Statement By

DONALD E. WEEDEN
Chairman of the Board
WEEDEN & CO.

before the

SECURITIES AND EXCHANGE COMMISSION
Hearings on Securities Market Structure

October 19, 1971

WEEDEN & CO.
INCORPORATED

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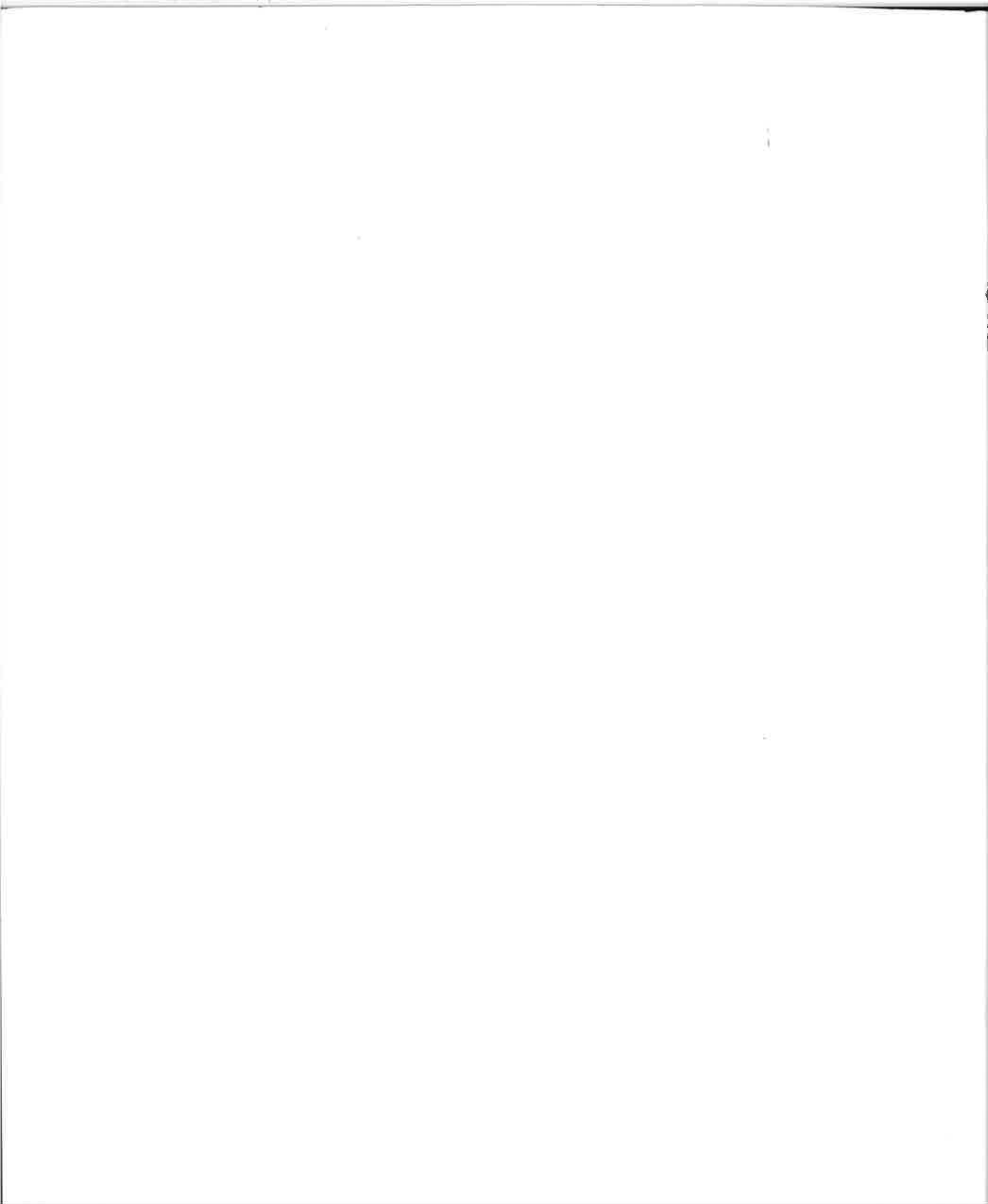

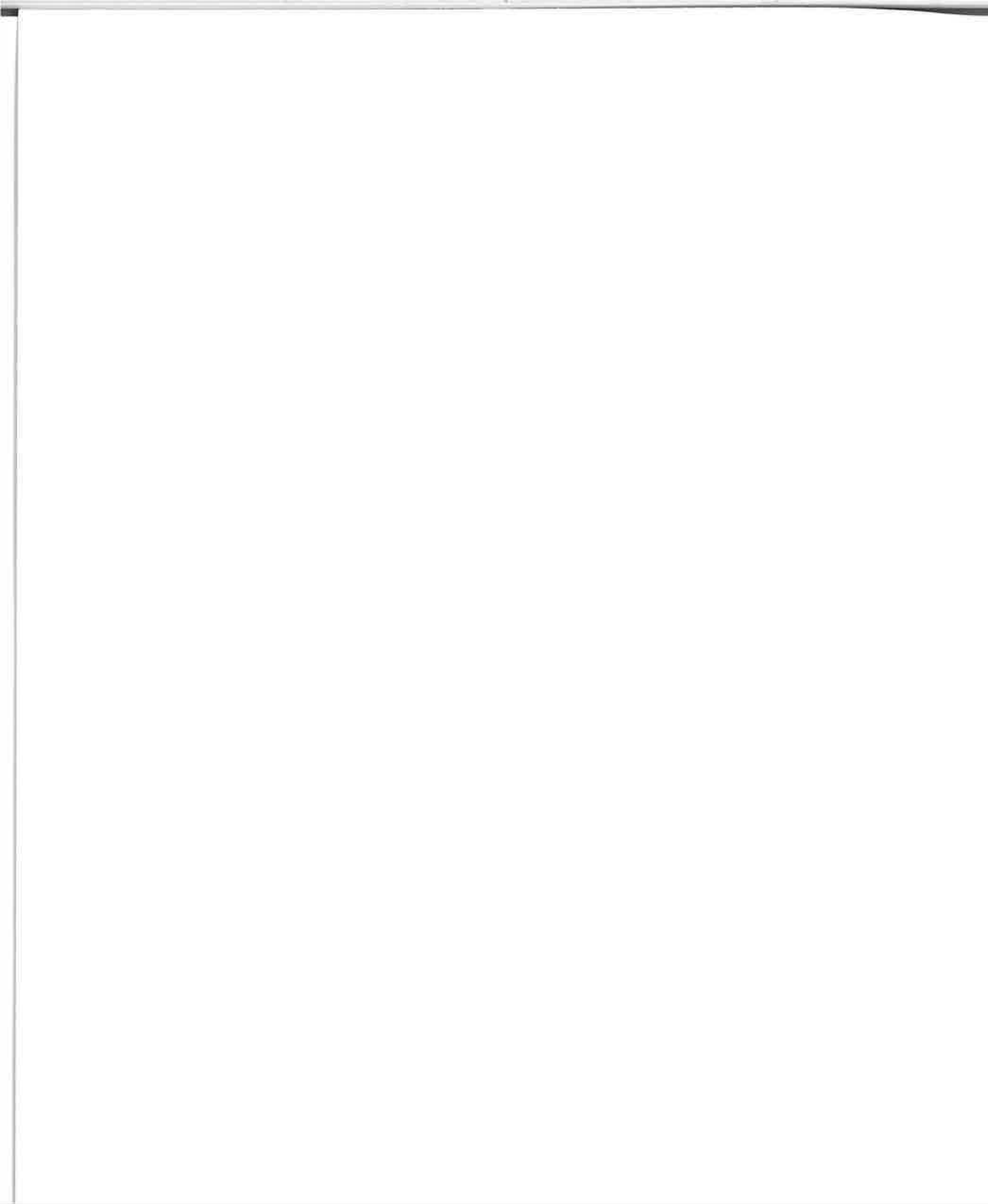

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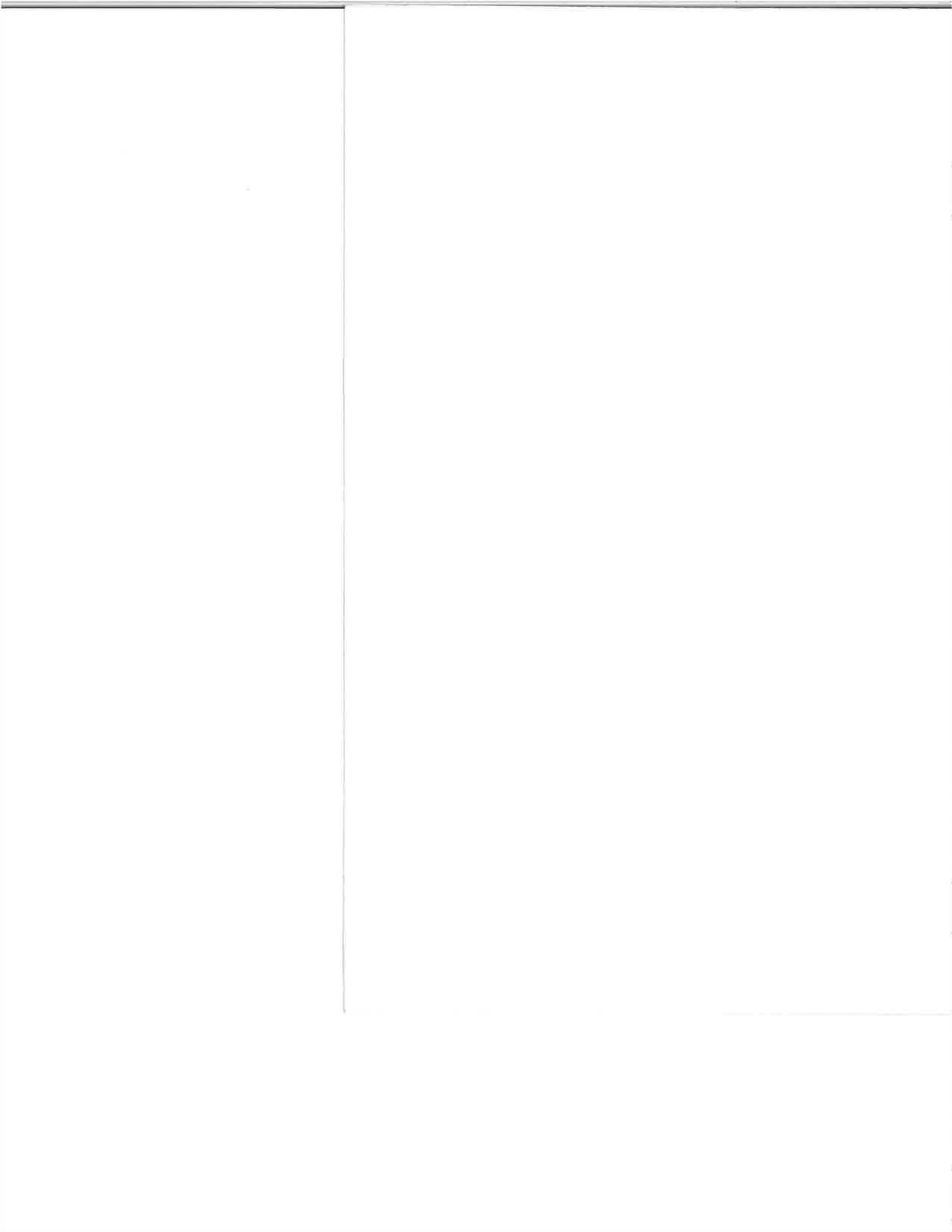

I am Donald Weeden, Chairman of Weeden & Co. With me is my brother Alan, who is President, and my brother, Jack, who is Executive Vice President and Treasurer. Together we form the Executive Committee which is responsible for the day-to-day management of the Company. In the interest of time, rather than describing our firm and our business as we did at the Commission Rate Hearings in 1968, we have submitted for the record our testimony at those hearings along with the prospectus connected with our public offering earlier this year.

One of the purposes of these hearings is to get at the facts on how the securities markets relate to one another so the Commission can determine how best it can make its influence felt in shaping a better central market. As one of the largest markets for listed securities, we are pleased to participate in these hearings and hope that our statement and our answers to your questions will help you in determining what constructive role the Commission can play.

For the first time in years many of us in the industry feel that real progress is being made. There are several reasons for our optimism. First, there is movement on all sides, indicating that people are willing to reconsider their old fixed positions. Mr. Martin's testimony of last week is a good indication of this. Second, competition has been recognized from all corners as a good thing, not only for the public but also for the industry. Third, the Commission seems disposed to make progress where it can, rather than simply speculating about perfect models that will never come to be. We've come a long way.

For our part, we have spoken out in the past on many of the issues before us today, either in articles, letters to the Commission or speeches. We have already submitted this material for your examination.

The first, a letter to the Commission in 1969, exposed the present fiction of an auction market, pointing out that once the institutions make their presence felt in any securities market, it

inevitably becomes more of a negotiated market, requiring well-financed dealers willing to position substantial blocks. The lack of such dealer positioning capital was apparent during 1969 and 1970. This need is still a vital one.

We also pointed out the fact that institutions want direct access to the market maker, as witness the growth of the Third Market, and that they also wish to minimize unnecessary commissions.

The second, our response to Commission Release No. 8791, attacked the New York Stock Exchange's Rule 394 as a violation of the antitrust laws, an unreasonable restraint on stock exchange members, and by no means necessary to make the securities laws work. We explained that Rule 394 is simply an unwarranted boycott of a competitive market which at the same time interferes with a broker's fiduciary obligation to seek the best price for his customer. Unfortunately, after 13 years, Rule 394 is still on the books of the New York Stock Exchange and serves, in the words of the Commission's transmittal letter to the Institutional Investor Study, as a barrier to competition.

Thirdly, during 1970, the New York Stock Exchange began a campaign allegedly in favor of the central market. As we examined its version of the central market, however, we came to realize that what the Exchange had in mind was a single, monopolistic market—really the functional equivalent of what was originally proposed in the Martin Report. We described that distortion in a speech given here in Washington, pointing out there is a world of difference between a central market of competing market makers and a vast, nationwide monopoly in the control of a handful of floor members in New York City. We titled this speech, "The Central Market vs. The Single Market."

During this time the industry went through the wringer. People were hurt, firms went under, some of the old stalwarts of free enterprise began to waver.

Winners, it seems, like competition. Losers don't. That applies to all businessmen, not just stockbrokers. By the spring of 1971, we sensed that some brokers were still so shaken they were ready to accept complete regulation in exchange for complete monopoly. Their theory was to stop fighting the regulator, embrace the Commission and get the Government to secure their future. That dangerous idea caused us to speak out in Minneapolis on, "Keeping the Power Spread Around." The burden of our argument was and is that this is too big a country to have one railroad, one airline, one automobile manufacturer, let alone one stock exchange. This country has prospered because, among other things, we have avoided unnecessary centralization of power. Now is not the time to turn our backs on that wisdom.

Then in the late spring and summer, the debate subsided. We joined the rest of the industry in waiting quietly to see what the Martin Report would contain. In early August the Report was released and public opinion began coming in.

We responded with a speech in Vancouver entitled, "Competition: Key to Market Structure," in which we analyzed as best we could the shortcomings of the Martin Report, criticizing the lack of factual support and the misplaced faith in monopoly rather than competition. The Martin Report is good when it deals with reforms needed within the New York Stock Exchange. It fails, however, to understand how competing markets presently work.

If there is any purpose to our being here, it's because we are market makers. And if anyone understands market structure, it is those people who are in the pit, banging heads and competing every day. The New York Stock Exchange says we fragment its market, thereby implying that we are doing something wrong. To the contrary, we keep the New York Exchange specialist on his toes. In the process, we offer the investor additional depth and liquidity. So much for the past.

Where do we go from here? We believe that the evolution of the equities market is proceeding along fairly well-defined channels and will give us a market place that fully interfaces a negotiated institutional market with a public auction market in a manner that is fair to each and immensely more efficient than at present.

We are much further along this path than most people realize. In fact, a central market is practically what we have today. Believe me, no one comes into Weeden without clear, current information on the last sale on the New York Stock Exchange. They tell us the current bid and ask on the New York Exchange and then ask us whether we are prepared to compete and in what size.

Even more interesting than having the New York Stock Exchange last sale and bid and ask quotes pushed at us, is that the New York brokers are now beginning to tell the specialists that they have to meet our quotes or the business will go elsewhere. A curious fact is that on those few listed stocks allowed on NASDAQ, the specialist is now able to see our quotes directly, while we are still denied his quotes.

The point is that the ingenuity of the professional investor has already fashioned the equivalent of a centralized market in the institutional area.

Innovation and competitive spirit are finding other ways to centralize our market. Over the years, regional stock exchanges have been moving closer together, making the markets on their respective floors more accessible to one another's members. Some have opened up their membership to many of the smaller broker-dealers and recently, several regional exchanges have brought the Third Market to their floor, and thus effectively interfaced the dealer business with institutions and the small exchange orders up for auction. We believe that this interfacing

has benefited all concerned; the regional broker, his customer, the institution and the exchange on which the trade is made.

The time has come to formalize these centralizing forces through the creation of a common tape. It is clearly the proper business of the Commission to ensure maximum disclosure under the 1933 Act on the issuance of securities in the first instance, and under the 1934 Act on their trading thereafter.

The job of the Commission should be to bring the consolidated tape into being now, so the private or smaller investor has available the same information as the professional. The legislative mandate for disclosure is there. The industry wants it. The means to get it are within easy reach. The time frame should be short. Before the end of 1971, the consolidated tape could be in operation.

It is just that simple. Print all transactions on a common tape and, initially, do not worry about where it took place and whether or not there was a commission charged and, if so, in what amount.

The important thing is to make progress where we can and not to think up problems which keeps us from acting.

The consolidated tape is the most important reform on the table. I would think it distresses the Commission that the New York Stock Exchange task force which is meeting weekly to implement the Martin Report, as one of its first acts, voted against any implementation of the consolidated tape at this time. One can only conclude that until the internal reforms suggested in the Martin Report are accomplished, the New York Stock Exchange will lack the capacity to effect any reform without persistent prodding by the Commission.

From the Commission's regulatory point of view, the effect of taking this first step will be to have a single staff going from market to market, supervising the reporting of transactions,

thereby achieving, as an intended by-product, the equal regulation called for by the New York Stock Exchange, Mr. Martin and others. As experience is gained, the amount of information reported can be increased to include place of execution, if that proves relevant, amount of commission charged, if any, and ultimately, bid and ask quotations, the specialist book, etc.

The thrust of our argument is clear. The consolidated tape is the pragmatic way to move toward a central market. You begin with executed transactions, and when that experience is in hand, you move on to bid and ask quotations. Notwithstanding a few diehards, I assure you the overwhelming consensus in the industry is in favor of a central market of autonomous, competing market makers, and the best way to tie these together is through common reporting and full disclosure.

We believe that the second, pragmatic step the Commission should take is to ensure that brokers can move easily from one market to any other.

In 1941, the Commission took the first step concerning access when it decided that no exchange could forbid its members from dealing on another exchange. Thirty years later, the Commission ought to be prepared to take the next step and insist that no exchange can forbid its members from dealing in any other market. Functionally, there is no difference between a Third Market maker and a specialist on an exchange. There is no public purpose served in preventing a member broker from accepting a better bid made by a registered Third Market dealer and publicly displayed by him on NASDAQ. Frankly, the continued existence of Rule 394 is a disgrace. The time has come to set that boycott aside. Brokers are sufficiently responsible to go where they should to get the best price for their customers. The New York Stock Exchange simply has no legal right to interfere. And the Commission corrupts its mission when it permits the Exchange to maintain this boycott.

This experience with Rule 394 and the movement towards a centralized market we have described should strengthen your conviction that there is merit in keeping diversity in the system. Quite bluntly, the flexibility and innovation being demonstrated by the Third Market and the regional exchanges is permitting the experimentation and reform which the New York Stock Exchange is unable to effect because of its short-sighted desire to maintain monopolistic power. The New York Stock Exchange is a great institution. So is IBM. But my admiration for IBM does not extend so far as to decree as a matter of federal law that only IBM can invent and market the next generation computer. The regional exchanges and the Third Market serve the same competitive function as Honeywell and Control Data. They help fragment monopoly power.

Finally, we come to the question of commission rates. It is our belief that most of the 1934 Act problems with which the Commission has been struggling over the past ten years are directly related to the distortions caused by high fixed commissions. Our own self-interest lies with high fixed rates because they give us larger margins within which to make markets. However, we are concerned that the continued existence of high fixed rates might impede the emergence of a true central market because of the competitive advantage that the Third Market would enjoy. Our objective view is that there is no need for fixed commissions—only a need for a maximum commission on the smaller orders to protect the individual investor. The fact that fixed commissions were an integral part of the original stock exchange is no more persuasive to us than that slavery was a way of life when this country was founded. Both are demonstrably wrong.

The result of fully negotiated rates will be to relieve the pressure for institutional membership. It is our opinion, based on extended conversations with our institutional clients, that precious few have any interest in being brokers. They have profes-

sional traders as capable as anyone on the Street and these traders refuse to be denied access to the market makers or to be charged excessive rates. Charge them reasonable rates, give them access to the market makers, and the demand for institutional membership will be reduced to that handful of institutions like IDS which have a genuine interest in having a subsidiary engaged in brokerage. So phrased, there is no reason why such a subsidiary which otherwise qualifies should not be admitted to any and all exchanges.

So much for our prepared remarks. My brothers and I know something about how markets work, for day in and day out $35 million of the firm's capital is on the line. That experience has a refreshing way of heightening one's perceptions about the real world. We would like to share these perceptions with you and welcome your questions.