Remarks by

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before the

HOUSTON SOCIETY OF FINANCIAL ANALYSTS

The Houston Club • Houston, Texas

December 1, 1971

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INCORPORATED

NEW YORK BOSTON CHICAGO HOUSTON LOS ANGELES PHILADELPHIA SAN FRANCISCO LONDON

During the past four months, we have been through the economic controls of Phase 1 and have been introduced to those of Phase 2. All economists, including those supporting the need for controls at this time, acknowledge that such controls can't be with us for too long without distortions appearing which will threaten the basic structure of our capitalist system.

During these same four months, the attention of our industry has been focused on the fact that our securities markets have not been functioning to the satisfaction of investors. The discussion over what to do about it has been far-ranging and is, for the first time, seriously focusing on the real problems of our present market structure. The consensus arising out of these discussions seems to agree with the SEC's view, as stated in its Transmittal Letter to the Institutional Investor Study, that

> "The evolution of the securities markets has been, and may continue to be affected and distorted by barriers to competition. Among the most significant of these are minimum commission rates and rules that insulate markets, market makers, and broker-dealers from each other."

Just as we all realize that an economic system based on free competition is best for our economy, we now are coming to realize that the same holds true for our marketplaces in securities. When historians look back at this period, I think that they will record it as a time when Wall Street moved decisively toward freer competition just as the rest of the economy was experimenting with massive government controls.

Although I have been critical of the Martin Report, as you are no doubt aware, I am, in a sense, grateful for its having been written. The reason is simple. It has helped define what the fundamental issues are that we must deal with: monopoly or competition; concentrating power on the floor of the NYSE or keeping it spread around this country.

Despite its many shortcomings, the Martin Report sharply accelerated the pace of discussion about market structure. The SEC has just concluded extensive hearings on the subject. In the House, the Moss Committee will be holding hearings later this month and in January on market structure, and on the Senate side, the Williams Committee is also going to take a good hard look at our industry.

In reading the 4,000 pages of testimony presented at the SEC Hearings during these past two months, I am struck by the general willingness of most to speak directly to the real issues. I am impressed with the clarity of viewpoint presented by different brokers, institutions, academics and others. In the process, much of the conventional wisdom of the past has been left behind. Competition, rather than regulation, is clearly desired. A competitive structure, rather than a monopolistic one, has the vote of the vast majority of those who testified. NYSE member firms are increasingly coming to realize that their fate is not tied to that of the Exchange floor — or any floor — that competition in market making is in their best interest and that the foundation of this industry is *not* the minimum commission rate structure.

The Exchange and particularly its specialist members, seem to realize they're in a new ballgame. They are finding it increasingly difficult to prevent and even to argue against competing marketplaces. Even Mr. Martin in his testimony recognized the value of competition. In fact, it now appears that the issue is not one of competition vs. monopoly, but competition vs. "some" competition. My feeling is that it will be difficult, if not impossible, to limit the degree of competition in the days ahead. It's like being a little pregnant.

The Significance of NASDAQ

The challenge to the NYSE's traditional hegemony comes from several sources. One is the Third Market. Another is the block positioner. And another is the re-emergence of the regional exchanges. Finally, there is NASDAQ. While the Third Market, the block positioner, and the regional specialist challenge the NYSE specialist, NASDAQ challenges the very foundations of the NYSE itself. NASDAQ may not be the ultimate answer, but it demonstrates a way that we can bring this industry together and create a true central market system.

At the beginning of this year, the vast over-the-counter market took on a new image — NASDAQ went on line. It is demonstrating that a central market can be created from geographically dispersed markets. At this moment it is only a quotations system. However, it does not require much imagination to perceive those features that could be added to provide the characteristics of an exchange market. One feature is already included. Look at the OTC price page in the Wall Street Journal these days and you will see something new. Volume is being reported every day for stocks on the NASDAQ market — and this is only ten months after the system began.

Regulation and the NASD

Not only is NASDAQ bringing the workings of the OTC market clearly into the public eye, but it is in my opinion clarifying the present and future role of the NASD itself. The simplification of the marketplace will inevitably demonstrate the equal need to simplify the industry's self-regulatory structure. I suggest that the way to do this is through the NASD. It is the organization that represents practically every broker in this industry and is least restrictive as to membership requirements and market access.

The NASD has designed and implemented the most advanced electronic communications system. It has developed the most advanced clearing system — a system that has the greatest potential, of any currently in operation, for solving this industry's operations problems. The NASD has demonstrated its ability to innovate in the name of efficiency and, finally, it has the two criteria needed to bring this industry together — open access and competitive commission rates.

NASDAQ enhances the market surveillance capabilities of the NASD. For the first time the NASD has the capability to conduct surveillance of market activity with the same degree of oversight available on an exchange. In fact it goes much further. Besides being able to collect volume, NASDAQ can record and recall all bids and asks on the system and has the capability of time checking every execution. From this it is possible to recreate the market as of any moment in the past. The NASD can then determine the degree of broker or market maker responsibility for any trade. NASDAQ can thus provide the instant oversight over any market makers' failure to respect their responsibilities. NASDAQ offers the opportunity to carry out regulation on precise and objective facts rather than fuzzy and uncertain information.

Following the Martin Report, the NYSE initiated the establishment of a task force, consisting of representatives of the NYSE, Amex and some of the regional exchanges to examine the question of developing a central securities system. In my opinion, this task force is not set up to effect necessary change, but is viewed by the NYSE more as a means of perpetuating its domination of the industry. It is unfortunate that this task force is attempting to discuss a central securities system without including the NASD in its discussions. The reason is clear. The NASD's NASDAQ system *is the means* of creating that central securities system.

Centralization Through NASDAQ

NASDAQ demonstrates the point that to centralize our markets, we must centralize information about our markets. It is a natural step in this direction to display the quotations of NYSE and regional specialists on NASDAQ in direct competitive exposure with Third Market quotes. This step can be readily implemented. However, we do not have to use that as our first step. To bring our markets together, we can begin with a composite tape. The technical experts agree that a composite tape showing all trades in sequence on a real time basis, on all exchanges and in the Third Market can be implemented in a matter of months. We favor the immediate implementation of such a tape. The NYSE which has long criticized the fact that the Third Market does not report on a tape now says "wait a minute — not so fast." The reason is clear and predictable. The tape in their hands is not so much an instrument of public disclosure for the public interest as it is a private merchandising tool. They have no interest in sharing such a tape and as long as they control it, we will never have the composite tape.

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While the NYSE, in my view, is now attempting to deal more directly with the basic issues they continue to raise problems such as unequal regulation in a manner that is misleading and nonconstructive. As a Third Market firm we are four square for equal regulation. However, the unequal regulation the Exchange speaks of is not public interest regulation, but economic regulation. To the NYSE the efficiency of the others in offering better prices and better service is "unequal" regulation. Elsewhere it's called competition. To "equalize" regulation, the NYSE would force everyone to charge their customers the same fixed commissions. Where is the public interest served by that? The SEC has always had the regulatory power to set equal standards for market makers throughout the system. To the extent they are necessary for the public interest, the entire industry is prepared to cooperate. This issue should not become an excuse for not moving forward as quickly as possible to implement the one change that is agreed by all to be in the public interest — the central reporting of all trades in listed stocks on a common tape.

Fixed Commissions

I think that the indications are sufficiently clear that the days of the fixed commission are numbered. Those who believed they were totally dependent on fixed rates are now realizing that the dire predicted consequences of competitive rates will not occur. More significantly they are also realizing that the *quid pro quo* for continued fixed rates will be eventual governmental control of profits. No one in this industry wants a permanent Phase 2.

Among the ideas that have been questioned is the belief that fixed commissions can be justified to support research. I do not believe that research is going to disappear if so-called soft dollars disappear. A lot of material that passes for research might disappear, but no one is going to miss that.

Good quality research will stay and be well received. If the rules of the game are changed, the research community will be still compensated by their customers either in commission business or in hard dollars. It would not surprise me if some of the research community found that they have been underpricing their useful service by tying it to the execution and clearance process.

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Neither do I believe that the individual investor is leaving the market because of institutional domination. Aside from leaving because he's lost all his money in the past few years of down and chaotic markets, he is probably leaving because nobody wants his business — the simple old fact is that stocks are sold not bought. He is leaving because the broker does not make money selling small amounts of listed securities. This problem is even greater for the non-member broker than it is for the member broker — which brings up a point that has been sadly overlooked. On the one hand, member firms are complaining that the present rates preclude profitability on the smaller trades; on the other hand, everyone thinks that the non-member broker is getting a good deal and should be able to survive in being allowed to keep 40% of the regular commission even though his cost structure is almost precisely the same as that of the member firm. The logic of this escapes me. As I see it, there is no longer any justification for denying complete market access to all legitimate members of our industry. And this, to me, is the significance of NASDAQ. It offers equal access to the market to all members of the industry regardless of their size, location or volume of business.

Fortunately some of the regionals have taken the lead in providing greater access to the market for many small brokers through the availability of commission access and by reducing the cost of membership through the splitting of seats.

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Last March the President of the IBA, Wheelock Whitney, spoke of the future of this industry, particularly the role of NASDAQ in a new central marketplace. Mr. Whitney said, "We can't go home again." I want to endorse that message before you today.

New Era Emerging

This is a new era for the securities business. Things won't change overnight — but, they are changing and will continue to change. The idea that a central marketplace is synonymous with a piece of real estate is dead. Fixed rates are on the way out and with it the sham arguments of unequal regulation. The concept of open access to all markets will continue to grow. And finally, research is not going to disappear.

The central market is almost here for the institutional investor. We must complete the job and make it a reality for the individual investor as well.

We cannot reverse current trends — nor should we. We must think clearly about where we are going and not confuse the myths with the realities. This industry is, I believe, moving toward a sounder basis both in terms of its capital structure and in terms of its markets structure — the results of this can only be for the better.