enough to have legislative proposals early in the year 1963. Whether or not January I cannot speak to that point.

We are at this time making every effort in trying to do something about a problem once it has been uncovered. Indeed, I think that the American Stock Exchange is an example. Also, we have begun thinking of rule-making changes already. So I think that you will find that we are not going to delay everything and then have a large amount of material on your desk at one time on April 3. You will find that we will attempt to make available both statutory suggestions, recommendations, if we have them, as well as reports even before the date of extension if that is granted.

Mr. MACK. I would like to point out that the original resolution required the report to be made on or before January 3 and if the extension authority is granted, then it would be on or before April 3.

Mr. CARY. Precisely. We so understand.

Mr. MACK. Just to mention the problem of legislating, I would be the first to concede that the machinery wheel turns slowly up here in Congress. On the other hand, I would not go along with any idea that the Congress could not legislate on recommendations which are made on April 3 because it would seem to me that that would be ample time for the Congress to hold hearings and to legislate before the end of the session of Congress, and as evidence of that I would like to point out, as my colleague mentioned a few minutes ago, that House Resolution 438 was introduced in June and hearings were held on June 21,

and it was enacted into law on September 5. I feel certain that if we have proper legislation prepared and it could be introduced some time in April, we ought to be able to enact it before the adjournment of Congress.

Mr. Dingell.

Mr. DINGELL. Mr. Chairman, you have given us the figure of \$200,000. That is a very nice figure, but how do you expect this committee to justify that?

We went to Congress once before with a \$750,000 figure and said this is what is needed for the scrutiny of the market by the SEC. We now are told that an additional \$200,000 is required. Can you give us some justification we can take before our completion on this matter?

Mr. CARY. Yes, sir; I can. If you wish I could divide it up and show where the primary expenditure will be made. Obviously the bulk of it will be the salaries of those 65-odd people that we have on the special study.

Mr. DINGELL. How much is the salary in total of 65 people?

Mr. CARY. If you include both personnel compensation and personnel benefits, Congressman Dingell, you would have a total of \$142,000 out of \$200,000.

Mr. DINGELL. \$142,000 is for personnel compensation and salary benefits?

Mr. CARY. That is correct. The travel item is \$12,000. The rental and communications, primarily telephone and telegraph, rental of tabulating equipment, which is very vital in this, is \$5,000. Printing and reproduction will be \$5,000. There will be a stenographic reporting, which is a very large item, sir, in the magnitude of \$20,000, taking of testimony. We have also supplies and materials of \$1,000, equipment of \$5,000, and we are engaging in an additional project by the Wharton School dealing with motivation of investors which would cover \$10,000 of that \$200,000.

Mr. DINGELL. How much are you giving Wharton School now?

Mr. CARY. If you refer to our past study with respect to the investment company area, I would have to ask Mr. Donaty to speak to the total cost of that.

Mr. DONATY. Over the past 4 years it has run approximately \$90,000.

Mr. DINGELL. I have often wondered how the SEC could delegate its responsibility to make studies of this sort to some private financial institution or some private learning institution. Where it is done I have always been somewhat critical. What is the justification of that last \$10,000 given to the Wharton School rather than having it done within the SEC?

Mr. CARY. Actually, Congressman Dingell, I believe as to that \$10,000, perhaps I misstated myself. That relates to a special study of investor motivation. If I am not mistaken, that \$10,000 will go to the Bureau of the Census. The investor motivation study will be done in part through interviewing a variety of people and you have to use the Census Bureau as a mode of getting to a sample of individuals.

If I am not mistaken, that \$10,000 goes to the Census Bureau. The Wharton School will be taking the Bureau of Census data and correlating the study with respect to investor motivation.

Mr. DINGELL. I see.
 Mr. Chairman, thank you very much.
 Mr. MACK. Any further questions?
 I think that the record should show that Commissioner Manuel Cohen is also present this morning.
 Mr. CARY. I should say he is.
 Mr. MANUEL COHEN. Thank you.
 Mr. MACK. I think that is all from the Commission.
 Is that correct?
 Mr. CARY. That is correct, sir.

Mr. MACK. I want to thank you very much, Mr. Chairman, for your testimony. I also would like to include in the record at this point a letter from the National Association of Securities Dealers and a telegram from Mr. Briltin C. Eustis, president, Association of Stock Exchange Firms.

(The letter and telegram mentioned above follow herewith:)

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,
 Washington, D.C., May 14, 1962.

HON. PETER MACK,
 House of Representatives,
 House Office Building,
 Washington, D.C.

DEAR MR. MACK: In respect to H.R. 11670 (Mack, Ill.), I wish to state that the National Association of Securities Dealers, Inc., favors the additional appropriation of \$200,000 recommended for use by the SEC Study Group and the extension of the date on which the final report should be filed with the Congress.

Sincerely,

WALLACE H. FULTON, *Executive Director.*

DEARBORN, MICH., May 14, 1962.

HON. PETER F. MACK, JR.,
 House of Representatives, Washington, D.C.

DEAR MR. MACK: You will be interested to know that the board of governors of the Association of Stock Exchange Firms assembled in Detroit for its spring meeting, today adopted a resolution in support of H.R. 11670 to provide for a 3-month extension of the stock market investigation by the Securities and Exchange Commission.

This action, in support of your resolution of May 9, was taken in recognition of the magnitude of the Commissioners' task and the importance of the study both to the investing public and the securities industry.

The board feels that completion of the study in a thorough and responsible manner is essential to the maintenance of investors' confidence in our securities markets and that the Commission must be given ample time and funds to permit it to carry out the heavy responsibilities entrusted to it by Congress.

Sincerely yours,

BRILTIN C. EUSTIS, *President, ASEF.*

Mr. MACK. Are there any other witnesses to be heard this morning?
 This will conclude our hearings on this subject. The committee stands adjourned.

(Whereupon, at 12:20 p.m., the committee was adjourned.)



