88th Congress, 1st Session - - - - House Document No. 95, Pt. 2

REPORT OF
SPECIAL STUDY OF SECURITIES MARKETS
OF THE
SECURITIES AND EXCHANGE COMMISSION
PART 2

CONSISTING OF

LETTER OF TRANSMITTAL OF JULY 17, 1963, FROM THE CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, LETTER OF TRANSMITTAL OF JULY 16, 1963, FROM THE SPECIAL STUDY OF SECURITIES MARKETS, AND THE FOLLOWING CHAPTERS:

CHAPTER V.—TRADING MARKETS—INTRODUCTION

CHAPTER VI.—EXCHANGE MARKETS

CHAPTER VII.—OVER-THE-COUNTER MARKETS

CHAPTER VIII.—TRADING MARKETS—INTERRELATIONSHIPS

OF THE REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS, RELATING TO THE ADEQUACY OF INVESTOR PROTECTION IN THE SECURITIES MARKETS, PURSUANT TO SECTION 19(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (PUBLIC LAW 87-196)

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REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS—PART 2

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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., July 17, 1963.

The PRESIDENT OF THE SENATE.
The SPEAKER OF THE HOUSE OF REPRESENTATIVES.

SIR: I have the honor to transmit the second segment of the Report of the Special Study of Securities Markets, containing chapters V, VI, VII, and VIII. This report is submitted pursuant to section 19(d) of the Securities Exchange Act of 1934, Public Law 87–196, which directs the Commission to make a broad study of the adequacy of investor protection in the securities markets. The first installment of this report, chapters I through IV and IX, was delivered to the Congress on April 3, 1963; the final installment should be transmitted within the next few weeks.

The chapters of the report here transmitted deal with the trading markets, the exchange markets, and the over-the-counter market. As we stated in our first letter of transmittal, this report should not impair public confidence in the securities markets, but should strengthen it as suggestions for raising standards are put into practice.

I

There is a wide diversity among the various markets. An exchange market is concentrated in a single place and has a limited group of professional participants, as well as a selected list of traded securities. The over-the-counter market, on the other hand, has no boundaries; it is everything outside the exchange markets. It is scattered throughout the country and represents, in essence, the sum of many markets. It is characterized by unlimited entry both from the viewpoint of securities traded and persons trading. It is vast, diffuse and heterogeneous. Indeed, there was no composite picture of the over-the-counter market today until this study was completed.

Because of these differences, the markets have received different regulatory treatment. The report points out the more extensive, and intensive, degree of controls over trading practices in the principal exchange markets as compared with the over-the-counter market. Consequently, the problems and needs of the over-the-counter market appear greater. But in both markets there are serious inadequacies in investor protection. Certain of these shortcomings have been of continuing concern to the Commission, such as floor trading in the principal exchange markets. Others are presented in a new context, as in the case of the odd-lot dealers. In still other situations, the Special Study has amassed the technical data necessary for a thorough analysis, for example, of the specialist system or of the operation of the over-the-counter market. Finally, the study affords a unified picture of the markets which previously have been viewed only in more or less isolated fashion. Thus, we are now in a position to appreciate the effect of the New York Stock Exchange commission rate schedule on the regional exchanges and the evolution of the "third market."

The study has properly focused on problem areas. To these the Commission, the self-regulatory agencies and the financial community must respond with promptness and thoroughness. The importance of the capital markets to our economic progress does not permit otherwise.

II

As we said with respect to part I of the report, we have been exceedingly fortunate to have assembled such a superior group to conduct the study. The Special Study was given freedom to analyze and point out problems as they appeared to it; in this respect, the judgments, analyses, and recommendations in the report are those of the Special Study and not the Commission.

In connection with this installment, we highlight three further points. In the first place, we emphasize that the recommendations in this part of the report, with the important exception of controls over operators of quotations bureaus, can be effected, without amending the securities acts, through the medium of the rulemaking authority of the Commission or of the self-regulatory agencies. Moreover, as the Congress is aware, the Commission has made legislative recommendations which have been embodied in S. 1642, H.R. 6789, and H.R. 6793. These recommendations are substantially based upon and supported by the first installment of the Report of the Special Study. The Committee on Banking and Currency, U.S. Senate, has reported out S. 1642, as amended. It is the Commission's opinion that these bills represent essential amendments to the securities laws and that their enactment will significantly improve investor protection. Improvement will be achieved not only through more reliable disclosure as to companies traded in the over-the-counter market, but in the market itself, through raising qualification standards for those dealing in over-the-counter securities. We further point out that, although our legislative program is a part of a general effort to raise standards in the securities markets, the program stands by itself; thus consideration of the bills can appropriately proceed independently of the discussion and resolution of the questions raised in the chapters here transmitted.

Secondly, as we have indicated, this section of the report contains recommendations designed to be carried out by the Commission under its rulemaking power or by the self-regulatory agencies. It is inappropriate, therefore, for us to speak definitively on various of the questions presented, which involve substantive changes in our rules or the rules of the self-regulatory agencies. In most cases, we cannot legally take final action until interested persons are afforded an opportunity to present their views. In other instances, a hearing and the making of a record may be necessary. In any event, we believe the responsible course of action calls for discussions with the securities industry before any final decisions are made.

Finally, as the study itself has so carefully pointed out, these problems are subtle and complex; many are just emerging; and many call for further study. Some subjects, such as automation, are long-range in nature, far-reaching in impact, and require a continuing and more elaborate analysis of a development only in its infancy in the securities industry. Many other recommendations are of a similar nature. For example, any conclusions about certain of the recommendations concerning the over-the-counter market must await further exploration and consultation with the industry. Similarly, any proposals regarding the structure of the New York Stock Exchange commission rate schedule must be premised upon a thorough understanding of the impact any change in that structure would have on other sectors of the securities markets, such as the regional exchanges.

These considerations, of course, do not preclude our endorsement of the general soundness of the report as a point of departure for discussion with the industry and for rulemaking. They do serve as a background to a more detailed response by us to the recommendations. We recognize that the Congress expects such a response, as evidenced by a letter dated April 5, 1963, from Hon. Oren Harris, chairman, Committee on Interstate and Foreign Commerce, House of Representatives, requesting our views as to the specific recommendations contained in the first part of the report. We expect to send a letter within the next few days detailing our views on the specific recommendations in the second installment.

III

At the present time the Commission's efforts are heavily committed to our legislative program which is under consideration by the Congress and to the completion of the Report of the Special Study. Upon completion of these efforts, we shall concentrate upon those areas calling for exercise of our rulemaking authority or that of the self-regulatory agencies. In the meantime, the staff of the Commission is preparing proposals for presentation to the Commission and to the industry. A special Office of Program Planning has been established whose initial task will be to coordinate and assist the operating divisions and offices of the Commission in this large and very important task of carrying out recommendations of the Special Study.

By direction of the Commission.

WILLIAM L. CARY, *Chairman.*

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., July 16, 1963.

To the Chairman and Members of the Securities and Exchange Commission:

We have the honor to transmit herewith chapters V, VI, VII, and VIII of the Report of the Special Study of Securities Markets. These chapters deal with trading markets for securities and are to be printed as part 2 of the total report. Chapters I, II, III, IV, and IX have been previously submitted under our transmittal letter dated April 3, 1963. The remaining chapters of the report should be ready to be forwarded to you within the next few weeks.

As we stated in our letter of April 3 with respect to the study and report generally, the total picture emerging from our studies is one of basically strong institutions subject to many specific weaknesses and abuses. The balance is, of course, different for different market institutions. In particular, the over-the-counter markets have received less systematic and thorough attention than exchange markets under existing regulatory measures and mechanisms and the need and opportunities for improvements are correspondingly greater, even allowing for inherent differences in the natures of the two types of markets.

The faults and defects disclosed in the study do not call for public alarm as to the basic integrity of the securities markets but neither do they permit of complacency. The weaknesses that have been found in trading practices and regulatory controls are of various kinds and perhaps varying degrees of seriousness, but in the opinion of the Special Study all of them call for attention and action—if not following the specific recommendations of the report on each matter, then seeking an alternative way of meeting the disclosed need—if our market institutions are to achieve and maintain a quality commensurate with their importance to the American economy and the American public.

The chapters transmitted with this letter, perhaps even more than others in the total report, deal with numerous matters of great complexity and difficulty, some of which have neither been the subject of continuous regulatory attention nor the subject of intensive studies in many years, if ever. The Special Study has arrived at its conclusions and recommendations after thorough analysis and thoughtful review of massive quantities of data and presents them with confidence and conviction as to their essential soundness. Nevertheless, it is recognized that many of them may be quite controversial, and that in some instances alternative solutions may be preferred after further exploration. It is pertinent to repeat here what we said in chapter I.A.5 (at pp. 7–8 of pt. 1) of the report:

> No part of the present report has been submitted in draft form, for comment or correction or any other purpose, to any of the private persons or groups referred to or potentially affected by the contents. Assuming that this would

otherwise have been an appropriate course, it was an impossible one within the time limit of this study. Thus, such persons and groups have not had the opportunity to respond directly to any of the factual material, analyses, or proposals contained in the report, as they undoubtedly would have been entitled to if the report amounted to a final disposition of any of the questions discussed. Since the report does not "decide" any question, but only expresses conclusions and recommendations of the Special Study, adequate opportunity for pointing out errors of fact or analysis or for disputing conclusions and recommendations will be afforded in the legislative hearings or administrative proceedings that necessarily will precede adoption of any recommendations to which there might be opposition.

* * *

Since the publication of the first group of chapters, a few errors contained in them have been brought to our attention. We most sincerely regret these errors and any confusion or embarrassment they may have caused. These are listed in an attachment to this letter.

* * *

In our transmittal letter of April 3, 1963, we identified the members of the staff of the Special Study and also referred to the invaluable assistance received from individuals and groups outside of the formal study staff. While the acknowledgements in our earlier letter apply generally to all chapters of the report including the present ones, it should be pointed out that the study received particularly important assistance in connection with the present chapters from the following individuals on the Commission's staff outside the study staff: Walter Werner, Gordon Henderson, Charles R. McCutcheon, Vito Natrella, John Woodward, and Joel Rabin.

In the list of those outside the study's own staff who have borne added burdens in connection with the study and have greatly facilitated its work, there should have been included the names of Harry Pollack, Director of Personnel, and Albert Fontes, Assistant Director of Personnel, as well as the staff of the Commission's Miami branch office. To the list of outside organizations rendering important assistance in data processing should be added the Computation Laboratory of the National Bureau of Standards and the Columbia University Computer Center. Additional persons serving on the clerical and stenographic staffs of the study included: Bernard H. Garil, Leola B. Kelley, Larry L. McKown, John F. Morris, Jr., Margaret L. Olearnick, H. Janice Purschwitz, Yvonne D. Scott, David L. Shriver, and Barbara J. Yokemick. Finally, our previous letter incorrectly listed one member of the regular staff, Fred Siesel, as a financial analyst instead of among the economists and statisticians.

Respectfully submitted.

MILTON H. COHEN,
Director,
RALPH S. SAUL,
Associate Director,
RICHARD H. PAUL,
Chief Counsel,
SIDNEY M. ROBBINS,
Chief Economist,
HERBERT G. SCHICK,
Assistant Director,
Special Study of Securities Markets.

ERRATA IN PARTS 1 AND 3 OF REPORT

At page 87 of part 1 of the printed report (ch. II.B.3) the following statement appears:

The brokers blanket bond essentially covers losses resulting from dishonest or careless acts (theft, embezzlement, loss or misplacement of property, etc.) but not from violations of Federal and State securities laws or from insolvency.

Since the report appeared, our attention has been drawn to two pertinent cases, one recently decided and the other still in litigation. In *The Home Indemnity Company* v. *Reynolds & Co.*, 187 N.E. 2d 274 (Ill. App. Ct. 1st D., 1962, reh. den. Jan. 31, 1963), the court held that a sale of securities in violation of the Illinois Securities Act was a criminal or dishonest act for which recovery could be had under a brokers blanket bond. In the second, *Atkin et al.* v. *Hill, Darlington & Grimm, et al.*, still pending in the New York courts, a broker-dealer takes the position that a bonding company is liable under a brokers blanket bond with respect to sales of insurance company securities in violation of section 51 of the New York Insurance Law.

At page 583 of part 1 of the printed report (ch. IV.E.3) a footnote lists Realty Equities Corp. of New York as one of five cash-flow real estate corporations having stocks listed on the American Stock Exchange. This company is not a cash-flow corporation and its name should be eliminated from the footnote. The text, accordingly, should refer to four rather than five such companies.

At page 54 of part 3 of the printed report (ch. IX.B.5.e) the following appears:

* * * The broad conclusion of the study, which is in accord with the publicly expressed view of one of the most knowledgeable authorities covering over-the-counter market, Wallace H. Fulton, the retiring executive director of the NASD,[1] is that section 16(b) should apply generally to unlisted securities.

The Special Study has been subsequently advised by Mr. Fulton that the above does not correctly reflect his position, since his expression concerning extension of section 16(b) to over-the-counter markets was subject to the qualification that it would be necessary to have an exemption "for a securities firm making a market in a security which has a partner or an officer serving on the Board of the company issuing that security."

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[1] New York Times, Feb. 27. 1962, p. 51.

CHAPTER V

TRADING MARKETS—INTRODUCTION

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A. BASIC COMPONENTS OF TRADING MARKETS

B. BASIC CONCEPTS AND STANDARDS RELEVANT TO TRADING MARKETS

C. PRACTICES IN FOREIGN SECURITIES MARKETS

CHAPTER V

TRADING MARKETS—INTRODUCTION

A. Basic Components of Trading Markets

As noted in chapter I, the broad term "securities markets" encompasses both the markets for distribution of securities into public hands and the markets for continuous trading in outstanding securities.[1] Markets for distribution of securities were the subject of chapter IV. Trading markets are considered in this chapter and chapters VI, VII, and VIII. It will be seen that the uses and mechanisms of trading markets are substantially different from those of distribution markets, although there is an overlapping area having imprecise boundaries but consisting of distribution into wider public ownership of blocks of securities already outstanding ("secondary distributions"; see ch. IV.C), and the handling of large blocks in the trading markets (see chs. VI.D.6.h, VII.C.6, and VIII.C).

Of the four chapters dealing with trading markets, the present one contains general introductory material including brief discussions of basic components, concepts, and standards applicable to trading markets and basic differences and similarities between types of markets; chapters VI and VII contain detailed discussions of the two major types of trading markets, exchange markets and over-the-counter markets, respectively; and chapter VIII considers various interrelationships between the two basic types and among markets generally, including factors affecting choice of markets, characteristics of securities traded in different markets, institutional participation in markets and use of market mechanisms, over-the-counter trading in exchange-listed securities, and the role of regional exchanges as primary and multiple markets.

1. PARTICIPANTS IN TRADING MARKETS—"PROFESSIONAL" AND "PUBLIC"

Participants in the trading markets include both "professionals" and the "public." The professionals—those who make their livelihood in the securities business as underwriters, brokers, or dealers—have widely varying characteristics and activities. At one extreme, the professionals may be members of giant wire houses with memberships on several exchanges and with nationwide or even worldwide networks of branches and correspondents; at the other, they may be one-man firms trading only in over-the-counter markets. The public—all who invest or trade in securities but are not in the securities business in the above sense—again show a tremendous range, from the very small or new investor who may lack market experience and sophistication and may depend for investment advice upon salesmen of varying degrees of skills and knowledge, to the great pension funds,

[1] In general, this report does not consider the category of Government obligations, and devotes relatively little attention to corporate bonds as a separate category.

investment companies, insurance companies, banks, and eleemosynary institutions and foundations, which may have large staffs of financial analysts at their disposal.

The public's access to trading markets is through the professionals—"brokers" who act as agents for the public in buying or selling, and "dealers" who sell to or buy from their customers for their own account as principals. A firm or individual in the securities business is permitted to combine the functions of broker and dealer and from time to time may act in one capacity or the other depending on the circumstances. Whatever the amount or kind of his transactions with the public, a broker-dealer may also buy or sell for his own account as an investor or trader. Most of these transactions presumably are entered into with the same kinds of motivation as any other investor's, i.e., to obtain a return on capital, capital appreciation, and/or trading profits. In the case of some professionals, however, particularly the specialists and odd-lot dealers on stock exchanges and "market makers" in over-the-counter markets, certain of their transactions are induced by needs of the market itself. In his transactions for his own account, the professional usually enjoys the advantages, among others, of immediate and intimate contact with the market, of trading in the "inside" market and/or paying lower commissions.

In the nonprofessional sector, two important developments in recent years have been a considerable increase in the number of persons owning securities, and substantial growth in activity on the part of institutions.[2] Thus, during the 1952–61 decade, the number of individual shareowners in America grew almost three times. Despite this expansion, activity of individuals as a proportion of total share volume on the New York Stock Exchange, according to its public transaction surveys, shrank from 57 percent for 2 test days in 1952 to 51.4 percent on the test day in 1961, while activity of institutions (which were growing substantially in number and size) during the same period rose from 24.6 percent on the test days in 1952 and 19.3 on the test days in 1953 to 26.2 percent of share volume on the test day in 1961.[3] With respect to particular securities, however, the degree of public participation may differ widely, so that the markets in certain issues may be dominated by institutional trading while in other cases, by individuals' or members' transactions. For example, on September 31, 1961, when institutions accounted for 26.2 percent of total New York Stock Exchange trading, they accounted for 90 percent of the purchases of International Nickel of Canada and 5 percent of the sales, while individuals accounted for 1.5 percent of the purchases and 4 percent of sales.[4] (Though figures are unavailable, members pre-

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[2] On institutions' impact on the stock market, see staff of Senate Committee on Banking and Currency, 84th Cong., 2d sess., "Report on Institutional Investors and the Stock Market, 1953–55," pp. 25–35 (committee print, 1956); and the report prepared for the SEC by the Wharton School of Finance and Commerce. "A Study of Mutual Funds," H. Rept. 2274, 87th Cong., 2d sess., pp. 21–24, 262–282, 359–397 (1962).

[3] NYSE, "1961 Public Transaction Study," pp. 2–3. In calculating total volume, the Exchange made adjustments for nonreported volume and for public transactions which were not accounted for by members.

As pointed out in subsequent chapters, there is strong reason to believe that, if dollar volumes were considered, the percentages would be significantly higher for institutions and significantly lower for the general public than the above figures. However, this would not affect the trends described in the text.

[4] The analysis of the trading in individual stocks was made by the Special Study, based on data from the NYSE and the odd-lot dealers. Data were not available to adjust reported volume figures for individual stocks as the NYSE had adjusted total volume figures. Therefore, the percentages for individual stocks are not strictly comparable to the percentages of total volume, but any distortion is likely to be small, because of the nature of the adjustments made by the NYSE.

sumably accounted for the remainder of the trading.) On the other hand, on that day individuals dominated trading in Studebaker-Packard by purchasing 68 percent and selling 63 percent, while institutions purchased 4 percent and sold 5 percent.

2. THE TWO BASIC TYPES OF TRADING MARKETS IN THE UNITED STATES

The governing Federal law recognizes two basic types of trading markets—"exchanges" and "over-the-counter," respectively the subjects of chapters VI and VII. For regulatory purposes all the registered exchanges[5] are treated as a single category, but the Commission is empowered to exempt such an exchange from certain rules otherwise generally applicable and to make rules for only one or several of these exchanges,[6] and each exchange is permitted to have and does have its own set of rules and regulations. Over-the-counter markets also are treated as a single category for regulatory purposes. However, by definition they are an essentially residual category: all trading that does not occur on an exchange is characterized as over-the-counter, and all broker-dealers registered with the Commission are entitled to participate.[7] As is developed below, there is great heterogeneity in the securities traded, and the precise character of the over-the-counter market for each security tends to adjust itself to the characteristics of that security.

a. Contrasting aspects of the two types

Exchange markets and over-the-counter trading markets are fundamentally similar in purpose and functions but substantially dissimilar in mechanics and practices. A brief introductory enumeration of certain of their respective characteristics may help to show their basic similarities and differences and, as to the latter, may help to differentiate between those that are fundamental, inherent or substructural, and those that are merely historical, superficial or incidental. It should be borne in mind that this enumeration is intended to be descriptive only; at this point in the report, no evaluation of any of these differences is to be inferred.

Although only two basic types of markets exist for legal purposes, within those types are many differences, some of which are almost as significant as those separating the basic types. Especially should it be noted that the major exchanges, particularly the New York and the American, differ in many ways from the other exchanges. In the following brief description of exchanges, which is primarily for the purpose of comparison with over-the-counter markets, the focus is principally on the major exchanges in New York.

In the over-the-counter category the great varieties of components and practices also make it necessary to limit the brief discussion in this chapter to broad generalizations for purposes of comparison with

[5] There are 14 registered exchanges and 4 exempt.
[6] Exchange Act, secs. 11(c) and 19(b).
There has been no occasion for formal exemption under the former section, since the Commission has never formally exercised its rulemaking power under that section; the exchanges, acting independently and at the suggestion of the Commission, have made rules on the matters covered by sec. 11.
The Commission has brought formal proceedings under the latter section only once, in the matter of NYSE rules limiting transactions by members in NYSE-listed securities also traded on other exchanges. *In the Matter of The Rules of The New York Stock Exchange*, 10 S.E.C. 270 (1941). This decision is discussed in ch. VIII.E.
[7] See sec. 15(a) of the Exchange Act for those broker-dealers who are not required to register in order to participate in certain limited areas of the over-the-counter market.

exchange markets. In particular it should be pointed out that over-the-counter markets in exchange-listed securities do not necessarily conform to some of the generalizations stated.

General

1. In general, although exchange markets differ widely among themselves, each exchange market is relatively concentrated, homogeneous and organized. By comparison, over-the-counter markets are diffuse, heterogeneous and more loosely organized.

2. In the exchanges, trading is accomplished through a type of auction process. Auction markets historically were, and some of them remain, "call" markets—an actual "gathering" at one time and place of potential buyers and sellers or their brokers, who match their wants and offerings of securities at the best prices obtainable on each side. In the classical market of this sort, each security is "called" in turn during a specified trading session, thereby establishing the price for that security until it is "called" again.

At the present time the major American exchanges are, for the most part, "continuous auction" rather than call markets. On the larger exchanges the various securities are allocated to different localities or "posts" on the "floor," and buy or sell orders may be brought to the appropriate post at any time during the trading session for immediate or later execution. Since there may not be matching buy and sell orders from public customers at the same moment, a continuous auction market requires mechanisms for linking the buy and sell interests during the trading sessions, and the main cog in the established mechanisms is the specialist who joins the orders in specific securities.

Over-the-counter markets exist, as organized markets, only as and to the extent that dealers elect to "make" them, by standing ready to buy and sell for their own accounts. As many as 20 or 30 dealers, or as few as 1 or 2, or none, may be trading a particular security at any time. There is no place of congregation of buyers and sellers, and therefore the transaction of business depends on telephone and wire connections through which firms may communicate and negotiate. There are organized systems for interdealer circulation of quotations, and an intricate communications network which permits broker-dealers to keep in touch with one another, directly or indirectly, and to be generally aware of changes in quotations and in buying and selling pressures. The only vestige of a "counter" over which business may be done is at the retail level.

3. On the exchanges there is a clear-cut definition of who may participate in the auction on the exchange floor, through the concept of exchange membership, or "seats." Furthermore, there is on most exchanges a recognized division of labor among members; the members act within a framework of regulations prescribed by their exchange and the Commission, which govern how particular functions are to be performed and who may perform them.[8]

In the over-the-counter markets there is no institutional limit on who may engage in any particular function with respect to any or all securities, except in the broad sense that all broker-dealers in interstate commerce must register with the Commission, and most over-the-

[8] For a classification of New York Stock Exchange members by their principal function, see ch. I, p. 12 (pt. 1), and tables I-3 and I-4, ch. I, pp. 28–29 (pt. 1), and ch. VI.B.

counter broker-dealers are under economic compulsion to join the National Association of Securities Dealers. The latter, which is the over-the-counter markets' only officially recognized central institution, is essentially regulatory rather than operational in function.

4. For the exchanges there is also a clear-cut definition of what securities may be traded on each exchange, through the concepts of "listing" and controlled "unlisted trading privileges," described more fully in chapter VIII.B. Broadly speaking, and subject to many exceptions, stocks listed on the New York and American Stock Exchanges tend to be national in scope, while those listed solely on the exchanges outside New York (often called the regional exchanges) tend to be of more local or regional interest. However, because of the phenomenon of "multiple trading," which is discussed at greater length in chapter VIII, the bulk of transactions in the regional exchanges, except for the three western mining exchanges, is not in their solely traded securities, but in securities also traded on one of the two major New York exchanges.

In the over-the-counter markets there are no similar concepts or controls, except insofar as the Securities Act of 1933 may limit initial entry into a public market.

Mechanics

5. In the exchange markets, the only persons present in the marketplace are members, through whom, directly or indirectly, all listed securities are bought and sold on an exchange. They act primarily as agents for public buyers and sellers. On the major exchanges approximately 75 percent of total round-lot share volume consists of agency transactions for customers and, at least for some listed securities, the market theoretically could function solely as a nexus for matching public orders, i.e., without any members' transactions for their own account.

In the over-the-counter markets, on the other hand, there is no similar mechanism for matching public orders; dealers making markets are the over-the-counter equivalent of the exchange as a nexus between buyers and sellers. In addition to this functional reason for greater dealer participation in over-the-counter markets, many purchases by members of the public are handled by dealers on a principal rather than agency basis; indeed, even a dealer who does not make a market in, or "position," a particular security often handles a customer's purchase order by himself buying from another dealer and selling to the customer.

6. In the typical exchange transaction the public customer pays a commission as compensation to the member who acts as his broker. In over-the-counter transactions, at least in those involving purchases, the customer frequently pays a "markup" to a dealer acting as principal, although evidence available to the study indicates that a majority of over-the-counter transactions are effected on a disclosed commission basis. Regulation of exchange commissions has historically been in terms of a minimum scale, whereas NASD concern with over-the-counter markups and commissions is expressed in terms of an upper limit. In general, stock exchange minimums tend to operate as maximums and are substantially lower than the markups allowed and usually charged in over-the-counter transactions between a dealer acting as principal and his customers.

7. These differences in bases of compensation are related in several important ways, as cause or effect or both, to the mechanics and economics of the respective markets. Thus, the compensation system in over-the-counter markets is said to be more conducive to "selling" effort, i.e., stimulation of public buying, than is the exchange commission system. On the other hand, it is often said that more "selling" is needed for most over-the-counter securities than for most exchange securities, because the latter are, in general, more widely known and widely distributed. These statements as to exchange securities, however, are much more applicable in the case of New York Stock Exchange and American Stock Exchange securities than in the case of securities traded only on regional exchanges: and as to over-the-counter securities, it is pointed out in chapter VII that agency executions appear to be relatively more frequent for less active securities than for the more active ones.

8. Because of the more unified and concentrated character of the exchange markets, it is generally possible for any member of the public as well as any professional to have complete and nearly instantaneous information about each transaction as it occurs, and for all transactions in the aggregate. In the over-the-counter markets, actual price and quantity usually are known only by the parties to each transaction, and aggregates are not available. Instead of the "last price" data published for exchange securities, over-the-counter markets primarily rely on interdealer circulation of daily bid and asked quotations supplemented by interdealer wire communication of current quotations and, for a more limited list, newspaper publication of retail price quotations. Thus, the "tape" has become a central mechanism of the major exchange markets, both as a record and as an active force, whereas in the over-the-counter markets, in the absence of any "tape," the quotation systems and wire communications are perhaps equally crucial but have quite different use and impact.

Regulation

9. Whether as a cause or a result of any or all of the foregoing differences, the major exchanges historically have been, and presently are, more highly organized for self-regulation of activities in the marketplace than are the over-the-counter markets. On each major exchange there is a central organizational structure and there are multifarious regulations and surveillance procedures governing the conduct of business in the marketplace. The counterparts in the much more diffuse over-the-counter markets are, in general, considerably more rudimentary.

10. The already more organized and self-regulated exchange markets receive more elaborate and specific treatment in the Exchange Act than do the over-the-counter markets. With respect to the exchanges, the act authorizes and directs the Commission to prescribe rules for various particular functions and activities (e.g., specialists, odd-lot dealers, floor traders) and particular problems (e.g., short selling, options), and also enumerates in some detail the subject matters of exchange rules over which the Commission has powers to require alteration or supplementation. With respect to the over-the-counter markets, the act relies primarily upon the broad concept of "fraudulent, deceptive, or manipulative" acts and practices and the concept of the "fictitious quotation," and authorizes and directs the

Commission to define them and to prescribe means to prevent them. On the other hand, the act goes into great detail about what a national securities association's own rules are required to cover, and expressly requires that proposed rule changes be filed in advance with the Commission; it also provides for Commission review of any proceeding by such an association disciplining one of its members. Taking into account the applicable statutory provisions and the rules made by the Commission and by the self-regulatory bodies, the total combined regulatory scheme is considerably more pervasive and/or exacting in the exchange sector than in the over-the-counter sector.

11. As a direct result of the listing concept, most issuers of securities traded on an exchange are brought into a contractual relation with the exchange itself, and the latter is in a position to impose a degree of regulation directly on such issuers. In the over-the-counter markets there is no counterpart, except in a very rudimentary sense in connection with eligibility for NASD-sponsored quotations. Moreover, requirements—by statute and by Commission and exchange rules—as to such matters as reporting, proxy solicitation, and insiders' transactions, applicable to issuers of securities being traded, are vastly different in the two types of markets, with important consequences on choice of markets and market operations, in addition to the obvious differences in investor protection.

b. Similarities between types, differences within types, and interrelationships

The foregoing recital, emphasizing differences in structures, mechanisms, practices, and regulations, may tend to obscure the many similarities in underlying forces, purposes, and needs as between the two types and, equally important, the many variances and gradations within each basic type. Many of the differences are actually only matters of degree, so that individual markets, securities, and situations may fall within a gray area where distinctions are not sharp.[9] Moreover, some of the important differences are simply historical or practical, rather than fundamental or structural, and thus are susceptible of being narrowed or widened by future technological, economic and/or regulatory developments.

There is obvious variety of needs, rules, and practices as among the 14 registered exchanges, and there is even surprisingly great variety of needs and practices as among individual "markets" within each major exchange. In the more heterogeneous over-the-counter markets, the variances are, of course, even more substantial. On the other hand, except in the area of fraud, existing regulation consists by and large of one set of rules and standards for "exchange markets" and a distinct and different set for "over-the-counter markets."

It is also necessary to recognize the various kinds of interrelationships between the two types. In the first place, there is considerable competition as to which market will become or remain the primary market—discussed in the next section—at least for many securities for which more than one market would serve. Secondly, there is some degree of choice, and therefore competition, as to whether a particular transaction will be effected in a secondary market rather than in the primary. These matters are considered in chapter VIII. Finally,

[9] For further elaboration of this point, see ch. VIII.B.

through arbitrage, offsets, price leadership, commission structures, and otherwise, there are numerous points of interaction or interplay between markets.

Like other major institutions, securities markets in the United States are dynamic rather than static. Historically they have shown a considerable capacity to change, grow, and adapt to the needs of their times, even if not always voluntarily, not always immediately, and not always perfectly—also like other major institutions. In their present forms, each market reflects the results of shifting needs and responses. The process of change and adaptation has not ended. For example, the volume of over-the-counter trading in exchange-listed securities has grown considerably in recent years and apparently is still growing. To mention only one more development, recent improvements in communications and data processing have had notable effects on the mechanics of doing business and the allocation of business, and there are strong indications that the full potential of these developments has not yet been realized.

3. "PRIMARY" AND "SECONDARY" MARKETS—FORMS OF MULTIPLE TRADING

A security may be traded on one market or several. The several markets may consist of one or more exchanges or over-the-counter markets, or one or more exchanges plus an over-the-counter market or markets.[10] If a particular security is traded in more than one market, the term "primary" is generally applied to the market which has the greatest trading volume, and not necessarily to the first to be established.[11] Though it is not a term of exact meaning, "primary" in this sense means that such market normally dominates other markets in establishing the price level for the security at any given time.

If a security is listed and traded on the New York Stock Exchange or American Stock Exchange, that market is ordinarily the primary one regardless of the number of types of other markets, but there appear to be instances in which the over-the-counter market in a listed security dominates and the exchange market is secondary; especially do the latter instances exist among bonds [12] and among stocks on the "exempt" list.[13] If a security is traded only over the counter, there are no primary and secondary markets in quite the same sense, although a dealer regularly making a principal market for other dealers (as distinguished from handling retail transactions) is sometimes described as making a "primary" market.

Most of the more prominent and more actively traded corporate common stocks find their primary market on one of the exchanges, particularly the New York Stock Exchange, but some individual stocks and some categories of stocks, especially those of banks and life insurance companies, form a notable exception. The over-the-counter

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[10] On the over-the-counter side, whether or not there is also an exchange market, the several broker-dealers "making a market" in a particular security at a given time may be considered as adding up to a single "market" or plural "markets"; hence, there is ambiguity in the use of the singular or plural as applied to markets for particular securities.

[11] The present use of the terms "primary" and "secondary" in respect of trading markets is to be distinguished from another use of the same terms, referring to the difference between all original-issue or distribution markets ("primary") and all trading markets ("secondary").

[12] See NYSE rule 396 (the "nine-bond" rule). NYSE Guide, par. Nos. 2396 and 2396.10.

[13] See NYSE rule 394, and its supplemental list of preferred and guaranteed stocks in which members can conduct transactions off the Exchange without obtaining special permission. NYSE Guide, par. No. 2394.10.

markets are primary for a vastly greater number of stocks, but most of these are stocks of smaller and less well-known companies and the total dollar volume of transactions in these stocks is less than that of the exchanges.[14] Indeed, it is less than that of the New York Stock Exchange alone.

B. Basic Concepts and Standards Relevant to Trading Markets

What are the qualities of a "good" trading market? It is sometimes said, in the law or elsewhere, that a market should be "fair," "honest," "free," "open," "efficient," "orderly," "continuous," "liquid" (or "fluid"), and perhaps other things. Some of these standards or criteria are written into the Exchange Act itself, others are not. Each may be deemed a worthy objective, yet they may not all be achievable to a maximum degree at the same time in the same market. In the following pages the origin, significance, and interplay of certain of these concepts are briefly considered.

1. THE STATUTORY PROVISIONS

The Exchange Act uses only some of the above terms, and then only sparingly. None of them is explicitly defined, and in any case none of them is nearly as conspicuous in the statute as the constantly repeated phrase establishing "the public interest" and the "protection of investors" as the dominant goals.[15] The strong congressional emphasis on these latter terms indicates that all other standards and substantive provisions, including the above criteria as they appear in the statute, are to be interpreted and applied in their light.

The maintenance of "fair and honest markets" in securities transactions is one of the purposes of the act, as declared in section 2. "Fair dealing" is called for repeatedly: section 6(d) directs the Commission to register an exchange only upon finding it has rules "just and adequate to insure fair dealing and to protect investors"; sections 12(b)(2) and 13(a) empower the Commission to require that issuers shall provide such information upon registration of a security on an exchange, and such periodical and other reports thereafter, as will "insure fair dealing in the security." The goal of "fair dealing" also guides the Commission's power over the rules of registered associations of securities dealers, section 15A(k)(1), and over the rules and practices of national securities exchanges, section 19(b); registered associations' rules also must not be designed to permit "unfair discrimination between customers or issuers, or brokers or dealers," section 15A(b)(7). A "fair and orderly market" is the criterion for the Commission's regulation of trading by exchange members for their own account, section 11(a). Similarly, section 11(b) directs that specialists shall not be permitted to act as dealers more than is "reasonably necessary * * * to maintain a fair and orderly market, * * *."[16]

The act itself speaks only once of a "free and open market" when, in section 15A(b)(7), it directs that the rules of registered national

[14] See ch. VII.
[15] See ch. I.B.
[16] In a very different context, registered national securities associations must have "fair and orderly" disciplinary procedures. Sec. 15A(b)(9).

securities associations shall "remove impediments to and perfect the mechanism of a free and open [over-the-counter] market; * * *." Such rules shall also promote "just and equitable principles of trade," a phrase found at several points in the act.

Given the lack of statutory definitions of the foregoing terms, the Special Study obviously could not purport to interpret them definitively or authoritatively in this report. Of course such terms are best understood, and their various shades of meaning best appreciated, when met in concrete settings. Nevertheless, it may be helpful to give a brief indication of their general significance and thrust, at least insofar as they pose issues discussed in this report.

"Fair" and "honest" presumably encompass the notion of freedom from manipulative and deceptive practices of all kinds [17] and may be regarded as positive expressions of the act's ban on such practices, acts, and devices.[18] "Fair" also presumably implies, especially in the several references to "fair dealing" and also the reference to "unfair discrimination between customers or issuers, or brokers or dealers," that there be no undue advantage or preference among participants in the marketplace; i.e., that there be no unnecessary discrimination in opportunity or treatment or in access to facilities or information. As among participants within any properly recognized category—those making similar uses of, contributions to, and demands upon the market facilities—discrimination would be altogether unacceptable. As between different categories—where different uses, contributions, or demands might appropriately be recognized—differences in opportunity and treatment would be held to the absolute minimum consistent with the recognized differences. In short, a market which recognized any improper categories or permitted any unwarranted discriminations would not be considered "fair" in the fullest sense.

"Free" presumably implies that the forces of supply and demand should operate without interjection of artificial factors. Insofar as the extraneous factors might be manipulative, the concept overlaps that of fairness. But "free," in its ultimate sense, may go further to exclude extraneous forces of a beneficient (i.e., stabilizing or market ordering) nature. In the latter sense a completely "free" market would be one in which the spontaneous bids and offers of buyers and sellers would be permitted to affect prices regardless of the sharpness or duration of the resulting movements.[19] "Open" presumably implies that anyone can enter the market to buy and sell. The statutory meaning of these terms might be thought to be limited to the over-the-counter markets, since their only statutory use in the the phrase "free and open," in a section added in 1938 and applying only

[17] See H. Rept. 1383, 73d Cong., 2d sess., at p. 10 (1934); brief on the bill's constitutionality, submitted by Messrs. Corcoran and Cohen, "Hearings on H.R. 7852 and H.R. 8720, on Stock Exchange Regulation," before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d sess., at p. 925 (1934).

[18] Sec. 2(3) declares manipulation one of the causes of those evils that the act is meant to correct; sec. 10(b) makes it unlawful for any person to use any manipulative or deceptive device or contrivance in connection with securities transactions; and sec. 15(c) (1) and (2) and 15A(b)(7) forbid brokers and dealers to use any manipulative devices or practices or fictitious quotations, and direct that the rules of registered national securities associations shall be designed to prevent any such use.

[19] A Commission staff memorandum of 1939, discussing the Boston Stock Exchange as a primary market, described it as "a free and open market not serviced by a specialist; i.e., any member on the floor can bid for or offer the stock in any number of shares which he desires." Interestingly, the memorandum went on to consider whether the Exchange should have "dealer-specialists * * * who would perform only a dealer function in narrowing the spread which may exist between public bids and offers * * * to make a fair and orderly market."

to such markets. However, the terms have wider usage: for example, the Senate and House reports as well as several witnesses at the hearings preparatory to enactment of the Exchange Act spoke of free and/or open markets in clearly general references; indeed, an exchange official and a representative of over-the-counter dealers both suggested that the exchanges' greater activity made them more "free." [20] Other examples of wider usage of the terms are a minority report of the New York Stock Exchange's Special Committee on Member Firm Costs and Revenues (1958), which referred to "the free and open auction securities market we jealously guard * * *" and a recent statement by the president of the NYSE, that "we have * * * consistently urged prospective investors * * * to recognize that—in a free market, subject to the laws of supply and demand—stock prices will go down as well as up." [21]

"Orderly" presumably implies efficiency and economy of operations, but also embraces concepts of regularity and reliability of operation—"a market which does not 'fold up' when the pressure on dealers becomes too heavy" [22] and the concept of avoidance of wide price swings within relatively short spans of time. In the sense of efficiency, "orderly" might include the degree of assurance, through available market mechanisms, that the highest bidders and lowest offerors do not miss each other to the disadvantage of both. In the sense of avoidance of wide price swings, "orderly" shades into and perhaps encompasses the concept of "continuity," discussed below; but whereas the latter term puts emphasis on price constancy from transaction to transaction, "orderly" may also imply constancy over periods of days or weeks; i.e., a degree of stability." [23] However, neither of these latter concepts is explicitly set forth in the statute, as a definition of "orderly" or otherwise.

2. NONSTATUTORY CRITERIA

The terms "continuous" and "liquid" (or interchangeably, "fluid") are not statutory. As market criteria they appear to have received greatest emphasis from the exchanges themselves, particularly the New York Stock Exchange. In exchange usage the two terms appear to be closely associated with "orderly"; indeed, they seem to be among the most conspicuous ingredients in the concept of orderliness.[24] These

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[20] Testimony of E. R. Grubb, president of the New York Curb Exchange, 1934 hearings, above, at p. 389; testimony of O. J. Troster, secretary of the New York Securities Dealers Association, id. at p. 613; see also id. at p. 785. And see H. Rept. 1383, 73d Cong., 2d sess., at p. 11 (1934); S. Rept. 1455, 73d Cong., 2d sess., at p. 81 (1934); H. Rept. 2307, 75th Cong., 3d sess., at pp. 4, 7 (1938); 1941 report by the public governors of the American Stock Exchange, quoted in SEC, "Staff Report on Organization, Management, and Regulation of Conduct of Members of the American Stock Exchange," p. 52 (1962).

[21] Address by G. Keith Funston, Business and Professional Women's Club of Waterloo, Iowa, Oct. 23, 1962.

[22] Testimony of E. R. Grubb, note 20, above.

[23] Compare 6 S.E.C. Ann. Rep. 91 (1940).

The close relationship of the terms "orderly." "continuity," and "stability" is illustrated in the "Saperstein Interpretation" (discussed more fully in ch. VI.D.3.b and 6.b), interpreting the Exchange's rule about specialists' transactions being effected only when "reasonably necessary to permit such specialist to maintain a fair and orderly market":

"* * * a transaction can not be deemed reasonably necessary for the maintenance of a fair and orderly market within the meaning of the rule if it is not reasonably calculated to contribute to the maintenance of price continuity and to the minimizing of the effects of temporary disparity between supply and demand * * * Transactions of [certain] types may, within the meaning of the rule, be justifiable * * * *only* when they are an essential part of a course of dealings designed to promote the continuity and stability of the market * * *" (Securities Exchange Act release No. 1117 (Mar. 30, 1937)).

[24] Since the degree of continuity or liquidity for exchange-traded securities may depend, to a greater or lesser extent for particular securities, on the amount of specialist participation, these concepts are especially prominent in discussions of such participation.

terms are no less relevant, however, to over-the-counter markets, even though the contributing factors and the potentials may differ between as well as within the two types of markets.

"Continuous" implies that a series of consecutive separate transactions, even though involving price changes, will involve minimum price variations or deviations.[25] While continuity thus refers to changes from the immediately preceding price level, it is an open question whether the term implies anything about the quantity traded at any given level or the extent to which a price trend may continue in one direction. Stated another way, and as is discussed in chapter VI, the line between the concept of "continuity" and the concept of "stability," or between maintaining a "continuous" market and "stabilizing" a market, is not a clear one.[26]

"Liquid" implies that a willing seller can readily (or perhaps immediately) find a buyer, or vice versa, at a mutually agreeable price. Thus, securities are generally said to be more liquid than real property, personal notes, or similar assets. Again, to what extent the term implies that a transaction occurs at a price closely related to current intrinsic worth is an open question.[27]

3. THE BALANCING OF OBJECTIVES

Although all of the above criteria may individually seem worthy, there is inevitably some degree of conflict among them. In many contexts and circumstances, therefore, some degree of balancing and reconciling is required, presumably with a view to "the public interest" and "protection of investors."

The point may be illustrated in terms of members' participation in the auction markets. As stated above, certain transactions of members for their own accounts are required and/or are claimed to serve the needs of the markets—to provide continuity and liquidity, or even, in the case of very inactive securities, to make it possible for a continuous auction market to exist. From this point of view, members' participation is presumably to be welcomed and fostered, since the less of it there is, the less "continuous" or "liquid"—and therefore "orderly"—may be the resulting public market. On the other hand, as mentioned above and further discussed in chapter VI, exchange members have inherent advantages over the public—especially in extent and immediacy of information—when they buy or sell for their own accounts. From this point of view, the larger the participation by members for their own accounts, the more impairment there may be of absolute "fairness" for public investors. Likewise, and par-

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[25] This use of the term is, of course, quite distinct from the previous reference to a "continuous auction" market.

[26] The House report preceding enactment of the Exchange Act expressed reservations about continuity: "The importance of active, constant trading can readily be exaggerated. A relatively stable market over a period is of much greater importance to investors than a fictitiously stable market that involves no more than one-eighth of a point spread between sales but results in wide fluctuations over days or weeks. The market's liquidity depends upon its relative stability and not upon the spreads between monetary sales." H. Rept. 1383, 73d Cong., 2d sess., at p. 14 (1934). But see also Twentieth Century Fund, "The Security Markets," pp. 294–296 (1935).

[27] For a discussion of continuity and liquidity as concepts and with particular reference to "dealer" activities on exchange markets, see SEC report on "The Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker," pp. 21–22, 36, 98–102 (1936). See also Twentieth Century Fund, "The Security Markets," pp. 25–26 (1935), and Senate committee print, "Letter from the President of the United States to the Chairman of the Senate Committee on Banking and Currency," and accompanying committee report, 73d Cong. 2d sess., at pp. 5, 16 (1934).

ticularly if the members' participation is intended to achieve continuity or fluidity, "freedom" of the market as a pure reflection of public supply and demand may be impaired.

This sort of dilemma is of many varieties and takes many forms in the securities markets—by no means limited to the question of member participation in the exchange markets—and the attractiveness of choosing one horn or the other may vary from context to context. An appraisal of the rules and practices of the securities markets requires continual weighing of the various objectives in relation to each other and a constant recognition that their balancing is a complex, delicate one that may lead to different answers in different markets, or even in different contexts within the same market. Stated another way, the more difficult substantive questions arising in a study of the adequacy of rules and practices, or in statutory administration generally, can rarely be answered by simple reference to any one or even several of the criteria mentioned; separately or in combination, they at best supply guidelines within which there are large areas for definition of policy on concrete problems.

4. "DEPTH" IN RELATION TO CONTINUITY AND LIQUIDATION

A somewhat different kind of concept—not a criterion of a total market in the same sense as the others, but important in the description or evaluation of the markets for particular securities—is that of "depth." Broadly speaking, this term refers to the quantity of buying and selling interest and the potential activity on each side of the market. It may refer to such interests and activity on the part of the public only; that is, excluding the professionals, or it may refer to the combination of public and professionals. Again, it may be used in an immediate and therefore ephemeral context; e.g., the depth of a specialist's book at a given time, or it may refer to a more or less continuous attribute of market; e.g., the characteristic depth of the market in General Motors common as compared with that of a relatively obscure and inactive stock.

If considered in the sense of public (i.e., excluding professional) interest and activity, depth is usually thought to be a product of several different factors, the most important of which are (i) the total amount of the class of securities outstanding, and (ii) the breadth of distribution among the general public, exclusive of amounts concentrated in the hands of controlling persons and other "permanent" holders of large blocks. Subsidiary but still important factors, tending to be of a somewhat more transistory character than the foregoing, are (iii) the prominence and prestige of a particular company, (iv) current economic and social developments leading to popularity or unpopularity of a particular company or industry among public investors, (v) broker-dealer soliciting activity, (vi) balance between trading and investing activity, and (vii) price level per share. Depth may also have a geographic aspect: (viii) the concentration of public interest and potential activity in a particular locale.

As is seen in chapter VIII.B, the listing requirements of exchanges all reflect, in one degree or another, a concern for the quantity of stock outstanding and the floating supply; i.e., the principal indicia of depth of public interest on a long-term basis. This is at least partly in recognition of the fact that the continuity and liquidity of an exchange market, as a continuous auction market, ultimately depend on the depth of public participation and the extent to which that can be, and is, supplemented by specialist participation. In other words, unless there is an adequate base of public interest and activity, either an undue burden may be placed on the specialist system or continuity and liquidity will be lacking. While this leaves room for considerable variation among listed securities, there is even greater variation in the continuity and liquidity provided, by the depth of public interest plus dealer participation, for the wide variety of securities in over-the-counter markets.

C. Practices in Foreign Securities Markets

Before proceeding with a more detailed examination of existing rules and practices of American trading markets, it is perhaps worthy of reminder that no particular rule or practice is immutable, inevitable, or universal. This is demonstrated by the many differences among American markets and the many changes in their rules and practices that have historically occurred, as already mentioned. It is demonstrated also by the many differences between rules and practices of American securities markets and those of nonsecurities (principally commodity) markets in this country and of securities markets elsewhere.

European stock markets, for example, provide illustrations of differences in a number of important areas, a few of which are mentioned below. In the actual conduct of trading, some of these markets use various forms of an oral "call" system; some provide for limitations on the extent of price variations in a given period; some permit bankers to act as brokers. The role of the government may be greater or smaller and may be felt in different ways, such as through government-appointed officials who are responsible for matching orders; the functions of the trading professionals may be separated or combined along different lines; and commission rates and rate structures may, of course, differ substantially.

While securities markets outside the United States are obviously beyond the scope of the Special Study and this report, a brief description of some of the distinguishing characteristics of the London Stock Exchange, as one example, supplies a useful background for consideration of the American markets.

Of all the European exchanges, the London Exchange does the greatest amount of trading and has the most elaborate trading mechanisms.[28] Almost 10,000 different stock and bond issues, British and foreign, are traded. A limited number of local issues are traded to a much lesser extent on the 21 other exchanges located elsewhere in the British Isles, there being no British over-the-counter market, as such. Among exchange-traded securities, however, there is a distinction between issues of securities that are "quoted" and those that are not, the former being somewhat akin to our fully listed category and the latter being roughly comparable to our (now restricted) unlisted-trading category. Any two members of the London Exchange can obtain permission to trade any security on the exchange, without a listing application by the issuer, and such unlisted trading fills the role of

[28] The Special Study is indebted to W. S. Wareham, secretary, Share and Loan Department, London Stock Exchange, for reviewing the material about the exchange.

over-the-counter trading as known in this country. This arrangement is designed for occasional transactions, and if a market develops, application for full quotation is insisted upon. Dealings may also take place in securities which are listed on certain other recognized stock exchanges.

The London Exchange is a voluntary, self-regulatory institution, much like the American exchanges in this respect but not subject to the supervisory control of a governmental regulatory commission. It is composed of some 350 member firms, all of which are partnerships and all the partners in which are individually members of the exchange. Strict rules govern admission to membership, although there are no entrance examinations as such.

Members must reapply for membership annually and at that time must state whether they will act as a broker or a dealer (known as "jobber")—they may not act in both capacities. Brokers receive their income in the form of commission fees and deal directly with the public, as agents. They buy and sell through the jobbers, who make their income by trading particular securities as principals and who may not deal with the public. The jobbers perform a function somewhat similar to that of the specialists on the New York Stock Exchange in that they "make markets," but there are several significant differences: The jobber does not have to make trades and has less responsibility for maintaining markets. On the other hand, he is permitted to make a market in any stock he chooses, and as many as 28 jobbers have been observed making markets in one particular security at one time. There is no differentiation between round lots and odd lots in jobbers' transactions. The number of jobbing firms has fallen from 175 to 81 in the past 10 years, apparently owing in part to British tax policies.

Prices at which transactions occur are usually, but not always, reported by the brokers and jobbers. The reporting of prices is not compulsory and the announced prices are not necessarily those at which the trades actually took place. While the number of transactions is reported, there are no figures as to the number of shares traded in a particular security, volume figures being a jealously guarded secret. With regard to dealings, there is much less emphasis on full and rapid dissemination of information, either as to transactions on the exchange or as to the issuers of the securities traded.

Members of the exchange may not advertise in newspapers although the exchange itself advertises and, much like the New York Stock Exchange, is seeking to broaden share ownership among the general public. Advisory literature issued by brokers may be sent only to customers of the firm.

British banks are far more involved in the securities business than is the case in this country, some brokers dealing almost exclusively with banks. Since exchange members do not have offices away from the vicinity of the exchange, public investor contacts outside of London are frequently made through branch banking offices. A large amount of the business outside London, however, is handled initially by members of the 21 stock exchanges situated in major provincial cities and by members of the Provincial Brokers Stock Exchange in some 110 smaller towns, most of which business is channeled to the London Stock Exchange. Exchange members are permitted to allow a return of commission (not exceeding 25 percent) to banks, and block discounts are allowed.

Short selling is not governed by special regulations. Payment for stocks and delivery often does not have to be made for as long as 3 weeks, and thereafter settlement can be further deferred through payment of a fee, an arrangement known as "contango."

The London Stock Exchange exemplifies many differences from prevailing American practices but, as suggested earlier, it by no means illustrates all the variations that can be found. Needless to say, the variations from country to country often can be explained by differences in maturity of the economies and in heritages of custom and tradition, so that operations or regulations successfully existing in one country may not function with equal effectiveness in the economic and political environment of another. To refer to variations of rules and practices in other markets is by no means to suggest a preference for any of them; it is merely to suggest that a broad study and investigation of the adequacy of existing rules and practices should not be blind to other possibilities.