

Tentative Proposals for Additional Study Relative to Broker-Dealer Segregation

A meeting was held in Commissioner Douglas' office on July 22 to discuss further study of the combination of broker and dealer functions. Those present were Commissioners Douglas and Healy, Dr. Gourrich, and Messrs. Katz, Saperstein, Dowd, Loucheim, Case and Walker.

A questionnaire was read which would be sent, if approved, to all member firms of registered exchanges and to individual members not connected with firms. (See copy attached.) These questionnaires would disclose the firm's or member's activities on the various exchanges, in the counter markets, and in the capital market, types of services rendered, connections with investment trusts, sources of income, etc. It was proposed to hold hearings on the segregation question after study of the replies of firms and members.

The point was advanced that there was involved the administrative question as to whether this process was not strictly educational and whether too much time might not be required for the reporting and study, whereas the immediate need is some step toward further regulation of the specialists and other members. It was observed by others, however, that our knowledge of broker and dealer activity is far from perfect and that replies to these questionnaires would throw light on the activities of all members and indicate how and to what extent broker and dealer functions are merged in each member and each firm. Such knowledge might be necessary in advance of further regulation. It was further noted, however, that this type of reporting is expensive to the firms and members; the H reports were cited. Moreover, there has been no study made so far of the effect trading rules for the specialist already adopted.

Various abuses of their privileges by the specialists were mentioned and actual cases cited. A study of the "can" system, used for inactive bonds, was proposed. It was also suggested that at some time the London Stock Exchange methods be studied, that NYSE specialists' trading be observed by men placed on the floor, and that the "can" system be considered as a substitute for the specialist system. It was also noted that, in view of the varying specialist systems on numerous exchanges, and the absence of them on some exchanges, the Commission should cease confining its specialist studies to NYSE and NYCE. The conference ended without any analysis of the broker and dealer functions of over-the-counter dealers. During the discussion of specialist activities and the bond market, the following proposals were made:

1. Specialist

- a. Obtain complete content of each day's book with all orders time-stamped:
 - (1) Sell orders above or buy orders below market
 - (2) Orders unexecuted
 - (3) Orders executed
 - (4) Orders cancelled
- b. Obtain record of specialist's dealer transactions, time-stamped.
- c. Record of specialist's firms trading in issues in which he is specialist.
- d. Observation of what the crowd is doing in the same stocks and the effect of the general market trading.
- e. Ask exchanges to report the true volume of all trading.
- f. Consider means to prevent disclosures of the book, as in the A.O. Smith case, or cause the book to be disclosed to all persons at any time on request.
- g. Get together case histories of specialists trading against their customers.
- h. Consider the abolition of specialist activities for a short term to observe how markets behave without them.
- i. Determine extent to which specialists over-bid or under-sell. (They must do this to trade at all for their own accounts.)
- j. Relation of each specialist's trading to his resources.
- k. See how present trading rules are working.

2. Bond Trading

- a. Study such abuses as:
 - (1) Crossing of orders to make double commission
 - (2) Depressing prices by selling on NYSE in order to buy from a larger seller at a lower price over-the-counter
 - (3) Dealers bribing traders of other dealers
- b. Study relation of exchange and counter markets:
 - (1) Volume on both markets
 - (2) Prices on both markets
- c. How well does "can" system work as a substitute for the specialist?
 - (1) Observe from floor

(2) Get opinions of brokers

(3) Get statistics on use of quotations on the NYSE when volume is over-the-counter, - selected issues.

d. Compare amount of trading by brokers and dealers for their own account with amount done for customers, - exchange trading and counter trading for each.

3. Commission Houses

Determine extent to which members and partners have their own margin accounts.

4. Floor Trader and Floor Broker

Determine extent to which the two functions are merged. Allow them to classify themselves. Obtain from those classed as floor brokers weekly reports on total number of shares bought and sold in each capacity.

5. Discretionary Accounts

Determine the number and importance of accounts in which each firm has full discretion, (not simply as to time and price).

6. Banks Replacing Brokers

a. Determine to what extent banks are handling brokerage business of:

(1) Customers

(2) Partners of firms