ADDRESS

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Last year, a few months after I became Chairman of the Securities and Exchange Commission, I spoke to this Association about some of the changes I saw taking place in the securities industry. I spoke of the need to keep pace with those changes, and of the challenges they present to those engaged in the industry or charged with its regulation. I would like to continue that theme today, with the added perspective of a year's experience, activity and understanding.

First, I must emphasize that any problems I will discuss should be considered against the background of a vigorous and thriving stock market and investment banking industry. The market places are performing well, by any test. Predictions of today's typical volume, if made just a few years ago, would probably have been dismissed as optimistic fantasy. Yet the stress of large daily volume seems to have been absorbed with a minimum of difficulty, even though the daily and monthly turnover continues to set new records.

Similarly, investor confidence in the markets, as measured by the popular averages, is reaching new highs. The price levels for common stocks are, of course, primarily the result of a prolonged business expansion which, despite its duration, shows none of the infirmities of advanced age. But the averages also reflect the fact that the securities markets have done an outstanding job in performing their economic function during this period of heightened business activity.

The investment banking community has done equally well in finding sources of funds for this expanding economy.

I believe this performance, which would be remarkable at any time, is especially noteworthy during a period of maximum competition from a variety of sources, all aggressively seeking to tap the pool of investor capital.

In our efforts to keep pace with the industry, the Commission is constantly being reminded that the economic changes which have been taking place are not necessarily reflected in the framework within which the industry has traditionally operated. Practices designed originally to serve a particular function may have significantly different effects in a changed financial community. In the financial industry, as in other fields, antiquated labels and fictions may obscure development and adjustment. There is a reason for this: economic and functional changes are made more readily, and more informally, than changes in structure or formal procedures, which occur only by design and with some effort. It becomes necessary, therefore, to analyze new developments within these familiar forms until the inertia which resists institutional change is overcome.

What does this mean for the Commission? It means, at the least, a realization that we cannot always rely on past solutions as we approach current or developing problems. Nor can we assume that methods which were entirely proper, even praiseworthy, at an earlier time are necessarily beneficial in a changed environment.

The development of the common law is a classic example of how the labels and shibboleths became less useful, as new economic and social forces shaped decisions -- though the forms and decisions often remained cast in archaic terminology and what we came to call "legal fictions." The financial industry, too, has its "fictions." But we cannot allow them to prevent full awareness and understanding of exactly what is going on in the real world. Humpty Dumpty put it well, when asked by Alice whether you can make words mean "so many different things." He answered that the only question is "which is to be master -- that's all." I am saying that we must master and go beyond the words to analyze the business facts of life which demand explanation and rationalization.

Let us look, for example, at the practice by which a member of an exchange shares commissions with other members. I suppose that this practice developed originally as a means for one broker to compensate another for a service performed in connection with the transaction, such as clearing, or caring for the customer while he was away from the broker's usual place of business. The recent announcements by the Boston Stock Exchange and the Philadelphia-Baltimore-Washington Stock Exchange, to the effect that they are joining the list of regional exchanges which permit commission-sharing with an expanded group of persons, highlights the fact that the principal use of commission-sharing has changed. Sharing a portion of the commission at the direction of an institutional investor, as a reward for services performed for the institution or an affiliate of the institution, rather than for the member of the exchange, has become an important factor in the securities business. Its growth in importance parallels the growth in importance of the institutional investor in the equity market, and in one sense may be considered a cause as well as a reflection of that growth. By changing their rules, the Boston and Philadelphia-Baltimore-Washington Stock Exchanges have made a deliberate decision to exploit this development to obtain additional business on their Exchanges. With the exception of these and other actions designed to broaden the practice, however, there has been no substantive change in the framework within which commission-sharing takes place, or any realistic evaluation of its impact on the market place. And this is so despite the possibility that an increase in the practice may have significant long-term effects on all securities markets.

It is a curious anomaly that, despite this fact and while major financial institutions seek through broker-dealer affiliates to join regional exchanges, important industrial corporations which are listed solely on regional exchanges are seeking to delist in order that their securities might be traded on what they consider to be a stronger over-the-counter market for their securities. These actions raise important questions and bear careful analysis of listing requirements in terms that are more realistic and less mechanical.

I have referred to commission-sharing only to illustrate that, in the process of overseeing the securities markets, the Commission must brush away many of the cobwebs of the past and re-examine, on a continuing basis, the present realities. To do this, we must have the means to know and understand the economics as well as the practices of the business. We must have an understanding of the economics not only of the markets, but also of those who make the markets work as they do.

To this end, we have asked our staff to develop forms by which all broker-dealers and investment advisers will supply the Commission with more meaningful financial statements. These statements would be in sufficient detail to enable us to evaluate the relative contributions of the various types of revenue-producing activities of broker-dealers. It is important to know the total capital invested in the securities business and how it is employed, the revenue of the business and related costs of operations by major sources. When we have solved some of the difficult cost allocation questions inherent in this undertaking, it will represent the longest step yet taken by the Commission toward achieving full knowledge of the securities industry as it presently exists.

The Commission has for many years required broker-dealers to file certain balance sheet figures each year. Various financial responsibility tests have required use of similar information. Up to this time, however, the only revenue information we have received has been the reports filed by some New York Stock Exchange members and designed to break out on a somewhat arbitrary basis certain income and expenses related solely to New York Stock Exchange commission business. Until recently, even these income reports could not be related to balance sheet data to provide a comprehensive picture of a firm's operations. An industry which has thrived on full disclosure with respect to the merchanidse in which it deals has, with but a few exceptions, kept its own affairs private to a remarkable extent.

The reports we now contemplate would go well beyond the limited nature of the present New York Stock Exchange reports. First, they would be on a mandatory basis for all broker-dealers and investment advisers, not merely for New York Stock Exchange members. Second, they would cover all phases of the securities business. And third, they would provide an indispensable tie-in of profit and loss information with balance sheet data. Because we have no experience with the proposed reporting requirement, and any problems which may flow from it, we do not contemplate that the reports will be made generally available, except perhaps as statistical aggregates.

The forms will take into account the needs of small broker-dealers, and those who are in the securities business on a part-time basis, so that compliance will not be onerous for them. All broker-dealers, small and large, should welcome this move, for it will enable the Commission to make decisions with a better realization of the impact particular actions may have on all segments of the industry.

Having a more complete picture of the economics of the industry will be of particular value to the Commission in fulfilling its responsibilities under the Exchange Act with respect to commission rates. Almost every regulatory problem we have concerning the securities markets is related in some way to the level or structure of the rates prescribed by the minimum commission rules of the New York Stock Exchange. Such seemingly disparate matters as the fragmentation of the markets by the regional exchanges and the third market, the New York Stock Exchange's Rule 394, the role of competing markets, the plight of the small broker-dealer, and the fiduciary obligations of mutual fund managers, all share in common the commission rate mechanism as a key to understanding and, perhaps, correction of current imbalances.

As an example of the effects of these interrelationships, I might refer to the recent action by affiliates of certain institutional investors in becoming members of a securities exchange. I have no reason to believe that an affiliate of a mutual fund would join an exchange for any reasons other than to obtain the preferential commission rate which membership offers. We must recognize that membership on an exchange is, for some, no more than a way of saving commission dollars.

A better understanding of the economics of the securities business will also be invaluable in dealing with what is probably one of the most crucial issues before the industry today -- the relationship between the securities laws and the antitrust laws. As you know, since the Supreme Court's decision in the _Silver_ case, antitrust considerations have come sharply into focus in connection with the commission rate structure and practices related to that structure.

The _Kaplan_ case, now pending before the federal District Court in Chicago, challenges the New York Stock Exchange commission rate structure as violative of the antitrust laws. Although not framed as an antitrust issue, a series of derivative suits brought by shareholders on behalf of mutual funds affiliated with New York Stock Exchange firms, question the alleged practice of these funds in going to the Exchange rather than to the "third market" for execution of portfolio transactions. The _Thill_ case, pending in the Milwaukee federal court, challenges the legality under the antitrust laws of the New York Stock Exchange's failure to permit its members to deal on preferential terms with non-member dealers.

Because of the importance of these issues, Senator Robertson wrote me last spring and asked my views. After these letters appeared in the Congressional Record, the number of my correspondents increased, and I had the opportunity -- usually reserved to members of the Congress -- to extend my previous remarks.

In that correspondence, I referred to the fact that the Supreme Court had indicated that no blanket exemption from the policies of the antitrust laws exists for stock exchange or member firm practices. Because of this, I expressed the view that a reasonable accommodation must be reached between those practices which are necessitated by compliance with duties created under the securities laws and the policies expressed in the antitrust laws. Stock exchanges must be free to exercise their self-regulatory responsibilities in the interest of protecting the public. To that extent, if necessary and required by the federal securities laws, they must be free to take part in concerted action which might otherwise constitute per se violations of the antitrust laws. At the same time, the equally important national policy which favors competition must not be sacrificed. The need for appropriate accommodation led the Commission in 1941 to overturn a rule of the New York Stock Exchange, on general antitrust grounds, in the only formal proceeding ever conducted under Section 19(b) of the Exchange Act.

The Commission can perform an important and informed role in reviewing concerted action by an Exchange to determine whether the balance between the securities regulatory scheme and the antitrust policy, both authorized by Congress, has been fairly struck. The assumed lack of Commission jurisdiction to review particular acts of self-regulation was an important basis for the Supreme Court's conclusion in Silver that the antitrust laws were "appropriate as a check upon anti-competitive acts of exchanges." I should also add that in areas such as commission rates, over which the Commission has been given specific jurisdiction under Section 19(b) of the Exchange Act, it is necessary and appropriate that the basic policy of accommodation be initially determined by the Commission, after appropriate consideration of the views of affected parties and subject, of course, to judicial review. Somewhat immodestly, perhaps, we firmly believe that in matters like off-board trading by exchange members and commission rate problems, the Commission is in the best position to reconcile the diverse and complex factors and considerations that bear upon the public interest, and to determine the appropriate degree of accommodation necessary for effective operation of the federal regulatory scheme administered by the Commission. Such determinations should not be left to *ad hoc* action by courts hearing particular antitrust cases, acting without the benefit of continuous study and appreciation of the interaction of rules and practices among the many institutions which make or contribute to our sensitive securities markets.

I am not suggesting, by the way, that these determinations will be easy. Indeed, the Commission would be induced to assume the burden -- a burden which we could well do without -- only because of a strong belief in the importance of the securities markets to our economy, and a deep conviction that their intricacies must be understood and taken into account lest their ability to function adequately be disrupted or competition unnecessarily inhibited.

There is evidence that concern over possible antitrust consequences may be dampening the vigor of self-regulation. We operate under a unique arrangement -- cooperative regulation, under which the self-policing function is of utmost importance in fulfilling the statutory scheme. If this system is to survive, it will be necessary to reach an accommodation between the antitrust laws and the securities laws fairly quickly, regardless of the length of time now-pending litigation may take. In the meantime, the threat of antitrust litigation, whether real or fancied, cannot be permitted to excuse non-performance of vital regulatory activities.

Let me turn again to the proposed broker-dealer financial reports, and the uses to which the Commission will be able to put the information we would receive. With those reports the Commission would be able to judge the significance and consistency of particular sanctions in some types of broker-dealer proceedings arising in the course of enforcement activities undertaken by the self-regulatory institutions and by us. While I hope that the need to apply sanctions will be limited, I am realistic enough to know that there will always be occasional disciplinary proceedings. An understanding of a firm's business could be of assistance in formulating appropriate policy. In this regard, you may be interested in the progress of the coordination program I stressed recently at the last convention of the North American Securities Administrators.

While important steps have been taken or are under consideration, particularly as between the NASD and the self-regulatory institutions, I am sorry to say that the work has not been without disappointments. I am hopeful, however, that substantial progress will be made. We are working with the NASD, the national securities exchanges, and the various state securities administrators. Among other things, we expect to evaluate the Commission's role in bringing proceedings and assessing penalties against respondents where other self-regulatory institutions have brought or are in a position to bring appropriate disciplinary action. The Commission is mindful of the problems caused by proceedings brought seriatim by the various enforcement agencies, as well as the time and expense consumed by such efforts. While I cannot now offer any comprehensive solution to this problem, we are actively studying the possibilities and searching for procedures to deal with it effectively.

Conclusion

Let me summarize what I have said today. Against the background of a well-functioning securities industry, there is a need for continual re-examination of the basic institutional framework, as changing economic needs create a demand for functional changes. To this end, we are proposing detailed financial information reporting by broker-dealers and investment advisers, to provide us with a greater understanding of their business and the effects or possible effects of any actions we and others may contemplate.

This information will also be of great help in connection with our examination of the commission rate structure and other charges levied in securities transactions, including those presently under attack on antitrust grounds. In the meantime, reaching an accommodation between antitrust policies and the securities laws is one of the most crucial tasks we face today.

In discussing these matters, I have emphasized the intricacy of this industry, and the many inter-relationships which make difficult the analysis of any one segment of it. In conclusion, I want to make two brief points. One, it must be clear that we cannot allow this complexity to paralyze our regulatory work. We will have to take each problem as it arises, bringing to bear on it as much awareness of related problems as we can, but equally aware that all the questions before us cannot be solved simultaneously. A principal criterion will have to be whether rule proposals, or other actions under consideration, tend to perpetuate the fictions of which I spoke, or whether they are based on functional and economic reality and tend to make the surrounding structure more rational.

Finally, I must once again, as I did last year, emphasize the assistance that industry groups must give us in this process. This program, too, is not without its disappointments. For example, a year ago I referred to the importance of eliminating unjustified differences in financial statements of similar companies. The objective was described as immediate and pressing. I suggested that investment bankers should, in their own self interest, pursue that objective, and I requested your support in working to achieve it. I believe that, in response, a committee of this Association was formed. While some action has been taken by the accounting profession, the overall picture is not encouraging. In this area, as in so many others, the job will be done better, and compliance will be more willing and therefore more thorough, if the initiative is shared with, if not assumed by, the industry. We would rather have it that way, if you will let us. I say this despite the fact that we are now considering some limited action of our own in this area -- action which is not designed to undermine the efforts of the leaders of the profession but rather to emphasize to the entire profession the urgency of immediate and effective support of those who are seeking sound procedures to obviate unjustified differences in the treatment and presentation of similar problems.

We have learned a great deal as a result of implementation of the Special Study of Securities Markets and the Securities Acts Amendments of 1964, and that work is continuing. As we approach some of the hard core problems, I hope that the industry will share with the Commission the search for sound, long-range answers. It would be appropriate, for example, if the economists recently hired by industry organizations and institutions and by broker-dealers were put to work in cooperation with our staff toward achieving an understanding of the role of the institutional investor in today's market, and on similar studies which would be of benefit to the industry and the government. The economic resources available to the securities industry should be used to help conduct basic research activities, perhaps on some joint basis, with that being done by others. Only in this way can government and industry promote, within our free market economy, those elements which contribute to progress and growth, and fulfill our responsibilities as public servants and business leaders.