UNITED STATES
SECURITIES & EXCHANGE COMMISSION

In the Matter of:)
)
ROUNDTABLE ON COMMISSION DOLLAR)
AND PAYMENT FOR ORDER FLOW)
PRACTICES)

PAGES: 1 through 151

PLACE: Washington, D.C.

DATE: July 24, 1989

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Monday,
July 24, 1989

Securities and Exchange
Commission
450 Fifth Street, NW
Washington, DC

The above-entitled matter came on for hearing, pursuant to notice, at 9:33 a.m.

BEFORE: DAVID RUDER, Chairman

APPEARANCES:

For the Securities and Exchange Commission:

Chairman Ruder
Commissioner Grundfest
Commissioner Shapiro
Richard Ketchum
Larry Bergmann
Bob Colby
Kathryn McGrath
Kenneth Lehn
Brandon Becker

APPEARANCES (Continued):

Roundtable Participants, Part I, Commission Dollar Practices:

Arthur S. Bahr
Executive Vice President
Equity Investments
General Electric Investment Corporation

Anson Beard
Managing Director
Morgan Stanley and Company, Inc.

W. Gordon Binns, Jr.
Vice President and
Chief Investment Funds Officer
General Motors Corporation

Richard E. Cusic
Senior Vice President
Director of Client Development
Autranet, Inc.

Peter DaPuzzo
Senior Executive Vice President
Director, Retail Equity Trading
Shearson Lehman Hutton, Inc.

Austin George
Vice President
Director of Equity Trading
T. Rowe Price Investment Services, Inc.

Charles Lerner
Director of Enforcement
Pension and Welfare Benefit Administration
U.S. Department of Labor

John B. Manning
First Vice President and Co-General Counsel
Merrill Lynch and Company, Inc.

Barbara Muston
Assistant Director
International Securities Division
Securities and Investment Board

(See next page.)

APPEARANCES (Continued):

Donald C. Potts
President and Chief Executive Officer
Capital Institutional Services, Inc.

William C. Ries
Managing Counsel
Trust and Investment Services
Mellon Bank

Basil J. Schwan
Assistant Executive Officer
Investment Operations
California Public Employees' Retirement System

Holly Stark
Vice President
Dillon Read Capital, Inc.

Roundtable Participants, Part II, Payment for Order Flow Practices:

Anson Beard
Managing Director
Morgan Stanley and Company, Inc.

Peter A. DaPuzzo
Senior Executive Vice President
Director, Retail Equity Trading
Shearson Lehman Hutton, Inc.

William F. Devin
Senior Vice President
Fidelity Brokerage Services, Inc.

Richard Falk
Executive Vice President
Paine Webber, Inc.

Emanuel E. Geduld
President
Herzog, Heine, Geduld, Inc.

APPEARANCES (Continued):

Joseph Hardiman
President
National Association of Securities Dealers, Inc.

Bernard L. Madoff
President
Bernard L. Madoff Investment Securities

John B. Manning
First Vice President and Co-General Counsel
Merrill Lynch and Company, Inc.

Leslie C. Quick, III
Quick and Reilly

Larry Stupski
President
Charles Schwab and Company, Inc.

John J. Watson
President
Security Traders Association

John G. Weithers
Chairman and Chief Executive Officer
Midwest Stock Exchange, Inc.

I N D E X

P A R T I

9:33 a.m.

CHAIRMAN RUDER: Good morning. I am David Ruder, Chairman of the Securities and Exchange Commission. I am pleased to welcome all of you to this commission soft dollar roundtable.

The roundtable has been organized for the purpose of examining several major topics which are vital to the continued good health of the securities industry. The general topic, commission dollar and payment for order flow practices sounds benign. But it masks some real current concerns regarding the securities industry.

The staff gave me some topics which it thought would be discussed today, including the following: the current nature and extent of the use of commission dollars to obtain research products; the effects of these commission dollar arrangements on execution liquidity and research availability; disclosure practices concerning commission dollar practices; commission dollar arrangements employed by pension plan sponsors; the pervasiveness of payment for order flow practices; the economic incentives associated with payment for order flow; and issues raised by payment for order flow arrangements.

After reviewing the briefing materials and the list of questions given to me by the staff, I believe that there are some harder questions which need to be raised which underlie these questions given to me in this way.

My list is these:

(1) Are adequate disclosures of soft dollar practices being made?

(2) Do acceptances of soft dollar payments by fiduciaries raise either best execution or fairness questions?

(3) Are accurate records being kept to distinguish between investment related and non-investment related soft dollar payments?

(4) Are soft dollar practices changing the way in which large trades are executed, restricting the profitability of block trading and thereby reducing market liquidity?

(5) Is there anything inherently wrong with direct payment for order flow by market makers or exchanges?

(6) Should the Commission engage in rule-making or seek legislation in order to change current practices?

We are fortunate to have with us a number of highly qualified representatives from government, the financial industry, and self-regulatory organizations.

The discussions should provide useful information to the Commission regarding the current status of and issues arising from commission soft dollar payment for order flow practices.

At this time, I am going to turn the program and discussion over to Richard Ketchum, the Director of the Commission's Division of Market Regulation. Most of you know Rick personally. I must state my personal admiration for him and the way he handles the Division of Market Regulation, the sophistication of his administration and analysis.

Rick.

MR. KETCHUM: Thank you, very much, Chairman Ruder.

First of all, I want to echo what Chairman Ruder said, that I appreciate very much the time which all of you have set aside to discuss a group of difficult and complex issues.

Our effort today will be to try to increase the information available to the Commission on these issues, as well as to provide a place to discuss in here some of the various arguments over the impacts of the use of current commission dollars in the industry today.

As a first step to that, I think it is important to identify precisely what the environment is in the marketplace today. In doing that, as Gordon Binns reminded us in a statement he made prepared prior to this roundtable, "It is important to be clear as to what we are talking about."

So I guess I would like to start off by attempting to get a feeling of the degree of use of commission dollars today to generate research products.

With that, I would suggest three different terms which commentators might wish to address or distinguish among in talking about that use. The terms are not novel with us; they are generally, I think, used in the industry suggested by the Greenwich survey and others.

The first term is research-oriented trades: the degree and percentage of trades that money managers and pension plan sponsors may choose to direct for reasons predominantly relating to research or other services to those persons.

The second term, third-party brokerage. Again, looking to directed brokerage based, in this case, on research and other services provided from third parties.

Finally, an attempt to -- perhaps a vain attempt -- to distinguish somewhat the term directed brokerage, and whether in some way there is a subset of research-oriented trades which involve a clearer, if not obligation, understanding between the parties as to the intent to direct brokerage or to provide commissions in return for research and other services used.

So if I can, I would like to start, perhaps, and address the first question to persons in a role as money managers, and perhaps ask Austin George to start off on this, and Bill Ries and Holly Stark also, any thoughts you have as to your impressions both with respect to your own firm and firms generally in the industry as to the amount of current commission dollar use, the amount of brokerage that is directed in research-oriented trades, and the amount of your activity or brokerage commission dollars which are directed as the result of third-party agreements.

Austin, would you like to start that?

MR. GEORGE: Yes. I would like to first suggest that the third party may not completely encompass what I would have in mind. For example -- and I will use a specific one -- a bridge is a service that is provided by the same firm -- well, it is actually a subsidiary of the same firm -- as contrasted to a third party. Yet, it is a product only available for soft dollars.

In our case, research orientated trades -- and this is a little bit of a squishy number to come up with a hard and fast figure -- approaches probably 50 percent of our activity. That includes, of course, the major providers of research, the Goldmans and the Morgans and, of course, many a regional firm.

Third-party brokerage -- and I am talking here of percentages of our listed commissions; I am not considering any over-the-counter trading or any underwriters -- third-party brokerage, or if you will, soft dollar brokerage, broadening that title a bit, accounts for maybe about 20 percent of our commission dollars.

Directed brokerage of our client business, which is the smaller portion of our business -- our bigger portion is in the mutual fund area -- our client-directed business amounts to about 15 to 20 percent of our client business, a much smaller percentage of our overall business.

MR. KETCHUM: Before asking whether Bill Ries or Holly Stark would also like to respond to that question, I should have noted one procedural point, just that we will be attempting, as best we can, to transcribe the proceedings today. Because of the number surrounding this table, it would be extremely helpful if as you begin speaking if you could identify yourself by name.

Bill or Holly, would you like to add something?

MR. RIES: I think I have a rather unique constituency in that we have probably eight separate distinct investment management firms and all work independently.

One of those firms is an index firm, engaged primarily in indexing transactions. They do not really pay for research at all, and they have no third-party transactions at all in the index firm. I think the rest of the firms use approximately 50 percent of their trades for research or soft dollars.

Then with respect to outside clients, I would say that approximately half of the clients direct trades either -- or direct us to make trades -- either through third-parties or in directed transactions. But usually that does not amount to much more than perhaps 20 percent of the maximum of the trades.

MS. STARK: My experiences in our firm echo those of Austin's. We kind of group research-oriented trades and directed brokerage trades in the same thing. We really try not to differentiate between the research that we receive from, say, Goldman Sachs, or the research we receive from some Washington analysis organization whose service we might take. That accounts for about 75 percent of our research budget.

Our clients, as with Bill's clients, about half of them ask us to direct commissions. That accounts for about maybe 10 percent of our overall budget.

MR. KETCHUM: In 1986, the Commission issued a release in an attempt to provide some more clarity as to the standard, among other things, of what research is for purposes of the Section 28(e) safe harbor.

At that time, the Commission suggested that it was dissatisfied with the complexity of its earlier test and that it believed that research was most properly interpreted to be for purposes of Section 28(e) anything that provides lawful and appropriate assistance to the money manager in the performance of his investment decision making responsibilities. There have been suggestions that that release, among other developments at the time, resulted in a quantum leap in the amount of directed brokerage and soft dollar business involved in the industry.

I would appreciate it if any of the three of you would indicate whether that is true, whether you saw significant differences after 1986 than as before?

MR. GEORGE: In our own case, we have not significantly availed ourselves of the new interpretation in '86, taking many of the expenses that previously we had paid and now are shifting them to soft dollars.

However, the one area that has come along quite a bit is, a lot of technological products that were not available, even as recently as three years ago, have come along. Most of them are made available soft dollars. There are several of them that we are now taking those soft dollars, but we have not had a significantly in our own firm.

MR. RIES: I would say the same thing. I think from a legal perspective, up until 1986, the lawyers kept getting these questions every time a new service was offered. Questions such as: Is it commercially available? Who is going to mail something to whom? That type of thing.

I think the '86 release has gone a long way for solving some of these technical legal problems that you had to keep looking at every time somebody offered a new service.

But I do not think it really opened the floodgates or anything. It think there have been new services that have been made available. I think it just makes it a little bit easier to provide them.

MS. STARK: My comments would echo Bill's and Austin's. We have taken more services that are of maybe a computer-oriented nature. The big increase that I have seen now is direction by plan sponsors.

MR. KETCHUM: On that question of direction by plan sponsors, certainly that is one of the more noted developments in the last five years.

At the same, 1986, the Labor Department -- led in a large part by, at least one part of it, Chuck Lerner who is with us today -- came out with a release indicating their views on an interpretive basis regarding directed brokerage by plan sponsors, both emphasizing the importance that any research or other services go directly to the benefit of the underlying fiduciaries, but also providing indications that the activity itself did not raise, per se, problems under us or otherwise.

I would appreciate hearing from the plan sponsors here today their view as to developments in directed brokerage, whether some quantification of what percentage of their business that they now provide to money managers is directed, and what that trend has been.

Perhaps, Gordon Binns, you could start off for us.

MR. BINNS: Again, I want to be sure that you are talking about the same thing, so let me answer that in two areas.

First, from the standpoint of what we do as a plan sponsor, we employ, one, a major consulting firm that provides us a lot of different investment related services. We attempt to pay for those services by asking, not directing, but requesting our investment managers to channel part of their commission business to a certain firm that would cover those services. We have requested that they do at least 20 percent of their business in that manner, if they could. We have never attained that 20 percent. So that is the only thing that we do of that nature as a plan sponsor.

Now, what our investment managers are doing we are not wholly sure, but we are concerned that there has been a growth in the practice of the investment managers using commission flow to pay for things, some of which we might feel ought to be paid for out of the fee that paid for those investment managers. I alluded to that or referred to that in my written statement.

MR. KETCHUM: You mentioned, Gordon, that you are not totally sure. Do you find the information provided by money managers as to their --

MR. BINNS: I guess we have to study it more and make some more inquiries, which we do. We do talk to and monitor our managers, but we probably need to do this to a greater degree to be certain of it. But I think that this is a practice that exists, and probably has been growing, and it concerns us.

MR. KETCHUM: Mr. Bahr, I know from your standpoint that General Electric is somewhat unique in the degree to which you manage your own portfolio, but I would appreciate to understand your role in respect to research-related broker.

MR. BAHR: About 95 percent of our assets are run in-house and we have a very limited number of equity managers. We do not direct brokerage through any of them, and I guess I must go along with Gordon that we have not monitored really tightly what the external manager has been doing. We assume that whatever source dollars they use are for the benefit of all the managers for money that they are managing.

MR. KETCHUM: Mr. Schwan.

MR. SCHWAN: We manage about 90 percent of our total portfolio in-house; of the equity portfolio, about 75 percent is managed in-house, 25 percent by external managers.

The external managers, we require that, of the soft dollars, they would generate as a result of the trading on our behalf, that some 25 percent of that be made available for direction by us. We monitor that with monthly reports.

We also, of course, for all of our trading, both internal and external, we get quarterly trade-execution cost reports, so we know what their total cost is as well as ours.

Of the internal, of the total commissions paid, the percent used for soft dollar purposes is approximately, during this fiscal year, a little over 6 percent. That percent of the total has been decreasing. In fact, in 1986-'87, it was 22 percent; '87-'88, 13 percent; and this year, during '88-'89, 6 percent. We do not see that increasing.

MR. KETCHUM: What has been the reasons for the market drop in soft dollar?

MS. SCHWAN: The services we purchase, our research services, in some cases that is a subscription type service. In another case, it is specific development of research software.

But we purchase services according to our needs, and we believe our needs have diminished for the services over time. I would expect that trend to continue.

We do not pay for master custodian or any services like that out of our soft dollar.

MR. KETCHUM: I think it would be helpful to just briefly get the feel from the other side, and that is from the broker-dealer standpoint. What has been the impact or trend seen with respect to directive business and research-related business, generally?

Perhaps, first, it would be helpful to hear from Mr. Cusic and Mr. Potts about what trends they have seen in their business in the last three of four years, and in connection with that, if you could also address what appears to be an extension of activities in this area, moving from the equity markets over to the debt market, and what trends you see with respect to directive brokerage or commissioned business with respect to debt market for your two operations.

MR. CUSIC: I think with the 1986 interpretive memoranda we did not see a market increase in volume having to do with that particular event. Rather, the SEC in its wisdom, in broadening the interpretation, allowed for major technological advances to be made with respect to how research is delivered.

I think that if you take it in a larger context, that is the way we view it. Our overall volume from 1986 has grown along with the advancement in offering technological services. Our research volume is virtually all of the business we do.

With respect to the other part of your question, as to other than equity-related services, we view the entire brokerage relationship as part of the research services we deliver. So in that regard we do provide fixed income trading as a method by which clients can acquire these various types of research services.

MR. KETCHUM: What percentage, a general matter, of that business is your debt assign at this point, and has it changed any?

MR. CUSIC: Well, I think we have seen -- as assets have shifted and as more products have become available for debt managers -- we have seen some growth there on a percentage basis. It is hard to estimate exactly what it is, but over the last few years, there has definitely been growth there.

MR. KETCHUM: Mr. Potts?

MR. POTTS: Actually, the '86 release did not help us at all. We were down in the year 1986. I think probably it was a response to a wait-and-see attitude on the part of the regulators.

As far as our principal or our bond business is concerned, what we would like to be able to do there is compete on a level playing field.

In summary, we did not have a windfall here in 1986. If anything, it was a down year for us.

MR. KETCHUM: What has been your trend since 1986?

MR. POTTS: It is back up, yes; it is back up.

As far as bond transactions are concerned, what we would like to be able to do there is compete, and that is what we do very well.

MR. KETCHUM: It would be helpful, also, to get a brief picture before moving into some of the policy questions from the -- to use a different term -- full-service brokers, both from brokers with a substantial retail orientation, along with investment banker orientation -- including Merrill Lynch, and Shearson, and then from Morgan, and Goldman -- as to the impact to the manner in which they have seen their business developed in the last three or four years.

Obviously, there have been suggestions made that there has been a fairly significant impact from soft dollar business to some extent for the retail firms that has resulted in a change in which those firms operate their business, and in deed, as well for the firms that have been most known for block positioning activity.

If we could, again, to just set the stage, have a brief description of changes in your business, I think that would be helpful.

Perhaps, Peter, you could start off.

MR. DAPUZZO: Well, it is a fact that the soft dollars in our firm has increased considerably since 1986 in a way that others have as well. In other words, we have also increased our research efforts, we have increased our capital commitment to block trading, and we have increased our capabilities in the over-the-counter side.

But, frankly, on the soft dollar side, right presently, it accounts for about 20 percent or more of our enlisted commissions which we receive. There is a department set up to sell the services; there is a department which we have that facilitates the transactions, although the majority of them do go right through the normal trading procedures.

On the over-the-counter side, which was something relatively new, started in '87, it accounts for a little over 10 percent now of our over-the-counter revenues.

As I mentioned before, this is growing along with other efforts which we had. Frankly, our overall institutional efforts x-ing out soft dollar sides has moved us up according to a national survey which has taken place.

So this did not in any way hamper the efforts which we made on the other institutional type of trading or block positioning as well.

MR. KETCHUM: Mr. Manning?

MR. MANNING: I think that in most respects, Merrill's experience has been analogous to what Peter just articulated, which is that since the '86 release, that there has certainly been a proliferation of research products, particularly electronic research, involving the pricing service and analytics and realtime portfolio management which have been provided, and there has clearly been an increase in the percentage of our trading volume which is subject to those kinds of soft dollar arrangements to the neighborhood of approximately 20 to 25 percent of the agency volume.

Our structure is, again, similar in that we have a separate unit set up which is responsible for providing soft dollar services, and I guess the one place where there seems to be a differential is that at this point in time, for a variety of reasons, we have in the Merrill Lynch side -- and I am not speaking at this point for the introducing firms for which we clear, but we have tended to avoid the over-the-counter bit or doing this business in an over-the-counter environment.

MR. KETCHUM: Have you, like Shearson, not found any significant impact on the remainder of your institutional business from the beginning or the expansion of your soft dollar activities at Merrill?

MR. MANNING: Again, I do not think that we have seen a significant impact on the remaining institutions

MR. KETCHUM: If there has been a focal point about the discussions over restructuring of the institutional trading business, it has probably been with respect to some of the better known block position investment banking house.

We are fortunate enough to have two of those firms here today. I wonder if they could perhaps briefly address what they believe has been the impact of the soft dollar business on their activities, and perhaps, Mr. Beard, you could start off and then Mr. Silfen.

MR. BEARD: I guess our position would be quite different. We think there has been a substantial impact, and in trying to quantify that I would refer everybody to the second page of the handout we have here. There is chart that will show you what has happened to listed volume. That is on all exchanges of 1987 until the present year.

You can see that total volume -- and this is adjusted for anything such as deal trading or dividend rolls -- reported volume on all exchanges was down probably 15 percent, '88 versus '87, and rebounded. So it is currently running at levels in 1989 off 10 percent for 1987.

The second line on that page, second chart, the orange line, would give you a proxy for full service and research firms -- there is an association called McLagan -- but not all full service firms put in their commission data, but there is a list of the high-40 number of firms they put in their commission data, and we participate in that.

You can see that that sector of firms -- and would include most full-service firms and block trading firms -- the volume would be off approximately three times the exchange volume and has not bounced back as rapidly in 1989 as the total volume.

MR. KETCHUM: Mr. Silfen?

MR. SILFEN: We are not in the equity soft dollar business and to date we have not changed our philosophy of doing listed business, which is customer-oriented full service, although there has been a great temptation to do so. The environment that exists now for our business has clearly had negative implications to our profitability. We are not making money in the secondary trading of stocks. Part of the problem is that as an acknowledged leader in this business, we continue to unfortunately receive the tough calls, but a lot of the so-called easy order business seems to have been directed to these soft dollar firms.

If I were head of a trading department on the institutional side, I think I would do that as well.

The combination of all of this has led us even some more greater concern. We see clearly less liquidity in the marketplace, as Anson had shown from the chart, and I would point out that the McLagan study does not include three leading block trading firms, Solomon Brothers, Merrill Lynch, and I think our sales, and I think that if that data were included, you would see an even steeper decline in that orange line.

As a firm that is still committing capital, it is clearly tougher for us to do so in the marketplace. We truly question whether the existing commission structure is enough to pay for customer-oriented value-added operation that brings trading, capital commitment, distribution, and research.

There has been a temptation within our firm to divert some of our resources. We have not done so to day. If we were short-term oriented and purely operating off of the economic data, we would have done so, as a number of other firms who had been in this business in the mid-'80s have either exited the customer service capital commitment business, or at the very least limited the numbers of clients that they are providing those services to.

MR. KETCHUM: Before turning to the specific policy issues that -- the questions that may be involved in this roundtable, I think it would be helpful to return to a point that Mr. Cusic made and perhaps flush it out just briefly.

That was, Mr. Cusic, you indicated that the primary impact of the Commission's interpretive positions in 1986 was to free-up the type of research services that might be provided, and that the result has been, as well as developments in automation, has been due to much more of the services you provided relating to automated systems, both, I assume, hardware and software.

I think it would be helpful if you as well as perhaps representative from the money management side and the pension plan sponsor side could take one minute to describe in a little bit more detail that change and the type of services that you generally see being favored by the institutional community.

MR. CUSIC: What I was referring to is the ability for various types of investment technologies to be provided through an electronic delivery system. It may include a combination of hardware and software that is solely used by the money manager in his investment decision making activities.

I think that we have seen a growth of that. It may not necessarily be related to the 1986 interpretive memoranda, but rather perhaps the needs of the money managers being recognized much more by the independents who provide these services and the ability to deliver them through a common terminal, perhaps, or through some other type of a PC arrangement or hookup to a mainframe computer, an area where I think there has been substantial growth. It has made it a much more efficient way for a money manager to evaluate his portfolio and make some of those decisions.

MR. KETCHUM: Austin or Holly, would you like to give your perspective of changes in the type of services provided?

MR. GEORGE: We have not seen in ourselves a dramatic increase in the number of these services. The primary increase in our case is a dramatic broadening of the utilization of ones previously used which would be a key example, and as part of that, an expanded use of quotation facilities they provide is contrasted with what we required previously.

MR. KETCHUM: If we can, perhaps we can move on to some of the questions relating to executions received in the securities markets today.

As I think all of you are aware, Section 28(e) provides a safe harbor for institutions or persons engaged in providing -- or investment discretion -- from paying up for commissions. It provides no safe harbor or no protection with respect to the obligations under the securities laws for providing best execution.

Over time, there have been arguments made as to both, of the question of whether best execution is provided in all cases relating to orders that have been directed in response to research provided, as well as the question of what obligations for monitoring execution are imposed, both on the money manager and pension plan sponsor side.

I think it might be helpful to start with the representatives from Autranet and CIS to provide a brief explanation of the type of execution services you provided.

Mr. Potts?

MR. POTTS: I am not a trader, but in reading the New York Stock Exchange annual report, I see that 80 percent of all transactions are entered into the Exchange via the DOT system. I would not find anything dissimilar about a DOT order from one broker to another broker.

Additionally, we work orders on the floor as any other broker does. It is similar to any other broker and the execution is quite similar.

Quickly, this conversation is going to get around to a conversation about positioning, and some 5 to 10 percent of transactions are availing themselves of broker capital. The extent that they need that capital and they are willing to pay for that capital, it should be available to them.

We do not do that, would not do that, and one of the primary reasons that we would not do that is that we do not consider it profitable business.

We also have another problem with it, and that is the idea of using John's assets to pay Fred's trades. We are dealing with a two-tiered market here: one that would avail itself of broker capital, and one that does not require or wish to have broker capital.

Now, to the extent that this operation, this system of broker capital and position trading can stand on its own merit and be paid for on its own merit, I have no problem with that. But to the extent we are going to use other trades from unrelated transactions to subsidize that activity, I find a difficulty with that.

So that is an area that we are not going to be involved in. Other than that, I think our execution is similar to any other broker.

MR. KETCHUM: Mr. Cusic?

MR. CUSIC: I think Don has been reading our position paper, because it sounds very similar. I might only add that not only do we agree with what Don just said, but that with respect to our own execution activities, we are extensive users of Autex. We are consistently in the top 20 for the Autex monthly volume.

We work almost all of the orders that we process. We are always natural buyers and sellers, meaning that we do not position, but we believe we are bringing liquidity to the marketplace by doing what we consider to be normal institutional brokerage, trying to do the best possible job, executing for the client, trying to work the order in an intelligent way, trying to make sure we always serve the best interests of the client.

About 95 percent of our equity order flow is a working order basis. We have our own floor brokers, and they are very active in trying to always seek the best price for the client.

We are extremely committed to the quality of execution. This has been one of the hallmarks of Autranet since its founding and it continues to be so.

MR. KETCHUM: You mentioned your extensive use of Autex. If I understand your statement, do you generally provide an indication of the full size of your order when you advertise in Autex, or simply advertising an interest in security?

MR. CUSIC: Well, it can vary. Sometimes you can be very specific with respect to what you are looking for, but it is always at the customer's instructions. So normally we will be indicating, either on the buy or sell side, a certain general size of interest.

MR. KETCHUM: Do you have any feel, Dick, as to the degree of times or percentage of times in which you identify the other side through your use of Autex or other calls to the institutional community, as opposed to effect execution through working the order the order down on the floor of the exchange. Is that 95 percent the number of times you actually worked the order rather than found the other side through the use of Autex?

MR. CUSIC: I wish I could give you a more specific answer. It is difficult for me to do that. The fact that we are a volume leader in Autex would suggest, however, that a high percentage of our business comes through block crosses.

MR. KETCHUM: The Commission, in its 1986 release, emphasized what it believed was the existing responsibility of money managers to monitor the quality of execution they received, both in connection with soft dollar directed business and as well, as we would expect, other business which they chose to direct to various brokers.

I think it would be helpful for the Commission if there could be a description of the type of monitoring tools that money managers generally are using today to evaluate the executions you receive.

Mr. Ries?

MR. RIES: As you know, monitoring execution is very difficult. It is very difficult to prove with any stage of conclusiveness that someone either did or did not get best execution in a given transaction.

Now, the traders tell me that you can tell by looking at the market and you can see what is going on, as the trades are going on you can see how one broker does against another broker.

But it is a very difficult item to monitor, and I think that is the heart of the problem. You just cannot prove it conclusively one way or the other.

MR. GEORGE: We have participated for over a decade in the Beebower SEI analysis. We use it to get an overall feel of the quality of our trading, vis-a-vis our peers. We have not made significant use of it in the analysis of the competence of individual brokers.

There are several reasons for that; probably the most important is it depends on how we employ them. I would suggest to David that more often than not, when I do call Goldmans when I need some help because I have someone with a certain amount of anxiety, and anxiety tends to mean a certain amount of price, he tends to get those trades, and depending on -- in a short-term sense, they can often look very expensive, so Goldman would look very ineffective. The reality is they were very effective in accomplishing something we wanted to do at that point in time for our own reasons, so that we have found in reality that it is hard to measure in a numeric sense the brokers because you really have to look at how they are employed.

We as traders do it all day long. It is part of our job. I think all traders have strong opinions; they are not always obvious.

I think one word, though, I would like to put on the record is "faulty execution." I do not really know what the best execution is. I know when I try to do my best -- but really it is in the eye of the beholder in what we are trying to accomplish, and it is a matter of hiring quality people, getting the quality job done.

In conclusion, we have found they were helpful to us, we make limited use of it, we do not use it to individually analyze it. The reality is they were very effective in accomplishing something we wanted to do at that point in time for our own reasons, so that we have found in reality that it is hard to measure in a numeric sense the brokers because you really have to look at how they are employed.

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MS. MCGRATH: I would like to ask if you believe that you have evidence to support your conclusions that the use of soft dollars is a cheaper or a more efficient way to pay for the services that you are getting, or does it result in better investment advice, better execution, or lower cost to your clients?

MS. STARK: I am not sure that it is cheaper or better for our clients, the third-party services we take. It is just another form of research that we want to use that we think is going to benefit all of our clients.

If we differentiate between the services that we purchase for a specific client, using that client's soft dollars, then I would say it is not nearly as good.

MR. GEORGE: The comment I think I would introduce is that I would describe much of the third-party services as focused research. It is highly focused; it is more laser-beamed. It is offered to us in a specific way for a specific purpose, whereas a full-service firm has a whole arsenal of things that they might be trying to interest us in, and we have that decision of, do we want this particular individual service or not.

I personally have no sense of whether it is more efficiently delivered that way or not. It is the difference in the way the products have been packaged over the years.

MS. MCGRATH: What you are saying is, this is the only way you can get that particular service?

MR. GEORGE: There are quite a few of these services that, as I said, use the word "focused." An individual or a group of individuals do a very special thing, and to date we have found that those are the people that can provide it. Yes, it is often the only way --

MS. MCGRATH: They will not give it to you for check, hard cash?

MR. GEORGE: Some will, some will not. I could not give you a breakdown. Some will definitely provide it for cash, if you are willing to pay for it; some will only provide it based on commission.

COMMISSIONER GRUNDFEST: If I may ask a follow-up question, why soft dollars? Why not hard dollars?

Hard dollars appear to be pretty good every where