

MEMORANDUM

September 14, 1964

TO: The Chairman  
FROM: David Silver  
SUBJECT: Mr. Funston's Charges of Commission Staff Misconduct

Introduction

In a telephone conversation with the Chairman on September 11, Mr. Funston made certain charges about the staff in general and about my conduct in particular. As I understand it, he claims that the staff has constantly sought to undermine his position at the NYSE and has "gone around him", presumably with the purpose of doing him some personal harm. His allegations concerning my conduct involve a meeting which I had with Mr. James C. Kellogg, III, President of the Association of Stock Exchange Firms; a conversation with Mr. Charles Moran, Jr., managing partner of Francis I. duPont & Co.; alleged conversations with Miss Eileen Shanahan of the New York Times and statements by me to the Commission concerning disagreements between Mr. Funston and Mr. Gray, Executive Vice-President of the Exchange. The purpose of this memorandum is to present the factual background of these matters and to state my position with regard to them.

In general, and with respect to each specific allegation, I want to state that my conduct and purpose through the period of implementation following the Special Study Report was not directed at embarrassing or injuring Mr. Funston or anyone else. My activities were designed

solely to carry forward specific projects which, in each case, were authorized by the Commission. Each of the matters which concern Mr. Funston was known to my superiors at the time and most were known to the Commission. However, since Mr. Funston apparently desires to press the matter, it might be useful for the record to set forth a complete statement on each of his specific allegations.

#### Background

After the conclusion of the Special Study the Commission assigned high priority in the implementation program to the recommendations concerning the exchange markets. I was assigned the responsibility for the implementation of these recommendations under the general supervision of Messrs. Saul, Louis and Werner. <sup>1/</sup> Six projects were undertaken in the exchange area -- Rule 17a-8 (pre-filing of exchange rules), odd-lots, floor trading, specialists, automation, and exchange organization. Of these areas, only the odd-lot project has been free from major controversy. I have been intimately involved in each of these projects, both in the formulation of policy and in the discussions and negotiations with the exchanges.

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<sup>1/</sup> See implementation memoranda to the Commission dated September 12 and October 14, 1963.

Statement of Facts

a. The conference with Mr. Kellogg

Mr. Kellogg is a member of the NYSE and a former Chairman of the Board of Governors of that Exchange. He is currently President of the Association of Stock Exchange Firms. The meeting took place on March 20, 1964 and concerned floor trading.

As will be recalled, after the Exchange held an initial meeting with the Commission, the Commission staff had a series of meetings on floor trading with representatives of the NYSE's Special Floor Trading Committee. During these negotiations it became apparent that the positions of the Commission and the NYSE were very far apart and the issue became deadlocked. The Commission finally determined that the matter could not be resolved without a public hearing at which the various views would be fully explored and evidence adduced. Accordingly, a lengthy release was prepared announcing public hearings, which was approved by the Commission. However, both the staff and the Commission felt that every effort should be made to arrive at a satisfactory solution without such hearings. Many meetings were held between the staff and the Commission and between members of the staff and various Commissioners.

It was in this context that one final conference was held with official representatives of the NYSE on the morning of Friday, March 13. At this meeting the staff conveyed to the Exchange representatives the views of the Commission that unless a satisfactory solution could be reached the problem could be resolved only after public hearings. Final

views of the Exchange were solicited but it was clear that it had not yielded on any important points. When the final meeting adjourned for lunch the staff discussed the matter with the Commission and it was decided that the Exchange should be finally informed that the Commission was prepared to issue the release. After lunch the Exchange was so notified and the meeting was adjourned.

The next day, March 14, the NYSE sent a circular to all members giving its version of the previous negotiations and indicating its intention to oppose the Commission vigorously. The document also contained a direct attack on the staff of the Commission:

During the course of our discussions with the SEC, it became apparent that the Commission staff had closed its mind to any suggestions short of its own proposals to emasculate floor trading.

This attitude may be explained in part by the fact that the staff with whom the Exchange representatives were conferring was much the same group of people who had written the Special Study on which the recommendation to ban floor trading was based. These people are in the enviable position of sitting in judgment on the validity of their own recommendations.

During the next week the staff and the Commission held further discussions on the possibility of finding some way for settling the controversy without a major confrontation. Various Commissioners suggested the possibility of opening contact with important members of the Exchange community. Both the Commission and the staff were aware from statements made by members in a questionnaire, that the position

that the Exchange had taken did not wholly reflect the attitudes of the Exchange community. <sup>1/</sup> Meanwhile, the Commission held up publication of the release.

On or about Tuesday, March 24, Mr. Kellogg paid an unsolicited visit to Chairman Cary and stated that he thought a solution might be possible. The Chairman informed the Commission of this on Wednesday morning and the staff was authorized to contact Mr. Kellogg. On the same day, Mr. Saul reached Mr. Kellogg by telephone in New York and Mr. Kellogg indicated that in his view a substantial capital figure was appropriate for floor traders. Since this was one of the major points which had prevented settlement of the problem with the Exchange, it was felt that informal discussions should be pursued with Mr. Kellogg. Accordingly, with the Commission's knowledge, I arranged to meet with him Thursday, March 26. At his suggestion, we met at his offices at the Newark Airport at 8:30 A.M.

At the outset of the conference it was agreed that whatever was said would be entirely off-the-record unless we could reach agreement. I asked Mr. Kellogg for some indication of which hat he was wearing. He indicated that he was speaking in his capacity as President of the

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<sup>1/</sup> This was also confirmed by several members who told us about efforts by the Exchange to solicit letters from member firms in defense of floor trading. Merrill Lynch and others refused to sign such a letter and Francis I. duPont indicated that if that firm were to write a letter on floor trading it would be opposed to the Exchange's position.

Association of Stock Exchange Firms and he had the informal authorization of his Executive Committee or at least a substantial portion of it. I told him that just as he could not bind the Exchange, I could not speak for the Commission. On these terms, we then engaged in a full discussion of the various problems associated with floor trading and possible solutions.

I outlined what in the Division's view was the minimum acceptable program. With one minor reservation, Mr. Kellogg indicated total agreement with each and every point. I felt that this point (which involved liquidations at a loss) should not be allowed to obstruct a possible agreement, and I indicated that his suggested solution of this matter would most probably be acceptable to the Commission. Neither Mr. Kellogg or I made any contemporaneous notes of our discussion.

At the conclusion of our discussion I asked Mr. Kellogg what the next step would be, since the Commission had by that time determined to issue its own release early the next week announcing public hearings. Mr. Kellogg stated that he would immediately speak to Messrs. Goodbody (senior partner of Goodbody & Co.) and Leness (President of Merrill Lynch) and if they agreed he would contact the NYSE.

Within an hour and a half after I left Mr. Kellogg in downtown New York, the Chairman of the Board of Governors of the NYSE, Henry Watts, was attempting to contact me. On Monday, March 30, members of the Exchange conferred with the Division and indicated complete acceptance of the package which had been worked out with Mr. Kellogg.

The above represents my best recollection of my conference with Mr. Kellogg. At all times the Commission was kept aware, formally and informally, of what the Division was doing. As was pointed out above, the Kellogg conference stemmed from a conversation between Mr. Gary and Mr. Kellogg. There was no thought of undermining Mr. Funston, going behind his back or otherwise damaging his position. Our attempt was to utilize every possible channel to solve a difficult and complex problem,

Not only is Mr. Funston in error as to the implications of the Kellogg conference but, I believe that had the floor trading matter gone to public hearings the damage to his position would have been substantial. <sup>1/</sup>

b. The conversation with Mr. Moran

Mr. Funston complains that another instance in which I tried to undermine him or go behind his back was in a conversation with Mr. Charles Moran, managing partner of F. I. duPont & Co., the second largest member firm of the NYSE. The background of this conversation, which took place on May 20, 1964 in New York, follows.

Some of the recommendations contained in Chapter XII of the Special Study Report pertained to the organization of the NYSE. In general, the issue was posed whether floor professionals, i.e., specialists, floor traders and \$2 brokers, exercised a disproportionate influence on Exchange government.

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<sup>1/</sup> It will be remembered that the staff of the Division was prepared to adduce evidence of manipulative activities and other improper conduct by floor traders.

As part of the implementation process for these recommendations, two major conferences were held with Exchange member firms. The first was with representatives of Merrill Lynch during the spring of 1964, and a short time later a similar meeting was held with representatives of duPont, at which Moran was present. Messrs. Saul, Loomis, Werner and myself, among others, attended both conferences. The Commission was advised of the results of these conferences in lengthy memoranda.

Both firms confirmed the existence of the problems noted by the Special Study. Both felt that the major commission firms were under-represented in the governing bodies of the Exchange. Both firms suggested various means by which this problem could be alleviated through changes in the Exchange Constitution.

Also during the spring of 1964 Mr. Funston and others on the staff of the Exchange had informal discussions with members of the staff of the Division and with various Commissioners. Mr. Funston indicated that the Exchange had certain major structural revisions in mind. Among these was a major change in the composition of the Nominating Committee. It is not necessary here to detail Mr. Funston's subsequent change in position on this and related matters.

On May 14, 1964 the Commission met with the Steering Committee of the NYSE to discuss exchange organization. Chairman Cary opened the discussion with a statement of the problem as the Commission saw it and adverted to Mr. Funston's change of position. The meeting was a lengthy one and several related matters were discussed. No conclusions



were reached but the Commission made clear its view that it regarded the matter of exchange organization as being of extreme importance.

The staff of the Division had further occasion to discuss the matter with the Commission. Although no decisions were reached, it was understood that the staff would continue to conduct informal discussions with Exchange members on problems related to the organization of the NYSE.

Since I was to be in New York on May 20, 1964, on another matter, I decided that it would be appropriate to have a further discussion with Mr. Moran and so informed my superiors. We met at his office. We generally covered the same matters that had been discussed in Washington, although we went into some detail on the <sup>1964</sup> recent floor trading controversy. Mr. Moran thought that this episode was an excellent demonstration of the fact that commission firms were not properly represented on Exchange governing bodies. Mr. Moran also mentioned that his firm had never been represented on the Board of Governors. He mentioned that his partners had insisted that he make himself available to the Board for election and that he had done so reluctantly because he knew he would be turned down by the Nominating Committee (which is what happened). Mr. Moran is especially interested in automation and he noted that if the Exchange was really cognizant of the problems facing the commission firms that it would be much more active in this area. We also discussed the then pending Coonet issue, from which duPont had withdrawn as an underwriter.

At the conclusion of our talk, I stated that while the Commission's authority over Exchange government and organization was limited, the Commission was aware that there were problems. I also stated that as a practical matter changes would probably have to come from the membership.

To the best of my recollection the above recounts the substance of my conversation with Mr. Moran. Mr. Saul was aware of my visit with Mr. Moran at the time and I later mentioned it to Chairman Cary. I did not regard the conversation as being of major importance and I told Mr. Moran any views that I may have expressed were my own but that he was free to make such use of them as he deemed appropriate.

I am somewhat baffled by the nature of Mr. Funston's allegations with respect to this conversation. It is possible that he heard a distorted version of it.

c. Miss Shenahan's article

A few months ago a long article was published in the New York Times under the byline of Eileen Shenahan, a financial reporter for that newspaper. It concerned the New York Stock Exchange and various problems which were allegedly dividing its membership into contending factions. A major theme of the article was whether Mr. Funston's position was in any danger. Mr. Funston has alleged that I was responsible for this article in some way. He apparently regards this as being part of an attempt to undermine him.

There is absolutely no truth in Mr. Funston's allegation. I know Miss Shanahan, and she did call me when she was preparing this article. I told her that she probably knew more than I did about the internal politics of Wall Street and that in any event this was an area in which employees of the Commission could probably provide her with little or no information. I especially mentioned that SEC employees would be extremely reluctant to comment or give any information about the particular matters she intended to cover in her story. I stated that she could probably find out more on Wall Street in a half hour than anyone in Washington could tell her. She stated that she had already decided to go to New York. I understand that Miss Shanahan did go to New York and spent almost a week interviewing various persons in the financial community, including Mr. Funston.

Of course, I have no way of proving that I was not the inspiration of Miss Shanahan's article. However, I believe that if Miss Shanahan were asked to verify my recollection of our conversation she would do so.

d. Relationship between Meyers, Funston and Gray

Mr. Funston also sees as part of my alleged misconduct the fact that I recently reported to the Commission that Messrs. Funston and Gray did not see eye to eye on certain of the specialist recommendations of the Special Study. He told Chairman Cohen that this was untrue and that he and Mr. Gray were in total agreement.

Exchange would gather such data consistently on a stock-by-stock basis. He urged that we accept a recordkeeping rule to solve his practical political problems but that he would make a personal commitment by letter to gather and use such income data.

Mr. Saul and I were confused by the diveras views that had been expressed at this conference. If Mr. Gray had stated the views of the NYSE then we did not see how we could recommend that the Commission accept a recordkeeping rule. On the other hand, if Mr. Funston was correctly stating the views of the NYSE then it might not be crucial that the rule contain a mandatory reporting requirement. For this reason we deemed it necessary to advise the Commission of the apparent disagreement between Messrs. Gray and Funston.

On Thursday, September 10, I had a conversation with Mr. Chapman. I told him that we were utterly baffled at the inconsistency between Mr. Funston's statement and that of Mr. Gray. He agreed that there were major inconsistencies between the two statements but that they could be explained by the fact that Mr. Gray was expressing the views of the Specialist Committee, while Mr. Funston was speaking as Chief Executive Officer of the Exchange.

In the course of the conversation I told Mr. Chapman that we were concerned that the whole agreement on the specialist recommendation seemed to be breaking down. I told him that neither the Division

nor the Commission wanted a fight about the specialist recommendations. I reminded him that on the stopping stock recommendation Mr. Watts had said at the time the Exchange agreed to go along with the Special Study position that the NYSE did not want to "bleed and die" over stopping stock. I stated that it was also my position to avoid blood, but that if somebody wanted to fight all of the blood would not be mine.

The above is the only knowledge I have with respect to disagreements between Messrs. Gray and Funston. As noted above, the matter was reported to the Commission because it had a direct impact on the kind of approach that the Commission should take with regard to a substantive issue. It was not reported for the purpose of undermining Mr. Funston's position.