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RESPONSIBILITY FOR AND QUESTIONS ON THE
STRUCTURE OF THE AMERICAN SECURITIES MARKETS

AN ADDRESS BY

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All of us who have anything to do with the securities industry must by this time be tired of being told that we have critical decisions to make. Certainly the time has come to make them. We will have valuable guidance from Bill Martin's report, from the work of Senator Williams' committee and Congressman Moss' committee and from the Commission's Institutional Investor Study. Against this background I should tell you why the Commission decided that it should hold a public investigatory hearing of its own beginning on October 12. Immediately on the heels of the Martin Report there came the proposed settlement of the stockholders action against Massachusetts Investment Trust in which, to settle this lawsuit, MIT agreed to join a regional exchange to recapture commissions. Other funds reacted that if MIT had to protect itself this way, they had better do so too. Many members of the New York Stock Exchange and other exchanges which had not yet decided to allow institutional membership began to feel that they should adopt

an institutional membership rule in order to avoid loss of trading volume to exchanges which do permit institutional membership. There seemed to be a danger that this important issue would get resolved by inaction and by fears engendered by a single private lawsuit. We felt that a decision of such importance to the American capital market should be made as a duly considered matter of public policy, and that it was our obligation to move immediately to place the issue under review from a broad public policy standpoint.

There is a widespread feeling that there may be unfairness in the disparity of the rules governing disclosure, access, off-board trading and other matters.

We have responsibility for disclosure and exchange rules and we felt that we should act promptly to discharge that obligation. Thus, our inquiry is to be primarily directed at the need for disclosure of prices and volume and changes in membership and other rules and our effort will be to develop a record on the basis

of which we hope to make early decisions on matters on which we have the authority to act.

I hope that these hearings will help to meet what I consider one of our most urgent needs -- to get these problems clearly defined and resolved according to a clearly defined set of standards and goals. As I evaluate many of the efforts to grapple with the problems of your industry, it has seemed to me that too often problems have been too narrowly defined and standards and objectives have been set at too mundane a level.

To make the necessary decisions, we must think about the American capital market in terms of its great power to fuel the American economy, its great value in building the living standards not only among 200 million Americans, but throughout the world, its great purposes in directing economic resources and establishing the criteria of value and responsibility and incentive which are needed to make a free economy work. We must remember how much the growth and liquidity of values in the

American equity market means to the financing of business and to the operation of our banking system. It is the record and promise of growth and liquidity which has attracted capital from other nations and caused investment managers to put an increasing proportion of pension, life insurance and trust funds into equity investments. We must remember what the participation of 30 million individual Americans who own stock means to this liquidity. We must remember how important the values established in our equity markets are to the educational and retirement and security plans of the families of the 100 million Americans who own shares directly or indirectly through their pension plans, insurance policies and mutual fund shares.

Today, I'd like to pose some questions about the securities industry and what is best for it. These are questions as to which I am seeking an answer and as to which I have suspended judgment while the Commission conducts inquiries and hearings over the next few months.

But, I have no question as to the primacy of the great purposes and values of the American capital markets which I have just enumerated. I have no question as to the absolute degree to which the achievement of these purposes depends on public confidence in the fairness and honesty of these markets and on the continuing participation of the individual investor in equity ownership. I have no question as to the responsibility of the SEC to see that our equity markets operate and are regulated in a manner which imparts to the individual investor the conviction that these markets are not only fair and honest but interested in him and hospitable to him. That does not mean freedom from risk but it does mean that full information and experienced judgment is available to the individual investor and that he will be the beneficiary of both fiduciary treatment and competitive efforts to serve him. So far these are principles and objectives with which few will take issue. But there are important questions as to

when and how we apply them and as to how and when and by whom priority is established as between regulatory, competitive and fiduciary approaches to making the securities markets work in the broad public interest. Private anti-trust suits are challenging rules and practices which have been in operation for 35 years and more. Private stockholders' actions are contending that institutions have a fiduciary duty to join a stock exchange to recapture commissions for their beneficiaries in a situation where some exchanges permit institutional membership, others do not and there has been no determination as to whether, in terms of the great purposes and requirements of our security markets, institutional membership is in the public interest or not. It is because the Commission recognizes its obligation to eliminate this kind of confusion in order to give full and true and coherent scope to regulatory, competitive and fiduciary forces, that our investigatory inquiry will be launched on October 12, 1971.

This inquiry will be designed to provide the information and the record on the basis of which the Commission will review the regulatory pattern which has been developed to date and the impact of new technologies and new economic forces like institutionalization on that pattern and effect such changes in that regulatory pattern as the Commission's responsibilities require and as its authority permits.

Let me back off and review the Commission's responsibility and authority for a moment. In enacting the Exchange Act of 1934, Congress determined that the securities industry was affected with a public interest, that the marshaling of funds for large and small business and the service and protection of investors, large and small, should be regulated. The Commission has been given the responsibility and authority to adopt or approve rules for those who would deal in securities on exchanges and over the counter. The touchstone in discharging this responsibility is the protection and service of the investor and the efficient operation of a free capital market to mobilize funds to meet the needs of the nation.

The courts are being asked to apply anti-trust principles to the regulation of the securities markets in such fundamental matters as membership and rates.

I believe that this is contrary to the intention of Congress in enacting the Exchange Act as the primary source of regulation of the securities markets and that the Commission's review of the regulatory pattern that has developed can reduce the confusion which prevails in this area. The great aims of the anti-trust laws need not be excluded or derogated in order to recognize that the great purposes of the Exchange Act are more immediately relevant to these mandates of Congress -- that the Commission act

- "to prevent inequitable and unfair practices on exchanges"
- "to impose requirements to make * * * regulation and control [of transactions and practice on exchanges] reasonably complete and effective in order * * * to insure the maintenance of fair and honest markets in such transactions"

and that the Commission and the self-regulatory agencies promulgate rules

- on "just and equitable principles of trade"
- "just and adequate to secure fair dealing and to protect investors"
- "necessary or appropriate for the protection of investors or to assure fair dealing in securities * * * or to insure fair administration of such exchange" and
- for the "public interest and protection of investors."

In promulgating its own rules and reviewing those of self-regulatory bodies, the Commission has and will continue to give weight to the objectives of anti-trust law, to satisfy itself that Exchange Act purposes rather than anti-competitive purposes are being served and to require as well as encourage the application of fiduciary standards.

But that is a very different matter than permitting anti-trust law to supersede the Exchange Act.

Thus far, I have dealt with our obligation -- yours and ours -- to deal with the problems of the securities markets today and with the objectives and standards which should guide our deliberation and action. Let me now suggest an agenda and some of the questions which need to be resolved in determining how to move on it.

One thing on which all studies and all who participate in the securities industry agree, is that we should develop a strong central market system. Indeed, the Commission in its Institutional Investor Study transmittal letter stated:

"In summary, our objective is to see a strong central market system created to which all investors have access, in which, all qualified broker-dealers and existing market institutions may participate in accordance with their respective capabilities, and which is controlled not only by appropriate regulation but also by the forces of competition."

To determine the proper ingredients of that market system, how its elements should relate to each other and the rules which should guide it will require the insights, the knowledge, the experience and the best judgments of all of us. In the investigative hearings which the Commission will commence on October 12 we will want to hear from the exchanges, from spokesmen for other markets, the brokerage industry, the institutions and from other knowledgeable persons on how they believe they can best contribute to the development of the central market system. We will ask for their thinking on the proper blending of regulation and competition. We will examine the disparities in the rules which govern the various markets and try to determine the extent to which these disparities are justified and the extent to which they should be reconciled.

One of the most powerful elements in molding our existing markets into a central market system under common regulation in which competition will work for the

benefit of the investor may well be the greatly improved disclosure of information on quotations, prices and volume in all markets made possible by the technological innovation of recent years. To this end we will explore the feasibility and desirability of having all executions reported on a common tape with a designation of where the transaction was executed, the net price and what portion, if any, was positioned by the executing broker and the desirability of making any specialist's bid and ask quotations available to all interested market participants.

We will want to hear from the institutions on how they balance their natural desire to save commission costs against possible risk to the liquidity and capital value of their portfolios, if having institutions within the exchanges, while the individual investor must deal from without, makes individual participation in our securities markets more costly and less appealing. We will want to hear what obligation and responsibilities institutions seeking exchange membership are prepared to assume in order to serve and protect nonprofessional investors.

While these hearings are going on, we will be analyzing the experience of the institutions with negotiated commission rates on that part of a trade in excess of \$500,000. We are reviewing the data received by the NYSE under its Rule 384 which requires information as to all executions of transactions eligible for competitive rates, which are submitted by each member firm monthly as to NYSE listed stocks in which it executes orders. The staff also expects to receive soon a copy of the transaction revenue study prepared for the NYSE by National Economic Research Associates for the second quarter of 1971 which should shed some light on the effect of competitive rates on the income of member firms. Among other things, we will be particularly interested in the impact of competitive rates on the liquidity of large blocks, on the desire and inclination of institutions to seek exchange membership, on price reporting, spreads, research and other services. In these hearings, we will carry forward the examination begun by the Institutional Investor Study into the handling of

large blocks, with particular attention to the relationship of block transactions to the trading of small investors and the need for additional regulation and disclosure of such transactions.

I believe that the industry and the Commission have learned a great deal from the problems of last year and that important first steps have already been taken to correct the deficiencies disclosed by that unhappy experience. The Commission together with the self regulatory bodies have already completed or are now formulating measures which will make the capital of brokerage firms more adequate, more liquid, more permanent, give additional protection to customers' cash and securities by new reserve and segregation requirements and establish higher standards for entering into the business.

We have put out a rule to increase capital requirements for entry into the business and to require a more conservative level of liquidity during the first year of a new firm's operation. We are working on measures to more effectively establish qualifications of experience and knowledge and the

existence of adequate operational and financial controls in order to enter the business. I believe that these steps will strengthen firms and give the public greater security.

Beyond that, I hope that the inquiry to be launched in October will provide the basis for developing a more coherent and efficient market structure which will enhance the depth and liquidity of our national securities market and convert the challenges of institutionalization and technological change into a more dynamic and efficient capital market. I solicit your advice and help in this quest.