

EXECUTIVE

January 18, 1972

MEMORANDUM TO: PETER M. FLANIGAN
FROM: RICHARD D. ERB
SUBJECT: Summary of SEC Statement on The Future Structure of
The Securities Market

The report covers the following subjects as summarized below:

I. Central Market System

The SEC favors a single central market system for listed securities (unlisted security markets will be brought together by NASDAQ.) The central market would include the following elements:

- (i) an information system including a central tape and a quotation system
- (ii) competition among specialists, market makers, and block positioners
- (iii) rules which would establish the terms and conditions upon which any broker-dealer can attain access to all exchanges
- (iv) inclusion of third market firms

Action:

1. Commission will monitor industry working committee trying to develop a communications system.
2. Self-regulatory organizations or the Commission should adopt rules to provide for making volume information available at the end of each day.
3. Another working group will be formed to develop rules concerning competition among specialists, third market makers and block positioning.

II. Block Trading

Proposals which need to be evaluated include the following:

- (i) put limitations on ability of institutions to change positions
- (ii) allow public to participate in block premiums or discounts
- (iii) separate retail from block markets

Action:

A working group will be established to study proposals concerning block trading and to recommend rules.

III. Commission Rates

SEC favors competitive rates, but believes that they should be phased in slowly by lowering the breakpoint.

Action:

Lower breakpoint to _____ dollars. (Currently at 500,000.)

IV. Research

The SEC holds the following opinions, some of which are quite vague:

- (i) research must be promptly and fairly disseminated
- (ii) changes in research recommendations must be communicated to customers who bought and may be holding shares on basis of previous recommendations
- (iii) apparently -- SEC believes that research should continue to be paid through commissions or paid directly but that management would have to stand ready to justify its expenditures either way
- (iv) suitability rules and standards imply that research services be made available to the extent necessary to comply with those rules and standards, i.e. every firm which makes recommendations must provide, without direct charge, the background research

Action:

Vigorous enforcement of “standards” of suitability (but report leaves these standards unspecified).

V. Mutual Fund Sales Reciprocity

SEC vigorously denounced reciprocity agreements.

Action:

SEC has directed a letter to the NASD urging the association to direct its members to discontinue the use of reciprocal portfolio brokerage for the sale of mutual funds.

VI. Institutional Membership

SEC believes that all stock exchanges have rules based on the following principles:

- (i) exchange members should be engaged in a bona fide public brokerage business
- (ii) an institution, in its brokerage capacity, should not execute its own transactions and its brokerage business should be confined to non-affiliated persons (non-affiliated persons include discretionary accounts and pension funds but not the investment company-adviser relationship or any other relationship)
- (iii) brokers should be prohibited from handling their own investment transactions
- (iv) reciprocal arrangements should be prohibited

Action:

Commission will formally request the stock exchanges to adopt uniform rules restricting membership to firms which do a public brokerage business.

--“Should work forward a market system” where brokers do not handle own investment accounts

--Rules should be adopted and enforced which prohibit reciprocal arrangements