(ADVANCE FOR 1:00 P.M., EDT, MONDAY, MAY 19, 1969)

REMARKS BY ROBERT W. HAACK, PRESIDENT
NEW YORK STOCK EXCHANGE
AT A LUNCHEON OF
THE ECONOMIC CLUB OF DETROIT
MONDAY, MAY 19, 1969

"AN AGENDA FOR THE SECURITIES INDUSTRY"

The Stock Exchange, for which I have the honor of speaking, is one of the nation's oldest institutions, founded in 1792 -- just 91 years after your city of Detroit.

To speak of the Exchange as an institution, which it certainly is, identifies it with some of the strongest and most significant cross-currents of our time. These are not easy times for institutions, be they educational, political, economic or financial.

A number of Americans today are questioning some of their oldest and most respected and accepted institutions. I am not speaking here only of what is happening on college campuses. Obviously, such institutions as Harvard University, Columbia University, the University of Wisconsin, Stanford University and a score of other colleges around the nation are caught in the tides of change. But this attitude of challenge, of testing the mettle of institutions formerly taken for granted, extends also to the structure of our religious institutions, the leadership and goals of our military forces, the appropriateness of material success, the relevance of many aspects of our political system. Much of the questioning comes from the youthful segment of the population -- extending down into the high school and even the junior high school years. But the attitude of testing the value of established institutions is not confined to young people. As Detroit knows full well, consumerism -- certainly an adult manifestation -- is one aspect of the tides of change with which established institutions must deal today. The direction of events seems clear. In order to continue playing useful roles in our national life, our institutions must be responsive to change and challenge, and adapt themselves swiftly and intelligently to the new expectations of the general public.

The New York Stock Exchange is not immune to the forces of change. Though we have been in business 177 years this week, we are deeply affected by new tides in the business and financial world. For the future we face a totally new set of conditions that will require changes in many time-honored business methods.

Throughout its existence, the New York Stock Exchange has occupied a pre-eminent position in the securities industry. If you want to buy stocks in the nation's leading corporations you almost invariably think of the New York Stock Exchange.

Past performance, however, does not mean that we can be complacent about pre-eminence in the future. The fabric of the market is changing, bringing new methods of transacting securities business.

For one thing, the nature of investors and the patterns of investing are very different today from just a few years ago. Today, about a third of listed stocks are in the hands of institutions such as pension funds, mutual funds and insurance companies, along with bank trustees. Furthermore, something like 40 per cent of all volume, and nearly half of the volume transacted by the general public -- as distinguished from brokers themselves -- is accounted for by a few thousand institutional investors.

To be sure, equity securities today are owned by an unprecedented total of 26½ million persons, and about 100 million more people have an indirect interest in the market through institutions that invest a part of their savings on their behalf. Yet institutions -- though their total transactions may be no more than the total for all individuals -- have considerable influence in the market. Furthermore, their needs and expectations are drastically changing the environment in which we conduct our business.

Those engaged in the securities business cannot take for granted the comfortable assumption that leadership in the field will continue to rest with firms and brokers that are members of the New York Stock Exchange.

Let me mention some of the new tides that require new methods and policies in the securities business.

First, the fact that the stock market has been forced to cut 90 minutes from its trading day in order to serve investors efficiently, is a constant reminder that we must develop new technology to handle the business of the future. Many of our operational methods for processing securities transactions are demonstrably inadequate for the needs of today and the anticipated requirements of tomorrow.

Second, a basic tenet of our business -- its minimum commission structure -- has been challenged by the Department of Justice.

Third, our membership now faces more competition from other ways of transacting the public's investment business than ever before in the history of our business.

Let me say a work of explanation on these three basic points. First, the matter of technology.

Technology

Our industry prides itself on the liquidity of the central auction market. Everyone is familiar with the fact that if a doctor in Detroit phones his broker in Detroit to buy or sell 100 shares of General Motors, the order is flashed to the trading floor in New York, probably executed in a few minutes, and the order can be verbally confirmed back to the customer a few minutes later. It still works that way and, as a matter of fact, the executions -- what with such innovations as direct order-switching -- are speedier than ever. Where we have not been as efficient in the past year or so, however, is in the paperwork that follows the transaction -- clearing and settling for the stock, transferring and delivering the shares, the dozens of clerical operations that have to go on in a member firm office to complete the details on a transaction.

The securities industry has been geared to handle comfortably, volume of about 10 million shares a day on the New York Stock Exchange and -- with special effort -- peak periods of another million or two. Last year, however, we averaged nearly 13 million shares a day -- and there were five days when volume surpassed 20 million shares. The average for the first four months this year has been over 11 million shares daily. When we handle that much volume on the New York Exchange, combined volume of all stocks bought and sold by our member firms -- including volume on the American Exchange, regional exchanges and the over-the-counter market also -- probably comes to well over 30 million shares a day.

The public's demands for brokerage services can be expected to grow at impressive rates. Our economist's projections -- just of New York Stock Exchange stock -- anticipate average daily volume of 17 million shares a day in 1975 and 27 million by 1980 -- assuming normal turnover rates. If turnover continues at last year's levels, the corresponding volume figures would be 23 million by 1975 and 36 million by 1980. You can estimate how large the total moving through brokerage offices will be when Amex and OTC shares are added.

Last year's technology will not be adequate to handle anticipated volume of such proportions -- double or even triple current levels. The entire work-flow for our industry may need to be redesigned. With our own engineers and those of leading consultants and equipment manufacturers, we have been developing new approaches to the mechanics of the marketplace. In cooperation with the American Stock Exchange, we have called in the Rand Corporation, the "think-tank" that has done such brilliant systems planning work for the U.S. Air Force and other major agencies. To put it plainly, the technology for the securities business must keep pace,even if this means redesigning aspects of it from the elimination of the stock certificate to improvement in the traditional trading floor. In a word, our effort must be to replace paperwork wherever possible by electronic impulses, while still retaining the irreplaceable personal dialogue between participants in the market.

Anti-Trust Immunity

Turning to the question of immunity from the anti-trust laws, this is a problem that goes to the very root of how Stock Exchange member firms charge for their services. Virtually since the start of the Exchange, the rates charged by its members have been based on the concept of a minimum commission. The minimum commission has served well both for the healthy growth of the securities business and to provide a widespread variety of brokerage services to the public. Early last year the Anti-Trust Division of the Justice Department questioned this principle in a brief to the SEC, suggesting instead a system of negotiated commissions. The Anti-Trust Division restated its arguments in another brief in the closing days of the Johnson Administration. The Exchange has responded in a major brief last summer, and again in a rebuttal early this month, supported by testimony of independent experts.

In our opinion, negotiated commissions would destroy the liquidity that has made our central marketplace the envy of the Free World. Small investors would be at a disadvantage compared with large ones, and the present nationwide availability of brokerage facilities would no doubt be severely curtailed.

Without question, the proposal for negotiated commission rates is a serious challenge to our industry. In addition to answering the arguments made by the Anti-Trust Division -- which we have done in painstaking detail -- we are considering further revision in the commission structure, so that it is more responsive to the demands of the marketplace and competitive pressures.

Last year we made a good start on this by taking two significant steps -- we introduced a volume discount for large orders and we did away with a practice that was tending to undermine the minimum commission structure -- the customer-directed give-up. Essentially this was a means whereby some large customers derived benefits from part of the commission dollar they paid to brokers.

These were first, interim steps. Other changes may be required to strengthen the minimum commission structure.

Earlier this month the Chairman of the Exchange and I testified in Washington in favor of certain rather sweeping reforms. One would be to give access to qualified brokers who are not members of the New York Stock Exchange by granting them a discount from the public commission. This would make several thousand nonmember brokers eligible for direct access to the central marketplace, when executing orders for public customers. Such a change would greatly broaden the brokerage services available to the average investors, particularly in small towns that lack branch offices of Exchange member firms.

At the same time, we stated that we were reexamining the practice of swapping commission dollars between members of our Exchange and members of regional exchanges. This practice may be regarded as another stratagem for rebating part of the commission dollar to certain large customers who are in position to benefit from it. Like the give-up, this may undermine the concept of minimum commissions.

Probably the Exchange's most far-reaching effort in this area is a study to revise our commission rate structure. With the aid of an outside economic research organization, we are conducting a year-long study of Exchange transactions and costs to gather facts for an appropriate and reasonable schedule of commission rates. We hope to build into it all the advantages of a competitive system without the drawbacks of negotiated rates. The consultants we have retained are working toward commissions that will provide a reasonable, industry-wide average of profitability. This means that if a firm operates its commission business efficiently, its profits would be higher than the norm. If it operates inefficiently, its profits would be below average, or possibly non-existent. Firms would have the incentive to innovate and to operate with maximum efficiency.

In making these changes, time-honored business practices may have to be revised -- but that is the cost of progress. The marketplace we operate is an essential financial facility for investors in this country and around the world. Quite rightly, the public will not tolerate "stand-pat-ism" by the brokerage community. If we do not move with the times, the public will be attracted to competitors with business methods more responsive to current conditions.

The Competitive Climate

And that brings me to the third of the three challenges I have mentioned today -- the new competitive climate.

For many years, competition from other markets and other methods of investing in equities were not a major consideration for the Exchange. Changes in the market have, however, brought about other ways of doing business in stocks listed on our Exchange.

Regional exchanges, with more permissive rules about sharing of commission dollars, have garnered some of the business. So-called third market firms that are not members of any exchange, undercut commissions of the Big Board. They are not subject to our rules of disclosure and business conduct, and provide few ancillary services such as research. Lately, some new techniques for trading listed stocks have been introduced, including electronic methods for matching large orders without going through the Exchange or even through a broker.

The point is that no organization, no matter how pre-eminent, has a franchise on the public's favor. The Exchange grew to leadership because it offered the nation's biggest, most liquid and most efficient market for turning money into stocks and stocks into money, at a low commission cost. To maintain our position, we have to continue to offer the best possible securities market service. This implies a willingness to drop old business practices when they have outlived their usefulness and introduce sound new ideas.

Equality of Regulation

If we are to succeed in this, however, one essential ingredient is encouragement from the government's regulators for the central market. Regulation is a part of our operating environment. We accept wise government regulation, and acknowledge that it has helped increase public confidence in the securities markets.

What disturbs me, however, and disturbs our membership is that lately a dual standard of regulation appears to exist. The safeguards afforded the public investor in the third market are not comparable with those existing on the Exchange. Some of these differences can be summarized as follows:

The Exchange, by its ticker, continuously informs the public of prices and volume. Nothing comparable is available in the third market. The SEC requires only that market makers report transactions to the SEC on a quarterly aggregate basis.

Specialists on the Exchange are extensively regulated, whereas market makers in the third market are subject only to the fraud and anti-manipulative rules of the SEC which relate to all brokers and dealers.

Some activities of market makers are comparable with those of floor traders but without the same rules and surveillance.

Specialists and market makers quote markets in listed securities, but only the specialist is required to deal in a unit of trading at the quoted price.

The Exchange and the SEC have established a price differential for odd-lot transactions. In the third market odd lots may be traded at any price set by the market maker.

SEC regulations prohibit short sales on a "minus tick" on national securities exchanges. There is no comparable prohibition in the third market and it must be presumed that short sales will be possible on a "minus tick," unless regulated, on the new computerized matching systems. This can have a very harmful effect on the primary market and the public customer.

My point in mentioning these examples of unequal treatment is that they tend unfairly to penalize and fragment the primary market. Because we do feel that regulation should be equal, we would recommend that the SEC promptly study areas in which regulation can be standardized.

Competition in marketplaces should be decided on the basis of depth and liquidity and overall performance and not on gimmickry or disparate regulation. To disregard these basic elements of investor protection is not in the public interest.

It is appropriate to raise the question: How can one justify unequal regulatory standards for markets dealing in the same merchandise and serving the same or similar customers?

Conclusion

Given an equitable regulatory climate, our industry I know has the resiliency to meet the three broad challenges I have described -- new technology, anti-trust questioning of our commission structure, and competition from other ways of transacting securities business.

In conclusion, I would like to call your attention to some remarks the other day on the subject of human institutions by John W. Gardner, the former Secretary of Health Education and Welfare, now Chairman of the Urban Coalition. In delivering the annual Godkin Lecture at Harvard, Mr. Gardner observed that human institutions require periodic redesign -- if only because of their tendency to decay. Why shouldn't the American people, he asked, be the first to take into account the aging of institutions and to provide for their continuous renewal?

Mr. Gardner was, of course, addressing himself to a problem that goes well beyond Wall Street. However, speaking for the Exchange, I think there is much merit in the question he has raised. As far as the securities industry is concerned, we see it as our duty to provide for the continuous renewal of its central facility -- the New York Stock Exchange. That is our agenda right now.

Thank you.

(END ADVANCE FOR 1:00 P.M., EDT, MONDAY, MAY 19, 1969)