ADDRESS BY

MANUEL F. COHEN

Chairman, Securities and Exchange Commission

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Thank you for the opportunity to speak here this afternoon. I am pleased that our schedules allowed this meeting as I rarely have the privilege to address an audience that combines such charm and sophistication.

I have been told by your president that this is a no-nonsense group and that you operate under a tight time schedule. Accordingly I will address myself to a number of subjects which I hope will be of immediate interest to you. Each relates to our expanding securities markets.

As you are aware, increased demand here and abroad in securities of American enterprises has produced an unprecedented and unexpected increase in exchange and over-the-counter volume. This has been accompanied by dramatic and important changes in the form in which savings find their way to the equity securities markets and some new theories or at least widely accepted practices of investment management. These developments have created public concern in at least two areas in which the Commission has certain responsibilities. One is reflected in our hearings on the commission rate structure of the national securities exchanges; another is the so-called back office problem.

In the first area, the problems we face today flow from certain decisions taken at the founding of the New York Stock Exchange. In 1792, the exchange conducted its business under the well-known buttonwood tree which stood between 68 and 70 Wall Street. We can visualize the forefathers of today's brokers, gathered in their wigs and waistcoats to deal in the bonds that had been issued by our first Congress to pay the war debts incurred by the Continental Congress. Current hair-styles and the strong retail market in Edwardian fashions suggest that these gentlemen must have borne a marked resemblance to today's brokers.

In early March, 1792, a group of auctioneers published, in <u>Loudon's Register</u>, a New York newspaper, an advertisement announcing the establishment of a market for daily <u>public</u> sales of securities -- open to everyone who wished to participate. On March 23, 1792, the stock brokers published in the <u>Register</u> a declaration that they would not attend any sale of stocks at "Public Auction". The stock brokers also "appointed a committee to provide a proper room for them to assemble in, and to report such regulations relative to the mode of transacting their business, as in their opinion may be proper."

One product of this committee's efforts was the Buttonwood Tree Agreement, signed by the 24 brokers and merchants who constituted the then entire membership of the exchange. The Agreement reads as follows:

> "We the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter per cent. Commission on the Specie Value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May, at New York, 1792."

Based on this early history of the New York Stock Exchange, one can conclude that the Commission is holding hearings on questions presented almost 200 years ago. The fixed minimum commission rate, the preferential intramember rate, and the prohibition against economic access to the exchange market by non-member broker-dealers, are but three of the subjects of inquiry detailed in our order for proceedings. Each has its historical antecedent in the auctioneers' challenge of March, 1792 and in the brokers' reply of November. Despite, or indeed because of, this and later history, questions have arisen, first, why the Commission is concerned about the commission rate structure and, second, why the Commission feels that an adequate public record must be developed as to these and related practices. Before answering these questions, I would like to recall a bit more history.

The exchange fixed commission level has, on other occasions, failed to receive universal approval. Thus, when on October 7, 1861, an increase in the commission rate was announced, at least one editorial of the day commented that:

> "The change in the rate of commissions creates a great deal of discussion, and does not work well. The rate adopted, 1/4%, (of par value) is evidently considered too high by parties who have business with the board, and they will seek the services of outside brokers, or do their business through banking houses . . . . "

With this historical background, we can now turn to some answers to the questions.

The short answer to the first question is that under Section 19(b) of the Securities Exchange Act of 1934, the Commission is responsible for fulfilling the statutory mandate that commission rates set by the exchanges be reasonable. As to my second question, I should note, at the outset, that many believe the Commission is acting now, for the first time. To the contrary, the Commission in 1958 and 1959 conducted a study of the level of rates fixed by the New York Stock Exchange. Our Special Study of Securities Markets, in 1963, discussed the problems and conflicts created by the rate structure and level, by the lack of a volume discount and by the existence of the "give-up" system. This Study put the industry, the public and the Commission on notice that changes were needed.

As you know, the New York Stock Exchange and the regional exchanges have adopted rules which will provide an interim volume discount that will afford to investors savings of an estimated $150 million dollars a year. Expressed another way, this amounts to a savings of at least $600,000 per trading day. Of course as our economy grows, and volume on the exchanges grow, so will the public's savings. The exchanges also made operative a rule prohibiting customer directed give-ups. Our staff is presently gathering data, as I am sure the staffs of the various stock exchanges are, and developing conclusions on the effect of the volume discount. Any attempt at analysis at this time of the effect of the new rules would be premature.

It has been suggested that there is correlation between commission rates and the volume of trading. There is some historical precedent for such a correlation. In 1861, as the Civil War progressed, speculation grew and total daily sales mounted to the point that the rate of commission was reduced from 1/4 of 1% to 1/8 of 1%. I do not know what the daily volume was during this period but I do know that on March 16, 1830, the Exchange's dullest day, 31 shares were traded and that, on December 15, 1886 the exchange had its first million share day. Of course this did not represent the usual daily volume.

The volume that the securities industry is presently experiencing -- and it has on some days reached, in all markets, a total of 50 million shares -- has created a critical back-office problem. It has been said of the back-office problem that (and I quote) "The Clearing-House has withstood severe

panics, the insolvency of banks, the failure of brokers, neglect to send in clearing sheets, and errors of every conceivable variety on the part of dealers . . . . " (end quote). This analysis of the back-office problem was made by a Mr. Francis L. Eames in his history of the New York Stock Exchange, published in 1894. At that time, the Clearing-House had been in operation for a little over two years and, on occasion, it had cleared as many as 4 million shares in a single day. Apparently back-office problems are not new either.

Many of the back-office procedures used today were, when implemented, answers to threats posed by paper logjams. In fact, the Clearing-House itself was imposed upon a dissident faction of brokers who were opposed to such an impractical idea. The existence of buy-in rules of today, and the reaction of some to their enforcement, thus seem to have a similar historical origin.

I hope I have not sounded too much like a history professor. But these few tidbits of history provide a perspective for current problems and a warning that those problems urgently require prompt and effective solutions. We at the Commission, are particularly concerned about the back-office problem, as I am sure you are. Together with the various self-regulatory organizations we have been seeking both long range solutions to the back-office problem and such effective short term measures as are necessary to ameliorate the present situation until the long-term measures become operative. It is obvious that modern securities firms and certain related service organizations cannot ignore the fact that procedures developed at an earlier time no longer meet current needs. Practices that arose in the 1880's cannot be expected to be effective now, let alone in the 1970's and 80's - which is the time for which we must now plan.

It is usually difficult to persuade prosperous businessmen, who are suffering what is unfortunately viewed by too many as merely an annoying clerical problem, that what is needed in this area is a fresh viewpoint. And there is very little question that the industry has been highly profitable. The leaders of your industry, recognize however, that in this prosperity may be the seed for much trouble. They need your earnest attention and effort to solve these problems and avert more drastic actions.

Some statistics will underscore both this need and the scope of the back-office problem. The latest figures

available to our staff indicate that 426 broker-dealer firms had a total of $3.36 billion in fails to deliver. Of this amount $586 million were in "fails" over 30 days old. Of the total "fails", New York Stock Exchange stocks accounted for $1.1 billion and Over-the-Counter stocks, and stocks listed on regional exchanges, accounted for $1.7 billion. While our figures indicate that, in the past few months, the dollar volume of fails to deliver over 30 days old has decreased, this decrease must be weighed against the fact that the total volume of fails to deliver has increased by approximately 10% within the past few months.

The dollar volume of fails is but one yardstick of the back-office problem. Another yardstick is the number of public complaints that have been received by the Commission, by Congress, and by the industry. Investors in unprecedented numbers are concerned with, and complaining about, their inability to obtain, within a reasonable period of time, securities they have purchased or the proceeds of securities sold. Investors, in unprecedented numbers, have also been complaining about errors in their brokerage accounts, about receipt of confirmations for securities they did not order or sell, about delayed receipt of proxy statements, and about their general inability to obtain prompt responses to questions concerning their accounts. These conditions pose a real risk to the investment community and to the public, a risk which is of growing concern to industry leaders, to the Commission and to the Congress, a risk which none of us can afford for very long.

I would like now to turn to another back-office problem. The Commission, too, is suffering from a back-office problem. Our back-office problem has taken the form of a substantial increase in the number of registration statements filed under the Securities Acts, particularly under the Securities Act of 1933. 2,473 registration statements were filed with the Commission in the fiscal year ending June 30, 1968 as compared to 1,543 in 1967. For the first quarter of fiscal year 1969, that is from July 1 to September 30, 1968, 840 registration statements were filed as compared to 507 for the same period in 1967. The dollar value of securities registered with the Commission from July 1 to November 30, 1968 was $20.9 billion as compared to $13.2 billion in the like period in 1967. Of the 840 registration statement filings in the first fiscal quarter of this fiscal year, 414 were filed by issuers which never before had been subjected to the registration process. This figure compares to 149 such statements

for the first quarter of the 1968 fiscal year. Moreover, as a result of the Securities Acts Amendments of 1964, approximately 3,200 additional companies became subject to the Commission's proxy rules. The number of definitive proxy statements filed with the Commission has increased from 2,661 in fiscal year 1964 to 5,244 in fiscal year 1968. Many more of these proxy statements involve complex merger or acquisition proposals. Unfortunately, this flood has come at a time when national policy as to the level of government expenditures has resulted in a reduction of personnel.

The increased number of registration statements under the 1933 Act and the apparent limitless public appetite for new issues contains certain parallels to our experiences in the 1960's. Now, as then, there is an avalanche of registration statements and there is a high proportion of hot issues relative to the number of new issues. Underwriters compensation has reached unprecedented levels and this compensation has taken numerous forms. Cheap stock, warrants, rights and options are commonplace in todays filings; and often the underwriters assume less than a firm undertaking. The issues underwritten range from highly speculative technological companies to novel mutual and other collective funds. The ease of entry into this business, and its great rewards to those involved in it, have also resulted in a substantial increase in the number of broker-dealer application Thus in fiscal 1968, 626 broker-dealer applications were accepted by the Commission as compared to 334 in fiscal 1967. Some of these new broker-dealers are related to institutional investors of one kind or another. As far as the "new issue" flood is concerned, I am sure most of you are aware of steps we have recently announced, after much consideration, to find a way to meet more promptly the needs of issuers who have made every reasonable effort to comply with the statutory requests. But these steps will not work if we do not receive the whole hearted support of everyone concerned with these new issues.

I would like now, if I may, to turn to another undertaking which the Commission has just launched and which is of substantial importance to all of you. I am referring to the study of institutionalization of the securities markets and related matters. The Commission announced that Professor Donald Farrar of Columbia University would be the Director of this Study. We will be meeting with representatives of the securities industry and of institutional investors of all

kinds next week. We expect that the Study will be in full operation shortly after the end of the year.

It is important to re-emphasize that our concern with respect to institutional investors and the impact of their growth and practices on the market, and on the companies whose securities they hold, is not based on any feeling of mistrust -- it is simply grounded in the necessity that you and we need to understand a great deal more than we do now about what has become a significant and rapidly expanding factor in our markets.

In 1954 institutional ownership of equities amounted to $66.5 billion, in 1968, $230.2 billion -- an increase of 250%. This increase is due only in part to the growth of equity values which, generally, rose 160% in that period. In the aggregate, institutions now own 33% of all publicly owned equities, up from 25% in 1954. In certain companies and industries the figures are higher.

Growth of this magnitude has already had an important impact, and has the potential for even greater effect, not only upon the functioning of securities markets but also upon the raising of capital by American business, the interests of individual investors, who also use the securities markets, and the companies in whose stock these institutions invest. This growth is also a significant economic phenomenon, and analysis and study of this phenomenon by competent economists and other specialists, which is an important part of the proposed study, should contribute materially towards our understanding of the workings of the economy.

To understand this phenomenon our first task will be to remedy various information gaps. Only after this is accomplished can there be any meaningful analysis of the impact of institutional investment upon the securities markets and upon the economy.

The available data with respect to the activities of various types of institutions in the stock markets range from fairly extensive information about registered investment companies, collected not only by the Commission but also by the Investment Company Institute, to almost no information at all about foundations, of which there are roughly 15,000 with about $19 billion in assets and $14 billion in stock at the end of 1965. No reports are required of foundations, except to the Internal Revenue Service, and stock data on

even a total-dollar-value basis are generally unavailable. In between these extremes there are bank-administered pension funds, bank trust funds and insurance companies. With respect to pension funds and property and casualty insurance companies, our staff collects a certain amount of statistical data on a voluntary basis, and with respect to life insurance companies the Institute of Life Insurance collects certain monthly data from companies accounting for 93 percent of total assets. As to none of these, however, does the Commission have data on individual transactions or holdings in individual stocks. For insurance companies, this information exists in the reports that they file with state regulatory authorities having jurisdiction over them, but these data have not been assembled or published in the past.

In closing I would like to note another study conducted by Murial F. Siebert who, as you know, is the only woman ever to acquire a seat on the New York Stock Exchange -- a step in the direction of equality which was somewhat overdue. Miss Siebert reports that a survey of 137 liberal arts women's colleges in the U.S. revealed that only a handful have courses on basic concepts of individual finance and investing.

Women today constitute over 51% of the nations' share owners. Perhaps if we take steps to make it clear that women really have an important role in the world of finance, the Women's Bond Club of New York, will one day, be gathered here to listen to an address by a lady chairman, or at least a commissioner, of the Securities and Exchange Commission.