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VISIT TO S.E.C. IN WASHINGTON

At the request of the S.E.C. staff, a meeting was held in Washington on October 8, 1963, covering the S.E.C. Special Study Report.

PRESENT

S.E.C.

Ralph Saul, Director  
Division of Trading and Exchanges

Philip Loomis, General Counsel  
S.E.C.

Walter Werner, Director  
Office of Program Planning

David Silver, Special Counsel to  
Director, Division of Trading and Exchanges

Norman Poser, Chief  
Office of Regulation  
Division of Trading and Exchanges

E. Rotberg, Counsel  
Office of Program Planning

From time to time, I. Pollack, Associate Director, Division of Trading and Exchanges was also present at the meeting.

NYSE

C. Klem  
A. B. Chapman  
W. K. Vanderbeck  
R. M. Bishop  
A. L. Meentemeier

Saul chaired the meeting for the S.E.C. staff. He explained that the meeting was not to set policy but just exploratory. The purpose was really to determine the Exchange staff's position on the S.E.C. recommendations, or if the Exchange staff had no position, and to get some idea of priority or procedure - to establish procedures in areas or to clarify S.E.C. recommendations. He claimed "they are not going to press the NYSE", and the meeting was to be devoted primarily to Chapter 6 and later on, time permitting, to other chapters. This memo will only cover points in which Meentemeier was involved.

I. ODD LOTS

Saul requested several times that the Exchange advise the S.E.C. staff in writing as to what areas Price Waterhouse & Co. was covering in the cost study. Each time I came back and advised that the only information available is what is contained in the press release a copy of which, I believe, was furnished to the S.E.C. Secondly, when we have the detailed outline, we expect to come down to the S.E.C. and obtain their views. From time to time as the cost study progresses, it is our intention to visit the S.E.C. staff and discuss the progress as was done with the cost study on the Income and Expense Report. I advised Ralph that I did not see how he could ask for anything else because we are making full disclosure to him as we had done on the I & E cost study.

Chapman advised the S.E.C. staff that there would be an odd-lot committee and that Vanderbeck would be in charge of rules relating to procedures, and Meentemeier would be involved in regard to the cost study. A copy of the composition of such committee would be furnished to the S.E.C. staff by Chapman, and the S.E.C.'s contact on odd lots was either Vanderbeck or Meentemeier.

In answer to questions, Vanderbeck expressed the opinion that, probably, the work on the rule adoption and surveillance requirements would be considered concurrently by the committee while the cost study is being performed by Price Waterhouse & Co.

In an attempt by the S.E.C. staff to pin me down on the completion of the cost study, I told them that the fact finding should take four to six months and then the report would be written. However, I could give them no assurance of a date of completion, but probably we should receive the report sometime in 1964.

II. SPECIALISTS

At one point in the morning proceedings, the S.E.C. staff commented about obtaining income figures on specialists. In answer to a question, they did not clarify whether they were interested in gross or net profit. They were advised that such item would be referred to the committee which will handle the specialist S.E.C. recommendations. Later on, I advised the staff of the Exchange which were present that such item is, in effect, covered by a S.E.C. recommendation in the commission area for an extension of the I & E to cover all types of members. It is on the back burner and should not be referred, per se, to the specialist committee as an individual item.

III. COMMISSIONS

This discussion took place in the afternoon. While in the morning session the S.E.C. asked questions continuously of the Exchange staff, the procedure changed in the afternoon. The S.E.C. staff asked Meentemeier to comment on the S.E.C. suggestions on what is being done, etc. I talked for approximately an hour and three-quarters on the S.E.C. suggestions in Section I of Chapter 6.

III. COMMISSIONS, cont'd.

I began by explaining that they had heard members of our staff express some idea of costs in regard to various practices that the Exchange is instituting, i.e. automation, etc. I explained to them that, as they know, there can be no Exchange and no commission business, nor any S.E.C. suggestions, if the commission business is not a healthy one. I reminded the S.E.C. staff that Commissioner Whitney in March, stated that the first prerequisite of the Commission is to see that the industry is financially healthy. Considering that the profit of member firms having over 85% of the NYSE commission business was only 4/10 of 1% in 1962, I could not comprehend how the S.E.C. could ask us to have a volume discount, give a break to non-member broker-dealers, protect the little man, institute ancillary services, etc. I explained that it was necessary for me to have clarification on all these points in that we are not dealing with eleemosynary institutions but rather with a group of businessmen who were in business for a profit. Therefore, if we adopt any of their suggestions and give away 4/10 of 1%, we would have a financially unprofitable business. Just what did the S.E.C. want us to do?

In attempting to draw out their comments, I gathered that Werner was going to be the person who would deal on the staff level with the recommendations on commissions. Werner claimed there is a difference between the return and rate structure, and I stated that when the profit is only 4/10 of 1% there can be no difference. His comments seemed to indicate that it would be possible for the NYSE to have a new commission structure, perhaps taking into consideration some of the S.E.C. points like volume discount, non-member broker-dealers split, etc. But it was not too clear to the writer of this memo.

I pointed out that the associate membership recommendation was not part of the problem being considered by the Cost & Revenue Committee. That was on the agenda of another committee. The purpose of the Cost & Revenue Committee was to cover all aspects of the commission problems that the S.E.C. had raised.

At this point in the meeting, Saul said, "Al, I wouldn't want to have your job for anything". I explained that we were trying to obtain facts on which prudent judgments could be made but I received a severe setback last week. In prior meetings, when other members of the S.E.C. staff were present, my oral request for additional information on non-member broker-dealers was to be referred to Mrs. Helen Steiner and Dr. Jonathan Levin. This I complied with, and was advised by Mrs. Steiner that we would have to have a letter submitted to the Secretary of the Commission telling what data we wished to look at and why. Ralph said it was not actually a turn-down in that they could not disclose names. I said I was not interested in names, but only in doing the job that the S.E.C. requested.

A. Volume Discount

With reference to this topic, I explained that the Cost & Revenue Committee was studying this problem and had been, but that no conclusion had been reached. Later in the conversation when I asked directly for priorities, and after “hemming” around, they decided that volume discount was the top one.

B. Ancillary Services

Later on in the discussion, I mentioned their recommendation for ancillary services and asked if the cost of these services, from their standpoint, would have a bearing on any rate schedule. To illustrate, could you cost a legal transfer in the firm which would probably differ from time to time within the firm and also, at times, between firms. They stated that a rate schedule for such services would not necessarily have to be based on the cost. I replied that suppose we had an ancillary services rate schedule separate from a commission rate schedule, and let us say that the industry was not doing well. Which one could be increased? Wouldn't the S.E.C. fall back on costs, in other words saying that you would have to really, in effect, justify any increase in costs. I remarked that the problem is so complex, especially from any consideration of costs, that I would like further clarification of what the S.E.C. has in mind covering ancillary service recommendations.

C. Commission Rates

In regard to their recommendation about reasonable rates, I explained that no one can misconstrue that the rates are not reasonable based on the profits; and it was their thinking, primarily that of Werner, that there should be an upper limit. I explained that it is not necessary to cross that bridge because of the poor profitability of the firms today, using 1962 figures. Here, too, I asked for further clarification of what they are referring to as reasonable.

D. Efficient Firms

In one of their recommendations they used the term “efficient” firms and “representative” firms from a cost standpoint. I explained that I cannot define these terms and I am unable to work on this problem because of the nebulous way in which firms were described. Here, too, I explained that we would have to have further clarification.

E. Interest Income

When it came to the inclusion of interest income on debit balances in the I & E, it was quite evident that Loomis is the driver on this point. I gathered that he wished to judge results of the commission business after considering interest income. I explained that it cannot be done. I did not attempt to argue the merits of inclusion or

III. COMMISSIONS, cont'd.

E. Interest Income, cont'd.

exclusion of interest income, explaining that that had been covered in the meeting a week ago at which neither Saul nor Loomis were present. I stated that I, not as a member of the Exchange staff, but as a C.P.A., am unable to cost interest income because I am unable to allocate capital to lines of business. This could be done by being completely arbitrary, but the result would not be worth the paper it is written on. Loomis indicated that something should be done, and I explained to him that the ball would have to rest with the S.E.C. because I would be unable to do this; and, if necessary, I could bring down experts in the field who would substantiate my opinion.

F. Partners Compensation

With reference to partners or stockholders compensation, Item 5 on Page 118 of Section I, Chapter 6, I explained that their recommendation is not clear in that there is a distinction between partners salaries and profit. Partners salaries are definitely costs of doing business and any fair return should definitely include partners salaries. It was my understanding that the staff approved of this when the cost study and the Price Waterhouse & Co. report was presented to them. I further related to the S.E.C. staff that the profitability of U. S. Steel is the net profit after taxes, after considering partners salaries. If you were an officer, you would not judge the profitability of U. S. Steel by combining any salary that you would receive in performing a managerial function and combining it with any dividends you would receive as a stock-holder for the risk motive in investing in a business. The two functions are separate and distinct - one is an item of cost and the other is an item of return. Therefore, I requested further clarification on this item and I explained that because it is necessary for me to inform the Committee, I would like all clarification to be made in writing so that I may adequately perform the function with which the Exchange has charged me. Bishop supported me on this point.

G. Income and Expense Report

I explained that I do not comprehend why the S.E.C. wishes to make such report mandatory. I explained that we had over 85% of the NYSE commission business in the 1962 survey, and when I use the figure 85%, I am referring to any type of commission business, including floor brokerages, etc. If one considers only those firms carrying customers accounts, we probably had 95% of such commission business. If they were implying that such figures were not valid, I, as a C.P.A. and not as an Exchange employee, feel that they are very realistic. They felt that they still wished to make the report mandatory, but I stated I could see no reason for me to make such suggestion when they have, not a statistical sample, but a valid result from most of the business.

In regard to their commenting that similar report (I & E) should be instituted by other principal exchanges, I said I failed to understand such request in that the Commission and Commission staff had approved our report which covered business

III. COMMISSIONS, cont'd.

G. Income and Expense Report, cont'd.

on other exchanges and the over-the-counter market on an agency basis. Saul replied that this only referred to non-members of the NYSE, and I said that such recommendation does not indicate that. This should be in writing so that I may properly inform the Committee what the S.E.C. means.

When we discussed the item about the S.E.C. obtaining copies of the I & E, I stated I did not see what good this would do. We were still having problems with semantics because of the compilation of the data by each firm with a range from a bookkeeper to a senior partner to an outside C.P.A., and semantics are very important. To illustrate, if I use the term give-ups, everyone here would have perhaps a different definition. We laboriously, through the use of over 20 pages of check lists, review these reports at considerable expense to the industry to obtain valid results. If they were to receive these reports, they would come up with a different result which would be incorrect. In view of this, I failed to see why we could not continue to give them summary information as they requested and as had been done by my predecessor, Mr. Schwieger, in a spirit of cooperation between the Exchange and the S.E.C.

I mentioned that they would have to increase their budget in order for them to tabulate the information because they did not comprehend the amount of work involved in doing such a project. Saul replied that they did not want to receive a lot of data which they would not use or to increase their budget. Bishop supported me in my remarks, and Saul, and later Loomis, joined the discussion that, in effect, Saul implied that he wanted to "lay it on the line" that it was their duty to obtain information and to regulate the business; and that had been the trouble for years with the S.E.C.

I repeated the comments that I had just made and informed Saul that perhaps we could continue to disclose summary figures. They claimed they would perhaps get a better result if the firms knew the S.E.C. was going to obtain a copy, and I replied that this statement was a slur on our member firms. The reports submitted to the Exchange were attested to by a senior partner of a firm and whether it was going to be submitted to the S.E.C. or not had no bearing on whether the figures were good. When a person does something that they know their boss is going to look at, they take pains in doing it well. Whether it goes to any outsider such as the S.E.C. is irrelevant.

In considering their comments concerning extension of the I & E to all member firms, I explained that this was quite a project and, in effect, was on our back burner unless they insisted otherwise. They did not take exception to my remark. I explained, especially to David Silver, the problems C.P.A.s had in allocating specialist expenses to floor brokerage and principal business, and that you cannot be arbitrary in anything you do.

H. Unit Costs

The discussion next centered on establishing unit costs for various parts of the brokerage and ancillary services function. I explained to the staff that Price Waterhouse & Co. had refuted unit costs, and I could not see how this could be accomplished. Therefore, I would like further clarification on this point.

The S.E.C. staff was informed that Items 7 and 8 of Section I on Commission Rates in Chapter 6, namely advising the S.E.C. in advance of commission rates and odd-lot differences on customers confirmations, were not in the province of the Cost & Revenue Committee, with Item 7 subsequently handled by Chapman and Item 8 by Bishop.

At the conclusion, I remarked that I thought the ball was with the S.E.C. on many of these items in that I must have further clarification, in writing, to further inform the committee and effectively serve the Exchange.

I also requested that some procedure be set up to kill items that do not effect our Exchange, or cannot be accomplished, etc.

Werner remarked that we would get together later on (subsequently a meeting was arranged for next Wednesday, October 16, in Washington).

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Since I was unable to take notes during the time I was discussing all these points, the above is my best recollection of what took place regarding the problems in which I am involved.

A. L. Meentemeier