

March 21, 1973

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TO: Ken ^XDam

FROM: R. D. Erb

SUBJECT: The Securities Industry

The following is a quick overview of the industry covering some of the major firms and individuals and their orientation or bias. Although it is probably an erroneous assumption, I assumed that you are not familiar with the industry. It is also only a thumbnail sketch. I will do more when I return next week.

Specialists

- These firms or individuals make markets, mostly for small and medium size orders. An individual specialist will have a monopoly usually in four or five stocks and will handle only those stocks.
- Bernard "Bunny" Lasker, Robert Stotts, and Walter Frank are key individuals from this group.
- This part of the industry has a vested interest in maintaining the status quo in the New York Stock Exchange and the group which faces the greatest threat from other exchanges and the third market. They want to see the third market eliminated and all orders funneled through the NYSE. They also want the specialist to remain a monopolist in the stocks he deals in.

Block Traders

- These firms make markets for the large institutional investors.

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- Salomon Brothers (SB) and Goldman Sachs (GS) are the two major block trading firms although Merrill Lynch, Paine-Webber, Donaldson-Lufkin and others will also deal in large blocks. Gus Levy, head of GS, is probably the most powerful and influential man on Wall Street.
- Competitive rates on large blocks ^{is} the ^{controversial} issue, particularly for the second line block trading firms which do not have the capital of Salomon or GS. Salomon has favored competitive rates.

Nationwide Retail Houses

- These firms have a network of retail brokerage houses throughout the country.
- Merrill Lynch, Paine-Webber, Bache, Reynolds are some of the key firms.
- Don Regan of Merrill Lynch wants to have competitive commission rates for all trades -- no matter what size. The other three would probably go along but there is strong opposition from the regional, independent brokerage houses scattered throughout the country.

Underwriters

- There are the first level underwriters (AA, AAA) like Morgan Stanley (Morgan Stanley is an old line firm with the best worldwide reputation for underwriting.), Dillon Reed, and First Boston. Salomon is making inroads in this part of the business. There are the second level underwriters (AA and lower) like Kidder Peabody, Lazard Freres, Lehman. These latter firms currently face a lack of business.
- Morgan Stanley depends on its relationships with a network of independent, regional firms for its distribution. Thus, it is concerned about their viability and independence.

Regional Firms

- Usually one office operations which funnel business through the exchanges and take their cut of the fixed commission. Some will perform underwriting services and make markets in the stocks of local businesses.
- These firms are facing cost pressures because they cannot take advantage of economies of scale in handling the computer and paper work.
- They want fixed commissions on small and medium-sized orders.

Research Houses

- Mitchell Hutchins and Baker Weeks are two top firms which specialize primarily in research. Most other firms serving institutional customers provide research as part of the service justifying the fixed commission.
- As commission rates become more competitive at all levels of trading, there will probably be a reduction in the amount of research done on Wall Street. Thus, many firms are trying to decide whether to improve or get rid of their research staffs.

Third Market

- Firms which buy and sell stocks off the floor of the exchanges. They have grown in strength because they under bid the fixed commission rates of the exchanges.
- Weedon & Company is the major third market firm dealing in large blocks of stocks.

The firms listed in most of the categories above engage in all segments of the business in one form or another. Merrill Lynch, for example, is also strong in block trading, underwriting, international investment and the bond and money markets.

The Securities Industry Association (SIA), the industry trade association, is headed by John Whitehead of Goldman Sachs. He is turning out to be a lot weaker than most people expected.

Bob Gardner of Reynolds, and former head of the SIA, is a good source to talk to about the industry.

I have also found Ralph DeNunzio, former NYSE Chairman and now back at Kidder Peabody, a good person to talk to for a relatively balanced view of the industry.