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THE FUTURE OF THE SECURITIES INDUSTRY

An Address by

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It is an honor to have been invited to give the first Gustave L. Levy Memorial Lecture. The invitation carried special significance for me since Gus was a close personal friend for 20 years. Thus, the opportunity to join in honoring him today, and in being honored by continued association with his name, is one I could not let pass by.

Gus Levy was many things -- he was a former Chairman of the New York Stock Exchange, he was a leader in so many civic and charitable organizations, and, indeed, it is rumored that he played a role in the in the success of Goldman, Sachs. He had an incredible capacity for doing and for giving. We served together on the board of Norton Simon and its predeccesor companies for 15 years during which he missed only two monthly meetings -- once to accept an honorary degree at Tulane University and once because of a trip to Europe. And when I became Dean of the Graduate School of Management at UCLA, Gus accepted my invitation to serve on the Board of Visitors -- another task to which he characteristically contributed generously both his time and his support. I miss him as a friend and colleague. I miss his wisdom and compassion.

The subject of my talk today, the future of the securities industry, is a topic on which Gus spent many hours -- including some during which he and I debated the issues in less than total agreement. As most of you know, Gus was the Chairman of the Securities Industry Association's National Market System Committee. That Committee was formed in January 1976, in order to formulate a plan for the development of a national market system during a period when it was rapidly becoming clear that the future of the securities industry would represent a sharp break with its past: On May 1, 1975, 200 years of fixed rates of commission had come to an end. Congress had, during the summer of 1975, passed the Securities Acts Amendments of 1975 which gave the Commission broad regulatory authority to facilitate, and if necessary mandate, the implementation of a national market system. During the Fall of 1975, the Commission had held hearings regarding off-board trading rules. In December of that year, the Commission had announced the adoption of Rule 19c-1 permitting execution of agency transactions with third market makers and block positioners and deferred action on the most troublesome question presented at the hearings -- whether exchange members should be permitted to make markets upstairs.

It was in this environment that Gus's National Market System Committee did its work. In June 1976, the Committee issued its report to the SIA, and, in his transmittal letter, Gus noted that the task "seemed awesome both in its significance and complexity." After nine months at the Commission, much of which I have spent considering how best to facilitate the establishment of a national market system, I can well appreciate that characterization. Nevertheless, despite the complexity of the task, the Committee offered several far-reaching proposals, including open access to every exchange, multiple competing specialists, and a pilot program to test the feasibility of a "consolidated limit order book."

Unfortunately, however, the proposals suggested by Gus's Committee were not implemented. Had they received the consideration they merited, it might have made all of our tasks a bit easier, the industry's future a bit clearer, and this talk both a bit shorter and considerably more laudatory. As I noted in my recent speech to the SIA in Boca Raton, however, the Commission cannot today -- almost 3 years after passage of the '75 Act Amendments and almost 2 years after the issuance of Gus's report -- draw satisfaction from the current rate of progress toward national market goals. And, in large measure because industry progress toward that system has been slowed and hampered by the inability of the self-regulatory organizations and the discrete segments of the securities industry to settle on a common course of action, the shape of the industry's future remains much more shrouded than many anticipated in 1975.

For that reason, I may disappoint those who expected from the title of this talk a definitive picture of the industry's future. Although Congress directed the Commission to facilitate creation of a national market system, it was, I believe, most everyone's desire that as much as possible of the responsibility and opportunity for developing and implementing that structure rest, in the first instance, with the industry and its self-regulatory organizations. I would, however, like to offer some insights into the Commission's role in the development of the national market system and particularly to describe the program directed toward that goal which the Commission announced last Thursday afternoon. While the Commission's policy statement may not itself define the future of the securities industry, it does, I believe, identify tools with which the industry can and must build the national market system part of that future.

The Role of the Securities Industry

In examining the industry's future, it is key that we bear in mind the role which the securities industry and those who comprise it play in our overall social fabric. The securities markets serve as the vehicle through which capital is channeled from private hands into what are, ultimately, national priorities -- the creation of jobs, the provision of equipment and facilities necessary to produce the goods and services which define our standard of living, and the assurance of economic security for our citizens. In that sense, the securities markets are at the heart of our society; those markets are the stimulus and the source of life blood for the most successful economic system in the history of the world. We cannot afford to let the public lose confidence in the fairness and integrity of our capital markets or of the corporations and businesses which those markets have financed and which they sustain. Our markets must continue to be -- and must continue to be perceived as -- the fairest, the most open, and the most liquid -- in short, the best -- in the world. At bottom, those objectives are the only goal of the restructuring in which we are now involved.

Liquidity is a product of money and confidence in the markets. Unfortunately, however, public confidence in our markets has been shaken. Questions have been raised, for example, about the integrity of corporate earnings, about whether American business is run in the best interests of its shareholders and the larger society of which it is a part, about whether our equity markets are an attractive and fair place for the individual investor to place his after-tax investment dollars, and about the inability of small businesses to gain vital access to capital markets. The challenge then, which we face together during my five year term as Chairman, is how we contribute to enhancing the integrity of the capital formation process and of the private enterprise system generally.

The Challenges Facing the Securities Industry

The challenges facing the securities industry today stem in part from the abolition of fixed commission rates on May 1, 1975, and will extend through the creation of the Congressionally-mandated national market system. As