

NEW YORK STOCK EXCHANGE

MEMORANDUM

April 25, 1963

TO: Board of Governors

FROM: G. Keith Funston

SUBJECT: Securities and Exchange Commission
Legislative Program

At the request of the S.E.C., an industry liaison committee has been formed to confer with the Commission on its legislative program and to be the liaison between the S.E.C. and the various industry organizations.

Attached are the drafts of proposed legislation and supporting memoranda which were made available to the Committee on a confidential basis last Friday.

The S.E.C., at a meeting in Washington yesterday with the liaison committee, agreed to the distribution of this material by the Committee members to their governing bodies on a similar confidential basis.

This is a confidential document and should not be discussed with anyone other than your closest associates and advisors. Under no circumstances should the contents of any of this material be disclosed to nor discussed with anyone else.

I would welcome any comments or suggestions you may have either directly or through Ed Gray or Duke Chapman.

G. Keith Funston

S. E. C. REPORTS

- (A) S.E.C. does not embrace every recommendation but it does accept them as a sound point of departure for proposals to the Congress, for rule-making by the S.E.C., for rule-making by the self-regulatory agencies, and for discussions with the industry.
- (B) Legislative proposals S.E.C. will make:
1. Authorizing standards of character, competence and financial responsibility as conditions for entry into the business, to be established and administered by the national securities associations, notably the NASD, which will complement similar regulation by the exchanges of their members;
 2. Requiring all firms and individuals to be subject to the authority of one of the self-regulatory agencies;
 3. Granting the Commission direct disciplinary controls over individuals and perfecting NASD controls in this area;
 4. Providing the Commission with intermediate sanctions over firms and individuals;
 5. Delivery of prospectus to purchasers of new issues for 90 days rather than 40 days;
 6. Unlisted companies with 300 or more stockholders to be subject to Sec. 13 (financial reports), Sec. 14 (proxy rules) and Sec. 16 (insider trading); Bank stocks, if Congress desires, to be administered by Federal banking authorities in order to integrate similar controls with existing patterns of bank regulation; and
 7. Operators of quotation systems, like National Quotation Bureau, be required to register with S.E.C., which would adopt and enforce rules of fair practice in the use of their system.

(To secure the benefit of industry views of these legislative proposals, S.E.C. will immediately request leaders of the financial community to form liaison committees.)

CHAPTER II

Qualifications of Persons in the Securities Industry

Incidence of inexperience is particularly high among mutual fund salesmen.

A reservoir of boiler-room "floaters" who may carry the "virus of high pressure salesmanship from firm to firm."

Critical of Branch Office managers and other supervisors of salesmen being producers of business.

Wants broker-dealers and investment advisors to file with the S.E.C. and keep current information on major activities, branch offices, size and composition of sales staff and research departments, and managers, supervisors and persons in charge of research.

Wants a system of direct individual licensing covering individual salesmen, supervisors. Principals and supervisors would be required to have a minimum experience.

Wants considerable improvement, refinement and coordination of present examinations and examination programs.

Wants the establishment of a system of character and fitness committees, as in the legal profession.

Recommends a minimum capital requirement of \$5000, plus \$2500 for each Branch Office and \$500 for each salesman.

Also a minimum capital requirement for underwriters of \$50,000, plus 2% of the aggregate of underwriting commitments or undertakings in the last 12-month period.

Chapter III

Selling Practices

Questions Branch Office Managers also being producers.

Notes general absence of fixed procedures to uncover abuses with respect to suitability.

NYSE methods of detection have left much to be desired and it has treated customer complaints, often a fruitful source of information on improper conduct of salesmen, in a manner which at best contributes little to effective enforcement.

NYSE and NASD should establish clearer standards and stronger surveillance and enforcement procedures to assure more effective supervision by their member firms.

Statements of Policy on "suitability" should be adopted.

Broker-dealers should be obligated to consult officially-filed company reports and proxy statements before recommending securities.

Study should be made to eliminate or reduce undue pressures and bias in the selling process:

- making monthly compensation less dependent on each month's production;

- eliminating commission rate step-ups based on production in a given month;

- discouraging undue compensation differentials for sales of different categories of securities where advisory bias may result from commission differential;

- requiring disclosure to customers of extra compensation in some situations.

S.E.C. should have power to invoke sanctions between no sanctions and excessive or inappropriate ones.

Reckless dissemination of written investment advice should be prohibited by statute or by S.E.C. rule and rules of the self-regulatory agency, and should be expressly subject to civil liability.

CHAPTER III

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NYSE and NASD should adopt standards re representation by member firms concerning representation about their research and advisory facilities.

There should be more effective market letter surveillance.

Complete segregation of free credit balances is unnecessary at this time on the basis of past experience. However, as a minimum protection brokers should be required to maintain liquid reserves in a manner similar to Federal Reserve Banks - (reserves of cash or Government securities equal to 15% of free credit balances).

Also, that brokers be required to inform their customers regularly of the amounts and of the customers' rights.

Fails. Mandatory buy-ins are recommended, also marks to market.
NASD to set trading hours
Central Handling of Securities

Exchanges and NASD should institute more positive, continuing programs for the study of conflicts possible in partners being corporate directors with a view to speaking out on particular points in the form of cautionary messages, policy statements, codes of ethics, rules of fair practice, etc.

Chapter IV

Primary and Secondary Distributions

Study Group recommendations with respect to new issues:

1. Adoption by the Commission and/or the NASD of appropriate rules to eliminate or temper certain factors which produce artificially high premiums. Among the rules appropriate for consideration and adoption would be:
 - (a) Prompt notice to customers following commencement of an offering as to allotments resulting from solicitations or indications of interest prior to the offering.
 - (b) Prompt delivery of certificates to purchasers.
 - (c) Prohibition of trading markets for a brief period after the effective date (except for permissible stabilizing activities).
 - (d) Clarifying restrictions on obtaining indications of interest or orders to purchase in the after-market before commencement of the offering.
 - (e) Limitations on underwriters' soliciting purchasers at premium prices in the immediate after-market.
2. Conditioning acceleration of the effective date of a registration statement or clearance of a Regulation A filing in the case of first issues upon delivery of a substantially final prospectus or offering circular to each expected purchaser in the original distribution at least two days before any sales are made.
3. Extension from 40 to 90 days of the period for required delivery of the prospectus in the case of "first" issues of common stock (the Special Study recommends that the 40-day prospectus-delivery requirement be eliminated in offerings of securities by issuers subject to the continuous financial reporting requirements).

Chapter IV

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4. Strengthening by the NASD of its enforcement of prohibitions against "free-riding."
5. Publication by the NASD, in implementation of its program for review of underwriting arrangements for unseasoned issues, of summaries of specific rulings.
6. A requirement that underwriters receiving non-cash compensation in a public offering shall report to the NASD and the Commission with respect to the exercise of options or warrants, transfer thereof, or disposition of shares.
7. Clarification by the Commission of the application of its rules relating to market activities by persons interested in a distribution of securities.

Also, broker-dealers managing an unregistered distribution meeting certain size standards be required to file with the S.E.C. a brief notification, including information concerning the distribution.

Consideration should be given to setting an interval of time, say 48 hours, between the filing and the commencement of the distribution.

Also, any broker-dealer participating in an unregistered distribution be required to advise each customer in the confirmation of the substance to be set forth in the notification, and appropriate portions thereof at the time of solicitation.

Issuers and controlling persons proposing to make substantial public offerings in reliance on the intrastate exemption of the 1933 Act would give the S.E.C. advance notice of such offerings.

Chapter IV

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Distributors and dealers in real estate securities would be required to become members of a registered securities association. All persons selling real estate securities would have to register and meet qualification standards the same as other persons selling securities must meet.

Recommends simplification of disclosure requirements of the 1933 Act for companies already subject to continuous reporting requirements of the 1934 Act. (In such cases it suggests a short form registration statement and prospectus. Also the elimination in such cases of present requirement that all dealers deliver prospectuses to purchasers of registered shares for 40 days after offering date.)

Chapter IX

Non-Listed Companies

Recommends making them subject to 1934 Act Sec. 13 (financial reporting), Sec. 14 (proxy rules) and Sec. 16 (insider trading) if they have 300 or more stockholders.

(1st phase - 2 years - 750 stockholders;
2nd phase - 2 years - 500 stockholders;
3rd and permanent phase - 300 stockholders)

Recommends prohibition and criminal penalties and civil liabilities for intentional or reckless dissemination of false and misleading statements. Also, disclosure of compensation of public relations firms, including options and warrants in stock of company.

Exchange and NASD are in a position to impose needed restraints on companies.

Urges news media and press and public relations associations to impose standards designed to separate corporate propaganda from news; to control conflicts of interest on the part of writers of financial news.

PROPOSED AMENDMENT OF SEC. 12(b) and 13(a) of 1934 ACT

(1) Proposal:

Under 1934 Act, to require companies to be listed and are listed to furnish the SEC for its public files information re material contracts (not made in ordinary course of business) and material patent rights or contracts; and to keep such information current.

(2) Present Situation:

1933 Act requires this information to be filed with a 1933 Act registration. This type of information is not required to be kept current.

(3) Discussion:

Unless this proposal is made part of the Frear-Fulbright bill, it will add another discrimination against listed companies and aggravate the present double standard problem.

(4) Recommendation:

That the Exchange urge consideration of this proposal as part of the SEC's proposal re a Frear-Fulbright type bill.

*Cary's letter
of 4/18/63
"2nd part"
"7/1/63"*

Sec. 15(a) and (b) and 15A - 1934 Act

Proposal 1:

All OTC broker-dealer firms will be required to be members of a registered national securities association unless the SEC grants exemption.

Discussion:

This would require registration of broker-dealers who do solely an intrastate business and those selling real estate syndications; also to join a self-regulatory agency and be subject to its rules and discipline.

Recommendation:

That Exchange make no objection.

Proposal 2:

National securities associations (NASD) will be required to adopt rules including:

- (A) establishing standards of competency, experience and integrity for members and persons associated with members
- (B) establishing capital requirements
- (C) on the fairness of prices charged.

Discussion:

The objectives sought are higher standards for entering the business and for capital requirements consonant with financial responsibilities. The Exchange can have no objection to these goals.

However, questions do arise as to

- (1) whether NYSE members would be exempt from NASD capital requirements and also from such other rules adopted by the NASD re financial responsibility - such as segregation of fully paid and excess margin securities; 15% reserve against free credit balances, etc., and
- (2) whether the Exchange may continue its own screening, investigation, etc. of persons proposing to enter NYSE firms. (It will be remembered that one of Cohen's ideas was a division of labor and a coordination of effort among the self-regulatory agencies.)

Also, there are questions as to the proposed broadening of the areas in which the SEC can require NASD to adopt rules, (see sub-section (k)(2) of Sec. 15A), such as

- (1) Procedures for denial of membership - and of disciplining
- (2) Fairness of prices charged

Recommendations:

(A) That the Statute or agreement with NASD

- (1) exempt our member firms from its capital requirements and any rules with respect to financial responsibility;

- (2) exempt proposed members, allied members, supervisors and registered representatives, etc., from screening by NASD character and fitness committee (continuing the present joint examination).

- (B) That the Exchange object to either the NASD or the SEC indirectly fixing profit differentials, still leaving the NASD in its present position of determining in specific cases that the profit was unreasonable in the light of the circumstances.

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Proposal 3:

The SEC will be empowered, in disciplinary proceedings, to proceed against an individual associated with a broker-dealer.

Recommendation:

No objection.

Proposal 4:

The SEC will be empowered to impose suspension, etc., and to close a branch office.

Discussion:

There appears no reason why SEC should not be able to suspend rather than revoke or take no action.

There is a material question of how the SEC will implement the right to close a branch office.

- Q.1. There is no limitation on the time such a sanction would run. (Note: SEC would be able to suspend only for 12 months.)
- Q.2. Why should the Branch Office be closed, perhaps permanently, if the firm is in a position to put in charge of such office a competent, qualified, supervising Branch Office Manager?
- Q.3. If a firm has two offices in the same city, how would the SEC rule? Would SEC say no customer of the closed Branch Office could be serviced by the remaining open Branch Office?

Recommendation:

That the SEC's power to close a branch office be limited to the time necessary for the firm to place in charge of such office another person of competence and integrity.

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Proposal 5:

- (A) To broaden the category of crimes and injunctions which afford a basis for SEC disciplinary proceedings;
- (B) To add aiding and abetting in violations;
- (C) To add failure to supervise employees and others who violate;
- (D) To eliminate the need for ~~pro~~viding use of mails;
- (E) To eliminate exemption from registration of broker-dealers whose business is solely "intrastate."

Discussion:

- (A) There appears no reason why these statutory bars should not be broadened.
- (B) The aiding and abetting provision was included in the SEC's 1959 program to which we objected as it was drawn. In its present statutory form it appears unobjectionable.
- (C) It is hard to argue about SEC having the authority to discipline supervisory employees. However, it is unclear what is meant by failure to supervise "others who violate." Who are these "others?"
- (D) There should be no objection to eliminating the need for proving the use of mails.
- (E) There is no basis for questioning the elimination of the "intrastate exemption from broker-dealer registration."

Recommendation:

That the Statute be further amended to permit the NASD to suspend or expel a person for violation of a rule, without NASD having to suspend or expel such person for conduct inconsistent with just and equitable principles of trade?

QUOTATION BUREAUS

Proposed Amendment to Sec. 15 of 1934 Act

Proposal:

To require persons who systematically collect and publish quotations (other than exchanges and NASD)

- (A) to register as such with the SEC;
- (B) to adopt rules "to assure the flow of fair and informative quotations;"
- (C) to give the SEC unlimited power to
 - (1) require such persons to adopt rules dictated by the SEC;
 - (2) to adopt such rules itself.

Discussion:

This would affect the New York Quotation Bureau and possibly Scantlin Electronics and anyone else who gathers and publishes quotations for an exchange or NASD. It would greatly broaden the SEC's present powers.

Recommendations:

- (1) That the Statute make clear the control of the exchange over its own quotations is not affected;
- (2) That the Statute define more closely the powers of the SEC.

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PROPOSED AMENDMENT TO SEC. 10(c) of 1934 ACT

Proposal:

To prohibit fraudulent, deceptive or manipulative acts or practices to influence or affect a market for or the market price of any security.

Present Situation:

Such prohibition is applicable to registered investment advisors, although the SEC has not as yet adopted any rules covering them. A case involving a possible violation - Capital Gains Research - is now before the U. S. Supreme Court.

As to others, such prohibition applies today only to acts or practices employed in connection with the offer, purchase or sale of a security.

Discussion:

While the purpose of the proposal can not be objected to, it may well seriously limit the amount of information re a corporation's affairs presently being given to the public voluntarily by corporate officials. This could materially affect the efforts of the Exchange to encourage prompt disclosure by listed corporations of important developments which may affect security values or influence investment decisions of stockholders or the investing public.

Recommendation:

That the legislation make clear:

- (1) that it does not apply to any person who has acted in good faith;
- (2) that the prohibition shall apply only to specific practices defined by SEC rules;
- (3) that it applies only to written material.

"Fulbright"

Proposed Amendments to Sections 12, 14, 15 of 1934 Act

Proposal:

Registration with SEC of OTC companies with 300 stockholders of record and filing of information equivalent to listed companies.

Also, such OTC companies would be subject to provisions re keeping such information current (Sec. 13), to proxy provisions (Sec. 14), and to insider trading provisions (Sec. 16).

Discussion:

The Exchange in past has been for this type of bill. However, there are a number of questions:

1. The separate proposal to require listed companies to file information with respect to material contracts, etc., should be made a part of the "Fulbright" bill to avoid an additional discrimination against listed companies. This would preclude the material contracts proposal from being adopted and the "Fulbright" bill being dropped.
2. In the "Fulbright" bill, the stocks of affected OTC companies would be subject to the same margin requirements as listed stocks. This provision should be contained in the present proposals.
3. Banks, so long as they remained OTC would be subject to a Federal banking authority. However, the banks would come under SEC control if they listed. This is discriminatory. All banks, whether or not listed, should be subject to the Federal banking authorities rather than to the SEC.

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DELIVERY OF PROSPECTUSES

Proposed Amendment of Sec. 4(1) of the 1933 Act

Proposal:

- (A) To extend the present 40-day requirement for delivery of a prospectus by any dealer to 90 days in the case of first public registered distributions.
- (B) To empower the SEC to shorten either the 40-day or 90-day period as to be provided by new SEC rules.

Discussion:

Our concern is for distributions of additional issues of listed securities. The Study Group suggests that with respect to companies which have been filing reports with the SEC:

- (1) that there be a short-form registration statement and prospectus;
- (2) that the 40-day delivery of prospectus period be eliminated except in the case of sales by a dealer of his unsold allotment.

Recommendation:

That there be a complete exemption in the case of securities which have been listed and traded for three years.

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