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SECURITIES AND EXCHANGE COMMISSION

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THE YEAR AHEAD:

COPING WITH OUR COMMON PROBLEMS

An Address By

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Securities and Exchange Commission

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Whether the past year has been one to celebrate depends upon where you sit and what you expected. It's been a good year for Arabs and for Evil Knieval -- when you consider what might have happened. It's been good, generally, for our detractors, including those curious people in our own midst who find pleasure in the distresses of democratic government and a free economy. It's been a good year for the Securities and Exchange Commission as an institution.

For the second year in a row we are getting a good budget increase, so that by next spring our staff will number over 2,000, nationwide, for the first time in our history. And we did it all on declining revenues. Our best source of revenues are the fees paid on '33 Act registration statements and in that department we have suffered a notable, and unfortunate, decline. It may not cheer you to contemplate our growing staff, and I suppose it is indecent for me to flaunt our new prosperity at this particular time. But I hope you won't begrudge us the new building we hope to occupy next spring.

If your fears and expectations were sufficiently dim a year ago, then we can rejoice in the fact that most of us have survived, and in the manner in which our Government survived its worst Constitutional crisis in over a century.

But it was not a good year for our capital markets or for the securities industry. We all know that, and we are deeply worried about it.

Several industry spokesmen have been generous enough to tender advice on how we at the Commission should behave in such a time of troubles. The tenor of this advice is that we should do something affirmative and helpful. We should stop thinking only about who we can sue tomorrow and get out there and fight -- get those market prices and revenues up and those costs down. Since those proposals extend to matters outside our jurisdiction, it may appear as though we have not been listening, but that is not true. And we have been trying.

While considering more mundane proposals, my wife and I have been conducting some secret experiments that even the other Commissioners don't know about. We have been trying to appease the Gods of the stock markets, to see if I could bring a little rain. It all began last June when Virginia, my wife, said, "I think the Gods are mad because you are talking too much, as though you know it all. If they aren't sick of it,

they ought to be. All of us down here are." Well, I realized that she is prejudiced in this area, but I decided to give it a try. From July 4 to Labor Day, I kept very quiet. Gave no speeches. It didn't work.

Toward late August, Virginia said, "There's little time left to stop this drought with a summer rally. Maybe the Gods are offended at your very presence. So we took off for Northern Minnesota to concentrate on fishing and let the Gods believe that I had completely forgotten about the stock market -- which was pretty well true. This gambit had a curious effect. Bemidji broke all records for the coldest Labor Day in its history, well below 30, but after a brief flurry on my first day at the lake, the market flopped back down.

We were puzzled, as you can well imagine. About this time, I had been invited to speak to Japanese securities and financial men in Tokyo. So Virginia said, "That's it. The Gods want you clear out of the country." So, we went to Tokyo. But, like Jonah, I couldn't escape. Prices were down in Japan, and the day I visited the Tokyo Stock Exchange was the slowest of the year, and of recent years. It was tempting to head on for Nepal

or the Gobi Desert, but President Ford wanted me to attend the pre-summit conference on banking and finance. Virginia thought that if I explained our rain-making experiments, the President would understand, but I lost my nerve and came back. Obviously it was not the right thing to do. My presence at the pre-summit and, even more, at the summit itself, so infuriated the Gods that you can see what happened.

One of the Japanese with whom Virginia got quite friendly listened with great interest to her description of our program. He said the Japanese had much experience in these matters and that there was one more measure I should consider. If she would like to buy an appropriate robe and pillow and a long knife, he would be glad to instruct me in the proper procedures.

That's the other reason I came home quickly. Much as I love the securities industry and our capital markets, I'm not sure even Hara Kiri would work, and I don't intend to find out.

If deity propitiation fails, what else is there? Obviously the big problems are fundamental ones of world-wide economic conditions and fiscal and monetary policy and hopelessly beyond

the reach of remedies concerned with capital market structure and regulation. Inflation, recession and high interest rates will not be curbed by the consolidated tape or composite quotes or the full-blown central market system or whether commission rates go up or not or become unfixed or not. These matters can only be dealt with directly by the Government itself, and probably by cooperative efforts among many governments, so interdependent have the economies of the free world become.

I sat through the entire summit conference with great interest. It was, among other things, a fascinating spectacle and unique in our history. There have been some good summaries of it appearing in the financial journals, but the coverage of it at the time seemed inadequate. There were some special interest harangues that were colorful and naturally drew the pictures and headlines, but there was much more of solid substance. Surely there could not be a better device for giving the President and his advisors a first-hand feel for, and understanding of, what is bothering Americans of all sorts. It is true, as several observed at the time, that the conference was directed to curbing inflation, which presumably means spending less,

and many of the speeches were devoted to how any cuts in spending must be imposed on the other fellow but we need more. And some of the remarks did seem more political and partisan than was appropriate. But these elements did not detract from its overall value.

Some of the lessons to be gained were negative. One that struck me with particular force was the vast amount of ignorance or deliberate unconcern displayed toward our capital markets and the securities markets. You got the flavor from Alan Greenspan's experience at the pre-summit on H.E.W. matters, when he observed that inflation was harming virtually all elements of our economy and, indeed, statistically the hardest hit seemed to be the stockbrokers. This was greeted with hoots and catcalls and was the subject of a few unkind remarks at the summit -- all without any effort to understand what Dr. Greenspan was saying and why he was saying it, to say nothing of any effort to understand the significance of the decline of the securities industry even to present welfare recipients. All in all, it was a bad scene for economic sophistication and free capital markets, but it illustrated clearly the political problems with which we are faced. And, as

Dr. Gabriel Hauge observed at our pre-summit, when economic problems get serious enough, they become political.

We will learn on Tuesday the program that the President will adopt. The diversity of views at the summit was such, that any program will find support from someone, but there was more nearly a consensus among thoughtful commentators than that observation would support. I am confident that the President's program will be a reasonable and fair balance with a good chance of success if fully supported. I am equally confident that it cannot possibly fully satisfy everyone. I hope all persons of good will understand this, accept whatever element of sacrifice for themselves is involved, and strongly support the President.

Let me also observe that Americans in general may be better educated about some things but not about the operational facts of capital markets. There is very little knowledge of how they operate and, what is really worse, little recognition of their importance to our economy. Most of the summit speakers did not even mention the state of the markets, as though investing in securities were a rich man's sport of no concern to the ordinary citizen. When we consider the

critical needs of our industry for capital today and the years ahead and the importance of attracting investor capital back into long-term debt and equity markets, the lack of popular understanding of this aspect of our total economy is tragic, but it is very real.

Besides futile efforts at rain-making and observing the Administration's efforts to develop economic policy, what is going on in our own bailiwick relevant to our general distress? In broad terms, our efforts are directed toward making our national market system more efficient and more attractive to investors. We at the SEC cannot guarantee profit to investors, and we dare not even create the impression that profit is assured. Indeed, we have made it a career of requiring that investors be reminded that markets go down as well as up. Five years ago many were laughing at this gloomy and antiquated attitude, but no one needs to be reminded today. This does not mean that equity and long-term securities are not, for many, better investments than other places they could put their money. Certainly it is bad for the economy when savings get diverted into non-productive inflation hedges that provide no capital for increased productive capacity and are hazardous even for their intended purpose.

Government and the private sector have been doing things that are making our capital markets more attractive. SIPC is a case in point. No government official wants to guarantee anybody anything, but SIPC combined with the vastly improved rules and surveillance programs of the Commission together with the self-regulatory bodies have increased the safety of dealing with your broker far more than the public realizes. Past troubles generated fears that persist even though the facts have changed. Savings accounts are still regarded as safe, but leaving money or securities with your broker is dangerous. Actually, today, there is little difference in safety.

Movements toward more efficient, less costly clearance and depository systems are progressing. Progress is not exactly even and peaceful. There are stormy aspects, but this is inevitable when we are seeking progress through maximum contributions by the private sector and minimum compulsion by government. The consolidated tape will shortly be in operation for its pilot period, and the other elements of the central market system program will be the subject of extended discussion, tomorrow and Tuesday.

Let me close with some remarks about the hottest bone of contention of them all -- namely, fixed rates. Judged by my visitors and correspondents and remarks of many industry people, this single issue overshadows all others. Passions are aroused to the point of most vivid imagery. My latest letter on the subject ended by saying --

"I guess by now it's clear my own view is that the SEC should cease and desist from its efforts to make the industry walk the plank and jump into fully negotiated rates on [all] trades. The water below is too icy now!"

There are, of course, knowledgeable persons in the industry who continue to favor the idea, but they are less inclined to write letters and make speeches. So the din to which we are subjected tends to be one-sided. That is not to say that many persons who once supported the idea have not changed their minds -- many have, usually now urging postponement rather than abandonment.

Procedurally, this is where matters stand. We have sent to each national securities exchange a letter stating our view that they should take steps toward unfixing commission rates not later than May 1, 1975, and that, if affirmative action to this end is not taken by November 1, 1974, we would call a

hearing under the Securities Exchange Act to determine whether we should effect such steps ourselves. We have not yet had formal replies from all of the exchanges. Two exchanges have made public statements to the effect that will not voluntarily end fixed rates, and one of them, the American Stock Exchange, has already written us a letter asking for a hearing. The Board of Directors of the New York Stock Exchange is scheduled to meet on October 16 to consider our letter. The past pronouncement of that board favored the unfixing of commission rates, albeit subject to certain conditions, and I do not want to lessen the chances for voluntary compliance by saying that we expect to be turned down. In the present atmosphere, however, we won't suffer severe shock should it turn out that way.

If a hearing is necessary, we expect it to begin on or about November 19 and to continue as long as appropriate to permit a full expression of views. This is the proper forum for final debate on the question.

As many of you know, there is also legislation pending in the House, H.R. 5050, that would effect this issue. If H.R. 5050 is adopted in its present form and survives the House-Senate conference, fixed rates will become unlawful on May 1, 1975, unless the Commission takes action to extend them

for 18 months. It is not at the moment certain whether this legislation will be adopted by this Congress. If it is, of course, the operative facts will shift.

Meanwhile, we are trying to keep as well informed as possible on the whole question, as well as on related issues. You are all familiar with what we refer to as the July experience -- when certain firms raised rates on institutional-size orders but others did not, and those who did came back down. We conducted an extensive survey to learn all we could of that experience by informally interviewing and collecting information from selected brokers and institutional investors throughout the country.

One of the central questions in the July experience and in contemplating an unfixed world is the behavior of institutional traders, and especially to what extent, and how, does their fiduciary status govern their allocation of brokerage business and the relationships of portfolio managers and brokers concerning charges for a variety of brokerage services. There is great debate and confusion on these questions, as you know. Several persons on both sides, so to speak, have urged us to assemble representatives of brokers and institutions to discuss the problems and see if some better understanding and even consensus is possible. We have decided to do this, and tomorrow

we will announce the holding of such a session at the Commission on October 29. All of the Commission plus key staff members will be there, and we should all learn a lot, whether or not agreement proves possible.

I appreciate your inviting me to your grand dinner. I am sorry to have to get back to Washington tomorrow, but in Lee Pickard and Shelly Rappaport you have the right people from the Commission to talk about more technical problems Tuesday, and you are also fortunate to have such a distinguished panel of industry leaders for tomorrow's discussion, in Henning Hilliard, Jim Davant, Bob Driscoll, and Sandy Yearley, Chairman of our Advisory Committee on the Implementation of the Central Market System. Sandy is doing a magnificent job in rather trying circumstances. We are most grateful to him, and when the dust settles from all of this, Sandy will be recognized as one of the great statesmen of the securities industry.

I want to close on an optimistic note. The summit convinced me that we have much toil and sweat and sacrifice before us, but this country and our economy are by no means licked. I predict that next year's annual meeting will be a happier occasion.