SELF-REGULATION AND THE EXCHANGES FROM AN HISTORICAL PERSPECTIVE

THURSDAY, APRIL 15, 2004

ALGER “DUKE” CHAPMAN: Thank you. I’m Duke Chapman, moderator of today’s panel, the discussion of Self-Regulation and the Exchanges from an Historical Perspective. I’d like to welcome both the audience gathered here in New York City and the persons listing Online at www.sechistorical.org. The program is being jointly sponsored by the Securities and Exchange Commission Historical Society, the Museum of American Financial History, and the National Council on Economic Education, and has been made possible through the generous afford of Pfizer, Inc. and the McGraw-Hill Companies, Incorporated.

In a few minutes I'll introduce our panelists. I’d like to state that the remarks we make will be solely ours and will not be representative of the institutions. We cannot give investment or legal advice. As we are being broadcast live, I will ask the audience present to turn off cell phones and pagers. Also, later in this program members of the audience will have the opportunity to ask questions of the panel. I will ask those persons asking questions to use the microphone and state their name and institution before their question.

In introducing the panel to you, collectively this group, the group of us, have been involved as the regulated or self-regulators, or in some cases regulators, for collectively over 200 years. I haven’t dared add up exactly how much, but it’s significantly over 200 years. As we look back over the period, the 70 years since the Securities Exchange Act was passed in 1934, this group covers a significant part of that history.

Don Stone, over on the left, came into the business as a member of the New York Stock Exchange in 1950, having spent a few years before that as a bond trader getting his toes wet, getting ready for a long career at the Exchange. Don has been Vice Chairman of the New York Stock Exchange on at least two times, and for a total of ten years service, maybe more.

DON STONE: Eleven.

DUKE CHAPMAN: Eleven. He has been a Senior Floor Official for a great number of years, and we wanted Don to come and bring his perspective of self-regulation and how it has worked at the New York Stock

Exchange for his service of 54 years connected with that institution. Currently he serves as a member of the Executive Board at the Exchange.

Bill Morton is a fellow who spent 16 years as Chairman of the Boston Stock Exchange, and prior to that he came into the business in 1960 with the Discount Corporation of New York, and spent a fair number of years at Dean Witter, some of them on the floor of the New York Stock Exchange.

On my right, Gordon Macklin left Cleveland where he had been with McDonald & Company. I'm not going to tell you when he started in the business. He'll tell you about it. And came to Washington to oversee the implementation or the creation of NASDAQ and spent 12 years as CEO of NASDAQ and the NASD.

And on my right, Bill Brodsky, the youngest member of the panel, he's our junior member. Bill came into the business in 1968 with Model, Roland. Left Model, Roland and went to the American Stock Exchange where he supervised the options program at the American Stock Exchange. Went to the Chicago Mercantile Exchange where he was president and chief operating officer, and he was my successor as Chairman of the Chicago Board Options Exchange in 1997, which he continues to do through this day.

We've seen a lot of change. We remember when -- some of us remember when less than a million shares a day in New York Stock Exchange volume was a good day. Some of us remember when exchanges would open on Saturday, and when 300,000 shares on a half-day Saturday was a pretty exciting day. And we were all in the business at a time when it was not yet computerized and automated, and those were the days when a sophisticated institutional money manager had a very complex matrix that they worked with. It was, "Do I buy, sell, or hold? Stocks, bonds, or cash?" Things have changed a lot and we're going to talk about three questions, share our experiences that we had over those years as they related to self-regulation of the exchanges, what would you wish could have been different now looking back at it that would have made it better, and what would you suggest now are the kind of changes that should be made as we look at the institution of self-regulation in the current environment. And I'm going to ask Bill, would you start out?

BILL BRODSKY: Thank you, Duke. I'm happy to do that, and good afternoon, everybody. There are so many things I'd love to talk about but I've only been given a few minutes, so I thought I'd give a couple of highlights of things that punctuated my career in the area of self-regulation -- which, by the way, is a very broad topic. If you are at an exchange as I've been now for 30 years in three different exchanges, self-regulation takes many roles.

To me, one of the most important parts is the policy-making role that an exchange can participate in, and I want to reflect back on a period that was very difficult for all our markets. I'm happy to see Don Stone here because he and I were colleagues in this effort, and I talk rarely about the period that lead up to the market break of 1987. Some people have called that "the crash" and what happened at that time, and the two things that happened then that have improved greatly since that time is that there wasn't good communication or coordination among the markets. I was president and CEO of the MERC at the time, and I worked very closely at that time with Bob Birnbaum, who was president of the New York Stock Exchange, John Phelan, who was chairman, and Don, who was the vice chairman. We had good communication between those two markets, but there wasn't a lot of good communication with the other markets. It was very hard. You'd have one phone call, but you're not going to have six phone calls.

And in a very brief few words, I'll say to you that the lessons of that period were, number one, that stocks, stock options, stock index futures, stock index options, were very often looked at as separate markets. They were like islands unto themselves, and those who were traders understood that they really weren't islands, that they really worked together. It was not until the Brady Report, which was in the aftermath of that stock crash, that the Brady Report came out and said there's really one market. It's one market and even though it's at different exchanges and different regulators, it is one market.

I think one of the very positive things that came out of that whole experience was the fact that the four major bodies that regulate markets and banks and brokers, the SEC and the CFTC, the Fed and the Treasury, started working together themselves, because until that point there really was no what I'll call regulatory coordination, and a result of that was the Presidential Working Group. And you won't find anything in any statute that establishes the Presidential Working Group, but in fact since 1987, that has existed in Washington with the Chairman of the SEC and the CFTC, and the Secretary of the Treasury, and the Chairman of the Federal Reserve Board, and they do meet on what I would call inter-market coordination. I think it's one of the most valuable things that has developed as a result of the '87 crash.

Another thing that came about was the creation of cross margins. Again, for people who are involved just on the stock side it might not be significant, but those who are involved in stock index futures, stock index options, the ability for the clearinghouses to offset positions from the future side and the security side, it became very, very evident during that '87, that dark night of October 19, 1987, if we didn't have something in place, you could have major systemic problems in the marketplace, and that's of course when the banks got into the act as well.

The other thing that we worked on, and I refer specifically to my working with Don and his colleagues at the New York Stock Exchange, was how to deal with program trading, index arbitrage, and for those who remember far back enough, the big issue of triple witching. I can remember at the time, there was a cartoon in The New York Times, and there aren't too many cartoons in The New York Times, of three witches stirring a pot on the Friday before expiration, because it was a big deal when Expiration Friday approached. And what we did, and again I look across the panel here to Don, is we worked with the New York Stock Exchange as business people, and said, "Let us fix a problem and not let the government do it for us." It was early in the game and it was very sophisticated and took a lot of trust, and it was to change the settlement of stock index futures from the close on that Friday to the opening Friday morning, by giving the New York Stock Exchange specialists the ability to deal with the imbalances, post the imbalances and get equilibrium. These are the types of things that show that the self-motivated business people from a self-regulation point of view can really do a very good job, and particularly knowing that if they don't do it, someone's going to do it and probably without the same knowledge of the markets.

I must take a minute to pause, by the way, because I think I'm the only one up here who has spent any time on the futures side. When I went from the AMEX to Chicago and went to the futures side, people thought I had lost my mind. You know, futures, you know, that's for cowboys. And, of course, the futures business has become integral and very important.

The agencies are very different. The SEC tends to be an agency that's mandate is protection of investors. The CFTC is an agency whose mandate is really anti-manipulation. The SEC tends to be much more of a micromanaging agency. The CFTC is much more laissez faire. But I would say that to try to say one is good and another is bad is unfair. I think that each has done a very good job. A fantastic innovation has occurred in both industries, and I think what happens is you get clashes because, as you see right now in the 9/11 hearings, the differences between the FBI and the CIA. I mean, agencies in the federal government tend to have rivalries and turf that they protect, and unfortunately that isn't good for the business people that get caught in the crossfire sometimes. So I would hope that over time those barriers get broken down. Some of them have gotten broken down, but they still exist, and a lot of it is literally historical and almost genetic, and that's a problem that we all face.

Just to make a couple of other comments, Duke, if you don't mind. If I can go on for a little bit?

DUKE CHAPMAN: A little bit.

BILL BRODSKY: One of the things that we did after the crash is we created a pretty sophisticated hoot-and-holler system among the exchanges. That doesn't seem like a big deal, but when things are very tense, being able to get on the phone and talk to everybody by just pressing one button is a very good thing because it did not happen during the '87 period, and interestingly, that became a very important thing during the 9/11 period. We had, I'd say, at least one, maybe two conference calls a day following the tragedy on September 11th, where we tried to get the markets open. And again, if you talk about how organizations can work together, and here you have the government agencies, you had the exchanges, you had the clearinghouses, I think we had conference calls with 20 different organizations on the phone at the same time. That couldn't have happened easily in 1987, being able to put together a conference call and saying, "We're going to have another call in five hours," and get on the line, and here's the dial-in number, and I would say that the SEC did an outstanding job coordinating those calls.

The last thing I want to mention is governance. Governance has become a very important topic and it is very important to our organizations. I would say that the issues that occurred at the New York Stock Exchange over the last, it's not even 12 months believe it or not, have reverberated to all our organizations. And I think what's very important is that although you can't minimize the significance of what's happened, I don't think that there should be a knee-jerk reaction to them either. I think that things should be thought out, that people who are sincere and professional about it should find good ways to do things and not just react to some particular problem or incident that's happened at a particular organization.

So, Duke, I'll wrap up there and be happy to chime in later.

DUKE CHAPMAN: We'll come back to you. I hope one of you is going to address what I think is one of the key issues in self-regulation, which is the natural tension or maybe unnatural tension that the self-regulators have in the industry with the members -- the members' economic interest. The self-regulators are basically employed by the members, and maybe public ownership will change some of that, and that this natural tension that needs to be managed so that the self-regulators know that they're going to be backed up 100%. And I think as we go on, maybe we could focus a little bit on that issue.

UNIDENTIFIED MAN: Do you want to take questions now?

DUKE CHAPMAN: Sure.

UNIDENTIFIED MAN: I just was curious because I wasn't involved in the tragedy on September 11th. I mean, communications is the hoot-and-holler system? I mean, when I was there it was -- we used to test it every morning but we didn't have a lot of dialogue. I mean, does it really work, you think?

BILL BRODSKY: Well, first of all, that day was a particularly difficult day because people really didn't know what was happening. I mean, it's not like a snowstorm or an earthquake or a power failure. I mean, it was a bad time. And so, I would say that to the extent that we could, we tried to deal with it. The problem is that we were watching it more on CNN than we were knowing what we were doing, and of course, those people in lower Manhattan had a particular problem. But the hoot-and-holler system works in two levels. It works on a daily basis among the operational people that run the markets, and then at the more senior level, it's only in an unusual situation. But the fact is that it's in place and it's tested so that if we needed to do it, it's there, and 9/11 was extraordinary.

DUKE CHAPMAN: Okay. Gordon, you had the chance to help the industry move from the pink sheets to an over-the-counter market that became NASDAQ. Can you share some of that?

GORDON MACKLIN: I'd be happy to. Thank you, Duke. Going back to your question about the balance of the regulators and the regulated, that's been, off and on, a subject of great concentration, and there is of course the appearance of a conflict of interest that's called the rabbit is guarding the lettuce. The answer has been that there has to be a balance, a constructive balance, between the forces of the federal government and the forces of the self-regulators. There are certain things that the self-regulators cannot do and there are some of them that they don't won't do. And Justice Douglas, the great legal mind, developed the answer for that, which was for the government to have a well-oiled shotgun behind the door to reconcile those differences, and when it works, it works great.

My experience from -- incidentally I'm older than Duke gave me credit, but I was enjoying that too much to correct him. I was at the NASD for 17 years, and my experience during that period was that our partnership with the SEC was invaluable. And those government bureaucrats that have people in the industry, like I was before I had gotten into the self-regulatory business, used to curse out, were really the forward-looking seers that steered all of the markets to great, great enhancements. And the mother document for all that was put out in the mid-1960s called the Special Study of Securities Markets. So you need the balance of the self-regulators and the well-oiled shotgun, and you need trust and commitment between the two to making it work.

It's funny. I started in self-regulation in 1970, which seems like a long time ago now, and we were looking at problems that were every bit as urgent to us, if not more so, in our eyes at the time. We didn't know about triple witching hours, except that might be sometime in October, [laughter] but we did know that there were problems. And our problems were, among other things, that the vast over-the-counter market had no central clearance and settlement facility, and that every transaction had to be cleared somehow by hand, dealer to dealer. And if you are old enough, you remember those little guys dragging around from one firm to another delivering certificates and cashing checks and making up excuses why it doesn't work sometimes.

We had a lack of clearance and settlement facilities in the early days of the NASDAQ. NASDAQ came on in '70 and started its early official count in '71. We really had nothing, except an informal, unorganized market policed by a group of volunteers throughout the country, and to make that even worse and absurd, in 1970 we entered four or five years of down markets, lousy, down markets. When we talk about markets today, we wouldn't even think about the times that Duke was mentioning of less than a million shares in a normal day and less than a half-a-million shares on weekends, and we all worked weekends because we needed the money. And of course, it was in the public interest. In any event, those were massive issues for us at the time and self-regulation, with the great help of the SEC, served us very well. So I'm a terrific fan of self-regulation under all conditions provided you have the balance between the government and the self-regulators.

I went to a seminar in Brazil, because they could see what was happening in our markets up here. They liked our regulatory scheme, and that the government sponsored a program for us and we were there for a week, and that our mission was to sell the Brazilians on a program of self-regulation. Then at the end, the Brazilians turned us down. They said, "We get along so well with our government, we'd just as soon let them do it. Not only that, it's cheaper." So they just set it aside.

They reminded me of the time, and it still reminds me, of the format for the savings and loans and the SOC. Now that doesn't work without the balance. They liked the self-regulatory. Well, what among other things we saw down there, that they changed SEC chairmen a half-a-dozen times during the same period that the self-regulators of the States weren't changing at all. That was even before the imbalance in pay between some self-regulators and the government, but it was that self-regulation installed a more permanent sense of continuity. And of course, self-regulation, because it was industry fueled, brought out a lot of the improvements. It brought on the improvements that we needed most, the NASDAQ and the Clearing Corp. Without those, I'd just hate to think what would happen to that part of the market.

We're very much impressed -- I'm very much impressed -- with self-regulation because of the industry experience. You know, it's funny but it is true in my experience that there's no better way to build a closer, more serious friendship than to work together with somebody on something with someone that you like and respect. And people dedicated their time from their desks and their clientele to make the world a better place. Developed a lot of friendships and it was the backbone of the building of our market, and it worked quite well.

So the crash of '87, I nimbly escaped that. I got at the NASD just in time to join Hambrecht and Quist, and instead of having these theoretical losses, I had some real losses. But, you know I prefer the theoretical. [Laughter.] But all things pass and markets do function well, but they do need to have strong oversight.

DUKE CHAPMAN: Thanks, Gordon. I think one of the things we can do as we go along, after each of you have a say-so, is maybe focus a little bit on there have been occasions when the self-regulatory system hasn't worked the way it should and it gets a lot of publicity when it happens, and what are the basic ingredients for making sure that the system works and doesn't founder occasionally the way it has.

Bill, I didn't mean to set you on that particular subject, so we'll come back to it.

BILL MORTON: Well, I wish I could be like our first two speakers and speak totally without acknowledgement of (inaudible) here, so thanks, Duke, and thanks for including me on this very distinguished panel.

I was asking Don Calvin (inaudible) anyone to just go into our background a little bit at the start, so I'll go over mine very briefly. Duke mentioned that I started my career in the U.S. government securities business with Discount Corporation of New York in 1967. I moved to the equity side and joined an institutional brokerage firm as their floor member on the New York Stock Exchange, and for the next 20 years spent time as a floor broker and later as a manager of equities and options floors for two major firms, and then was appointed, as Duke mentioned, as chairman and CEO of the Boston Stock Exchange in 1985 and held that position for 16 years.

Today, I think I was asked to address your questions, Duke, from the perspective of my last stop, which was the Regional Stock Exchange such as Boston. I never cared much, and I think I've probably got a couple of people in the audience that will join me on this, for the term "regional." We were smaller

exchanges, but we were nationally registered with the SEC and we did do truly a national business. We numbered five in my times in Boston, Chicago, Cincinnati, Pacific and Philadelphia. The Pacific has now become ARCA Exchange which is owned and operated by Archipelago ECN, and Cincinnati has recently been named the National Exchange. Names notwithstanding, I think you know the group.

My experiences with self-regulation, let me frame that question by briefly commenting on the structure of the equity markets during my tenure in Boston. The structure was determined by requirements coming out of the amendments to the Exchange Act approved by Congress in 1975. Duke talked about the 34 Act which focused on regulation of the markets; '75 amendments were focused on competition between the markets, mandating the development in the United States of a national market system made up of competing exchanges.

Exchanges, essentially, as you know, perform two functions: the operation and promotion of their marketplaces, and the regulation of that marketplace and its broker-dealer members. The '75 amendments and their subsequent development of ITS in the inter-market trading system opened up a competitive battle among exchanges for member firm order flow. This battle has raged continuously for the last 25 years. Having been involved on the order flow as a large member firm, I kind of consider myself a child of the '75 amendments. I believe in the competition between the markets and joined the Boston Stock Exchange in 1985 to help lead their growth efforts. I think this is important in a discussion of self-regulation because under the new market structure, exchange resources had to be used to address the new competitive environment in the promotional side of the business as well as regulation.

Over the years, critics have questioned whether or not there's an inherent conflict -- Duke raised that question -- between the regulatory and the market roles of exchanges. Several years ago we had a governor at the Boston Stock Exchange who thought that allowing exchanges to regulate the markets and their members is akin to allowing gas stations to set the speed limit on highways. From my experience at Boston I would respectfully disagree with that and by that analogy. It's important, I think, for exchanges to maintain their self-regulatory power over their own markets. To begin with at the regionals, we have a little bit of an advantage, I think, because our self-regulatory responsibility was narrower in scope than at the New York Stock Exchange or at the NASD. We focused largely on trading in our own markets, on rule-making, and on the regulation of our own floor members. The broader oversight of broker-dealers which includes inspections, examinations, in compliance with financial requirements and that sort of thing, was usually delegated by the SEC to the New York Stock Exchange or the NASD.

The fact of more limited regulatory responsibility did not decrease its importance, in order to decrease the possibility of conflicts. Over my years we faced regulatory issues that resulted in disciplinary actions from large fines and member suspensions, to daily assessments of smaller fines and penalties for minor rule violations. Never, to the best of my knowledge, did the exchange ever abuse its self-regulatory power by imposing any competitive policies and rules, nor did it favor certain key floor members or important order flow customers. In a sense, the structure of self-regulation at the exchange helped prevent this, in my opinion. The exchange staff worked closely on rules and regulatory matters with committees of the exchange, and the combination created a very effective give-and-take system. Everyone involved in the process had first-hand experience with the operation of the marketplace and they often represented opposing constituencies and different points of view.

Furthermore, the second layer of regulation which we should talk about also, which is the SEC, Gordon referred to that SEC oversight, provided a great check and balance. SEC inspection teams would make periodic visits and always come up with specific recommendations and corrections and improvements. But like all systems, we know looking back it wasn't perfect. We had glitches, we had situations we missed. In hindsight, what would I have done differently? Question two.

First, I think would have been more aggressive in trying to build exchange resources. Along with just a few others, I never foresaw the tremendous explosion in market levels creating volume and innovative new products that developed in the '90s. I'd like to think the competition provided by the regionals within the national market system contributed to market liquidity and to market quality and helped facilitate the tremendous growth in volume we had, but for the most part, we didn't have the resources to support all our competitive efforts and airtight oversight of every single trade that we execute. Our growth efforts were assisted considerably in Boston by the success of our Beacon trading and ordering routing system, but we were not as quick to apply that technology on the regulatory side. Much of the surveillance during my time had to be conducted manually by random sampling of trades. More resources would have allowed us a larger investment technology which would have led to better and more consistent surveillance.

Although I feel that a combination of responsible self-regulation and SEC oversight has been reasonably effective, obviously it hasn't been quite good enough. The failures in corporate governance and the misconduct of market participants that have come to light over the last three years are a testament to the fact that we need to do better. Going back to the '75 amendments, perhaps our mission and strategic and business plan should have given more emphasis to regulation.

What would I recommend now? Certainly I think it's a given that all registered exchanges must have online capability to deal with every single trade that they process, and I'm told that is happening and has happened, and is in the process of happening at all exchanges. There are other changes and alternatives that have been suggested to improve regulatory effectiveness. Suggestions range from elimination of self-regulation and replacing it with a super-regulator, to breaking down self-regulation into components and delegating responsibility to the different exchanges.

My view is that it's essential to retain self-regulation of the individual exchanges. It's in everyone's interest for exchanges to maintain responsibility for their own marketplaces. They're in the best position to improve their regulatory programs and they should be required to do so, and the commission should continue its role of overall higher level of oversight, but we must do more. I personally think the change that the NASD made in the mid-'90s separating regulatory responsibility from market responsibility was a strong step in the right direction. The New York Stock Exchange has now followed suit by creating two boards, splitting the role of the chairman and the CEO and separating staff accordingly, all of which ensure more economy for regulation. The BSE is moving in the same direction. The pendulum of competition began swinging away with the '75 amendments and swinging back in the direction of regulation. This should ensure that the exchange priorities reflect a better balance between the two areas. For the present I think that's the way we should go. But I just have to make one commercial comment.

DUKE CHAPMAN: I thought that was a commercial.

BILL MORTON: Okay, maybe I'll stop there. [Laughter.] I'll wait. I'll make the commercial later. Go ahead.

DUKE CHAPMAN: Don?

DON STONE: None of us have enough time to talk about what we want to talk about. I've been a longtime member of the New York Stock Exchange and been very proud of it. I used to be the fellow when guests would come to the exchange, I would tell them that I and my peers were the most regulated businessmen in the world. No doctor, no lawyer, no academician, no one, no businessman, no fiduciary had the regulation on them that we all had. Every transaction, as Bill talked about, is real time in a computer. Remarkable. They can reconstruct every bid. I think there are 40 million made daily now that are in the computer and you can figure out who put them there. There's an audit trail on every move we make.

I debated whether or not I wanted to be on this panel in the light of the problems the New York Stock Exchange has had, as we are all aware of, both with the specialist system and the governance system, but I'm a great believer in the New York Stock Exchange, and the fairness of that market center and the aberrations that took place are corrected, and we will go forward and rebuild the credibility that we richly deserve. It's a remarkable institution. I wanted to, and may later, talk about the national market and how it's grown with the SEC pushing, pushing, pushing, to make sure that anyone who had any new application that was considered competitive to take order flow and get more order flow would be justified, and whether it meant the consolidated quote system which we have seen come into place, or ITS, or the removal of Rule 390, or making the tape, which originally was a New York Stock Exchange tape, available so all trades looked the same and didn't have a Cincinnati or an "M" or a "B" on it, those have changed. Rates became competitive. Listed companies can leave the exchange without any order, they can change their specialists without any order. All of that is good. The time and place priority that specialists have had, or presumed to have had over the years, the book is totally available to anyone who wants to see it, and I will talk later about where we're going or what's happening.

But what I want to talk about, if I may, is self-regulation. I didn't think I belonged on this panel, but when thinking about it, I have been a self-regulator. I was a floor official for many, many years, a floor governor for many years, and then on a different role as a director and vice chairman of the exchange for many years. As of today, and even then, there are 190 floor officials -- that's a lot of floor officials -- and they are all over the floor trying to help or to make sure that regulation is taking place in very difficult openings, stocks that break out, making sure that things are done properly. There are 20 governors, half of them specialist governors, half of them brokers who leave their place of business and go, as the floor officials do, to help when something happens. If there is friction between brokers, "I bought, I sold," immediately on the floor the buyer picks a governor, the seller picks a governor, a director picks a chairman of that committee, they go off the floor and settle it right away.

But self-regulation on the floor is active and ongoing. Each week on Wednesday afternoon, after the close, there is a meeting of the Market Performance Committee. Has been and is for all these years. And if that committee, as suggested before, people who give up of their time as they do in the self-regulatory system during the trading hours, after hours, go and meet on an ongoing basis to discuss problems that took place that day, things that are anticipated and also involved with in listings and friction that has taken place. The relationship between the membership and the staff, over my number of years -- that's a long number of years -- has been very helpful and respectful. The staff of the New York Stock Exchange over the years had the courage to be, particularly in the regulatory area, their own people and that was very reinforcing to people on the floor who are making rulings against their fellow members. And I think surely by the time I got done I probably alienated about 90% of the membership,

and you learn to live with that if you come in friction with any decisions that are made, and that's the price you pay if you're willing to take on those jobs.

But self-regulation worked, and I spent a lot of time at the SEC, and that was a very enlightening and pleasurable experience for me. I was just looking at the -- I think there were six SEC chairmen that at one time or another I was on some committee that they were involved with at that time. And going back through the years, I won't bore you with all those committees, I started with the Institutional Investors Study which was in the late '60s -- I think '69 -- and on two others that had to do with the national market, the last one being the National Market Advisory Board -- that was in '75 -- I learned a great respect for the Commission. I met many, many staff people and they were the best and the brightest. Rather than go to the Justice Department, most of them in the latter years, bright people went from law school to the commission if they could get that job, and then later on they left the commission and they went either in the industry or started in very good law firms or started their own law firm, and they extended their knowledge there to strengthen the industry, and it was wonderful.

I'm a strong believer, as was said earlier by Gordon. I think that crack about a well-oiled shotgun belonged to Bill Morton, and I don't necessarily believe in the well-oiled shotgun but it's good to know they're there. They always wanted more money to regulate as the industry grew and grew, and that was a constant tension with the government. But it seems to me that they could have been more proactive in the governance which would have changed my life and a lot of our lives had they, looking to the future, the governance changes at the Stock Exchange are real and effective. So I believe, as I was always proud to be a member of the New York Stock Exchange when I started, I still am, and I know I will be in the years ahead. What we always said was that our word was our bond, and meant it, and that we would trade in millions and millions and hundreds of millions of shares daily, and you didn't shake hands and you didn't take a thumbprint. Your word and that was it, and you went on. People who left the industry and found out that that's not how it is in the outside world, but that's how it is and was at the Stock Exchange.

One last thing then I'll shut up for a moment, if I can. The amount of volume has been amazing. In 1970 the average daily volume was 11.6 million, '80, 44 million, '90, 156 million, '95, 346 million, the year 2000, the first year it went through a billion, and it was a billion forty. And now four years later the average is a billion four. I guess I've served on every committee at the exchange at one time or another, and once I was chairman of the Finance Committee with a lot of corporate people. And we used to, at the end of the year, figure out what we thought the volume would be in the coming year and I always lost. I was always low-ball. But the volume increases, I figured out, about 15% a year, and so five years from now we'll be up there in 2 billion shares with ease, and it doesn't happen overnight. The exchange has spent 2 billion dollars in the last ten years, and is spending now at the rate of 400 million a year to

make sure that we can handle that heavy, heavy volume and prepare the systems so that they effectively work, and they do effectively work.

DUKE CHAPMAN: Okay. I have a question which I want everyone to focus on. It's one that I think points out some of the shortcomings of the system, and it's the application of the antitrust laws to the Exchange markets.

When I first left the SEC and went up to join the New York Stock Exchange staff, the common wisdom in the legal fraternity, fostered in large part by the then outside counsel of the New York Stock Exchange, a gentleman named Sam Rosenman, was that the antitrust laws don't apply to the securities business and to the stock exchange, and that was accepted as that's the way it was. It was when the Special Study of the Securities Market came in the '60s and they focused on Rule 394, which was the rule that required that all transactions by a member firm had to be on the New York Stock Exchange, you couldn't trade away in other markets, that was a first application of the antitrust law.

As we looked further on down the antitrust investigation of the NASD, the antitrust look-see at competitive trading of options, these were areas that had been overlooked by the self-regulators and overlooked by the regulators, and overlooked by the Justice Department. And you see these things happening where it isn't a breakdown in what's actually going on, it's a lack of awareness that something's happening, and it happens in industry practice, and then all of the sudden someone focuses on it. In this day and age it may more likely be a class-action attorney, but focuses on what's been an accepted practice. And there you have both self-regulation and the regulators both missing something, and it usually gets a lot of attention. Those things are out there, I'm sure they're out there. I mean, some of these practices that we're seeing about in the mutual fund industry, they've been going on for quite awhile, and then just all of the sudden someone focuses on it and says, "Hey, that's not right. That's not appropriate," and then everyone has to focus on it and straighten it out. And I think we'll always have those things popping up, and I think the self-regulators can be as vigilant as they want, and I think that the regulators, the commissions, also be as vigilant as they want, and there will be pockets of things that will happen as we go along.

BILL BRODSKY: Duke, let me make a comment on what you just said because, as you passed the baton to me seven years ago, the specter of antitrust had just started to rear its head, and I must say that I think that it cries out for more clarity. The SEC, in my view, had the jurisdiction, exercised the jurisdiction, and when up against the Justice Department, at that time kind of crumbled. And it was a great disappointment to those of us in the business because I think that they had precedent on their side and just allowed things to happen, which ultimately the Southern District Court in New York reversed them,

in the sense that they didn't agree with the way the SEC had, I guess, not stood up to the Justice Department. It goes back to the early case Gordon versus the New York Stock Exchange where it was established that the SEC's regulatory scheme is so pervasive that in fact it does, under normal circumstances, supersede the antitrust laws. And I think that if you talk about what you'd like to see changed, I think one of the areas is the SEC ought to get its act together on what its role is when it comes to the antitrust laws.

DUKE CHAPMAN: Gordon, you had your hand up.

GORDON MACKLIN: I did want to talk about somewhat of a different subject because we've talked all about the evolution of the markets and the pros and cons of self-regulation, but we really haven't positioned these markets as well as we might. It's clear that vines have grown tremendously, but as I was listening to Don's remarks about the volume on the New York Stock Exchange up to a billion four of daily volume. My question was, and my suspicion is, that that's a New York volume, and when you add in all the other volume we're now talking about almost twice that. And I think that to have a piece of regulatory machinery that can work at all during this huge expansion of volume and transactions and new products has been a big plus. I understand quite well some of the problems, but in the world I came from in the over-the-counter market, just putting in place the facilities like NASDAQ and the Clearing Corp., to give them the same kind of trading volume or similar trading volume to the New York Stock Exchange and well in excess of the other markets, has been an absolute miracle and a lot of hard work.

Part of that hard work, one ingredient that we've left out of the analysis of what makes self-regulation work or not work, we talked about the self-regulators and the SEC, we didn't talk about the volunteers like Don, or in our case at NASD, we had a fellow named Bill McGowan, the chairman of MCI, that's back when MCI was a great word. The commitment we got out of that kind of talent is the same kind of commitment they got at New York from Don, and in our case we didn't pay them a thing. We'd take these directors to three watering holes a year out of six meetings, but we didn't pay them a thing. And I watched the Wilson Werns and Bill McGowans and others participate and throw their talent and their resources to make a better market. That's part of what I meant by generating great deep friendships out of something you believe in, but those are important, essential ingredients that were great for the success of this whole system. And the fact that that system survived and grew geometrically, I think is a real treat here, and I think before we close we ought to think about self-regulation as done in a securities industry with markets of all sizes and how that might compare with government regulation as performed at the savings and loans industry.

DUKE CHAPMAN: The question that was mentioned twice of separating out the regulatory activities and the business activities of the organization, do you think that was constructive, Gordon, when you're watching it from a distance?

GORDON MACKLIN: Well, I view it with mixed change. I'm somewhere just to the right of Calvin Coolidge when it comes to change. [Laughter.] But I could be swayed up to Herbert Hoover. [Laughter.] I thought for awhile it was a make-work remedy for a problem that I didn't see as seriously as the legislators. On the other hand, it has, and the newer types of problems that have arisen are making a stronger and stronger case. What I didn't like was that the package of regulation and market operation has done so much literally to create facilities that didn't exist. And think of it: the facilities that we've all described here, a world renown set of facilities at New York and NASDAQ and Boston and everywhere else, they didn't cost the government one dime. One dime! And before we start figuring how we're going to cure this, we better figure out that we've got the finest market system in the world that didn't cost the government a dime. And so I was a little reluctant about that, but it does seem that as these markets get closer together and more competitive, that there is a strong case to be made to do with many of the regulatory facilities, the same thing we did with the clearing facilities.

When money got very tight in the mid-'70s, and I'll show you how it's affected, the NASDAQ average started at 100 in '71, and by 1975 it had skyrocketed down to 50. [Laughter.) But as money got -- and that, of course, brought the shrinkage of volume and it brought a lot of economic trouble to the industry. A group of us, with the assistance of the banks too, worked hard to develop a central clearing facility to cover all transactions and all markets. It was a great, great operational savings for the industry, for our members, and for the markets, and I'm beginning to think -- I do think -- that a similar move for many of the operational regulatory problems is appropriate.

DUKE CHAPMAN: Thanks. Now Bill, you haven't integrated the business and the regulatory part at the CBOE now as it was when I was when I was there, and you've maintained it and done that same system.

BILL BRODSKY: Well, we have but we haven't. In the past since you left, Duke, we do have a board that's 50% public, and it goes much more than just the headcount. Our governance structure that we've developed over the last few years with tremendous involvement of the SEC on, again, more than the form but the substance, has really given us I think a great strength, and one of those strengths is in the area of regulation. We now have a standing committee of the board which is called the Regulatory Oversight Committee, and it's comprised of four public directors. And when we say public directors, I mean they have nothing to do with the business, they are not connected with any member or member firm, and they supervise our whole regulatory function where the Chief Regulatory Officer reports to

them and where they meet once a year with SEC staff without the presence of any of our staff. And one of the things I think that's very important, and where I am very concerned with what I see happening in other markets and in each of those cases, both the NASDAQ and the New York Stock Exchange, it's been as a reaction to a major problem. And so, when you have major problems you get reactions and sometimes it can be an overreaction.

One of the things I think is very, very important, as Gordon talks about, not only the volumes but the complexity of the business. As I spoke earlier, a lot of things happen these days that did not just occur in our market. They occur in a futures market, they occur in a stock market, or a variety of things, or other option markets. You need to have trading professionals who know and understand what's happened here. You can't have such a separation that the people who are regulating and the people who are judging the conduct have no hands-on experience. I do think it's very important, however, that there be an integrity to the process, and one way to do that is to have people who have no vested interest in the outcome make sure that the process is working well. The system we have has been in place now several years, we're getting very, very good feedback from the SEC on this, and I think that it should be something that should be given a chance to work because I'm not convinced that having a total separation in the complexities that we have is the sole answer.

DUKE CHAPMAN: You know it's funny, because you talk about that system. We did something similar quite a few years ago when we brought public governors on to the NASD, and much to our surprise, incidentally, it worked this wise. But the public governors came in and said, "Good God, I wish they had that in our business. [Laughter.] This is a model." And they never expanded it but it looked like it's got a lot of merit done right. Bill?

BILL MORTON: Well, I've got the point of view and I --

DUKE CHAPMAN: Yeah, I promised you we could come back to your commercial at some point.

BILL MORTON: I was just listening to Bill comment. I mean, I think the question, the $64 question, is what's going to happen in the future? And we have had some issues and we've had a lot of negative publicity and some real serious problems in is self-regulation with the combination of SEC oversight going to be enough with floor officials and so forth to take us into the future? And something has to change, and that's why I'd be interested in Don's comment on this is, on what New York is doing by separating it out and going to two separate boards and then dividing up the responsibilities of the

CEO. It may be reaction to some of the problems, but I think it's going to result in probably more effective self-regulation.

DON STONE: I would agree. Could I change the subject a tad to something that I think is terribly important that all of us, the markets looking to the future, should be aware of, and that's market structure and regulation impact. Everything we're talking about will be impacted by market structure. There's always been a tension between the tremendous competition in the industry which works because it makes everybody do better and makes people be creative, as Gordon said. We spend millions of dollars to be competitive as our peers come up with systems that are more advanced, more technologically friendly to the user, and so on. What we're looking at today, as we looked at all through the years, is the same thing, market structure, the competition between the dealer and the auction market, and dealerizing the market, there's always a thrust. With New York Stock Exchange listed stocks that people trade them away from the central market and break down the liquidity that takes place in the central market and the transparency of what people can judge to make their prices, and we've always tried to see that the small investor gets the same price as the big investor. And with the NMS proposal that the commission is going forward, this is one of the first and it's the only time I am aware of that they've done something that isn't in the public interest. It's in the interest of arbitragers, it's the interest of hedge funds, it's an interest of big traders to say that with ECMs you can obviate best price. You don't have to take care of best price, which means that it might Aunt Minnie, who is the little investor, is offering XYZ at 51 1/8, $51.12, they can trade away from her above her or below her, and the confidence one had in the markets of being fairly treated, equally treated, is obviated.

And I think wisdom should prevail. So far no one's repealed the rule of fiduciary responsibility. That responsibility figures small to get best price in the name of speed or anonymity which is the pressure that goes forward to say we'll trade below, we'll trade above the ECM and the markets in the future will find that we were right to have paid too high, we were right to sell too low. That's not healthy for the greater markets we've got where people can look at these markets and feel they are being fairly treated, small as well as big. And I think it's something for us all to be aware of, market structure, as we go forward. Regardless of how we spend money to compete with each other, we should be aware of market structure and come together on that.

DUKE CHAPMAN: I take it, Don, you're not in favor of the opt-out. [Laughter.]

DON STONE: I always knew you were a bright guy. [Laughter.]

DUKE CHAPMAN: It's exactly 4:00 and we wanted to leave some time for questions from all of you of the panel.

DON STONE: It's 5:00, Duke.

DUKE CHAPMAN: Five o'clock; I'm on Chicago time. [Laughter.] It's 5:00, and what we would like you to do is get to one of these microphones and identify yourself and your affiliation and fire away. Is there anyone out there who would like to -- I see someone getting to his feet. Don Calvin.

DON CALVIN: I seem to recall a story Gordon Macklin reminded me of when he told about going to Brazil. I was in Switzerland a couple of years ago at Burgenstock, and at the table there was a fellow who was the head regulator from the U.K., and he was telling that he just had a visit from some Chinese regulators who were looking at the system, and he was explaining these arcane terms and all of this type of stuff, and he got to talking to him, he said, about the best execution rule. He explained the best he could, and when he got through the head of the delegation, who usually sits with his eyes closed through these meetings, they poked him and he woke up and he said, "Oh, yes, yes, yes." He said, "We agree that in China when there's a rule violation, execution is the best way to proceed." [Laughter.]

But I mention that because what's happening elsewhere in the world is that they're moving primarily to government regulation. And also what hasn't been mentioned here today, that some people have proposed, is why not have a single self-regulator? That's my question.

DUKE CHAPMAN: In addition to that, there's a question. If you go to the government regulator, who do you go to? The Attorney General of the State of New York? The Attorney General of Massachusetts? There are a lot of questions connected with who's the single regulator.

BILL MORTON: Thinking about the question you've asked, Don, it seems to me if we're looking at combined markets that are going to in just a few years be doing 4 billion transactions a day, and with the number of participants and the sophistication of products, having one regulator -- wipe out the self-regulatory aspect of it, and have one regulator be responsible for supervising and keeping the pot right and the game straight, seems to me a pretty mammoth task. Everything being in the computer and every trade being able to be reconstructed aside, it seems to me that that's a tremendous task and it would almost be self-defeating.

GORDON MACKLIN: And I think what you lose, Duke, I would reinforce that, is every marketplace is somewhat different and has somewhat different rules. I think it's very important that each marketplace retain responsibility for what they do, and I think they also have the capability and the people, the number of staff, to do a better job than one more removed super regulator. That would be my comment.

DUKE CHAPMAN: Bill?

BILL BRODSKY: I would agree with Bill Morton. The business is very complex and there may be areas where we can find efficiencies by not having five exchanges do the same type of thing. But to have one organization try to regulate everything, I fear that you'll end up with just another bureaucracy, and again, I go back to what I said earlier. The marketplace is always ahead of the regulators. It's almost impossible for it not to be. Between the technology of trading and the technology of instruments, you need something a little closer to where things are happening. And I think we need some creative minds working together to come to a better balance than just say, "Well, let's just give it all to one regulator." One regulator doesn't solve a problem; it may create other problems.

The other thing I would mention that I think is very important, and again, it's in relation to the events of the last two or three years, and that is that there can be problems or issues where self-regulators don't do the job they should do. In most cases I don't think it's acts of commission, it may be acts of omission, or again, it may be situations where the markets have moved more quickly than the regulators, even the self-regulators have kept up. But what is very, very important as long as self-regulation exists in any form is for there to be a mutual respect between the self-regulators and the SEC, that you are in this together and one can't operate without the other. And I really mean this very sincerely. I don't want to see that because there have been problems, whether it's in one marketplace or another, or in multiple marketplaces, that there is a breakdown in what should be the professional rapport and respect between both, because we're all doing this for the same reason and that's in the public interest. And if there are problems we should sort them out and not try to freeze out one or the other, because it's really more where the government would try to freeze out a self-regulatory organization if that organization is capable of doing a good job, and I think that's a very important thing to keep in mind. The business is too big and too complex. I don't think the government or any single regulator can hire enough people to do the job that can be done when you're closer to the point of the trade.

DUKE CHAPMAN: Well, Bill, I would agree with that. I think our industry over the years has been blessed in having really high-quality regulators overseeing us, keeping an eye on how we were doing and what

we were doing. And I think that the SEC has always had a high professional standard and contracted very bright people, and I think that's been a blessing for self-regulation. Without it we could have gotten into a lot more trouble than we have. We've had our moments of trouble but I think it's worked pretty well. I think that's what you were trying to say earlier too, Don.

DON STONE: Yes, sir.

DUKE CHAPMAN: There's a gentleman over here?

ALEXANDER BURNS: Yes, Alexander Burns. My question follows on the market structure and how do you believe self-governance will work in the future with more people trading via the Internet rather than through traditional brokers, and how self-governance can sort of move into the different light with people instead of talking to their brokers, now they're going onto the Internet and seeing and looking at securities and making their own decision, and moving markets quite a bit more than individual traders used to. So I'm wondering how you think self-governance will move to educate investors as individuals so that when your Aunt Millie reads on the Internet that, hey, there's this great biotech stock that's supposed to release a drug and decides to buy 100 shares, she can be as equally well protected as she would have been 10 years ago or 20 years ago.

DUKE CHAPMAN: Well, I'd say if Don's Aunt Millie were to receive the spam stock recommendations for penny stocks that I get every morning when I walk in coming off of my fax machine, we have a long way to go to protect her from what's going on out there. [Laughter.]

GORDON MACKLIN: I'm not sure we have the obligation to do that. That borders on being the impossible. If you're going to protect everybody in the investment universe against poor judgment and lousy recommendations, I think you're taking a job that literally can't be done. I think there are a lot of operational conditions, capital and uniform practices, and examinations of participants. There are a lot of regulatory functions that could be homogenized and put into one regulatory, one self-regulatory organization, that serves the whole industry with some outs, if you will, or creativity among markets, but I don't think that protecting every single investor is a doable thing. And in the meantime, markets have changed so much. You know, for years, generations, this idea of Aunt Millie out in Iowa and Uncle Ben up in Massachusetts, we found out that Aunt Millie has a hedge fund in midtown Manhattan. [Laughter.] The world has changed and we've got to be able to adjust our goals to that.

DUKE CHAPMAN: Well, Gordon, you know, we've made efforts like this sort of in the past. We had a major push on investigate before you invest as a result of some bad things that happened, and the industry and regulators and everyone got behind it. I can remember Keith Funson at the New York Stock Exchange leading the way on taking investors, educating them, and it was all designed to go hand in glove with, "And go see your broker at your New York Stock Exchange member firm."

GORDON MACKLIN: Or perhaps an NASD member firm. [Laughter.]

BILL BRODSKY: Old rivalries don't die easily.

DUKE CHAPMAN: Bill? You had a comment?

BILL BRODSKY: Yes. I would say that we do have, as a community, a continuing obligation for investor education. I don't think you can protect everybody from themselves as Gordon is suggesting, but I think that investor education and economic education, financial literacy, is a major problem in this country, and we've made it very easy for people to get up on their computer and buy and sell a stock, but that's not the answer. The answer is they understand what they're doing, they understand what the difference is between investing and speculating, and I think that's it's incumbent on all of us in our organizations to do what we can to add to investor education. Because I am, and I teach a class on personal finance at a graduate school, a law school in Chicago, and I am shocked that people who are in the best graduate schools in the country have so little knowledge of the investment markets. And if they don't, it scares me even more what else is out there. And I think that if we're in this business, we should do everything we can to see that there's information out there. And in that case, the Internet is a wonderful tool because it makes information that was never available to people in the past very accessible to them.

DUKE CHAPMAN: I've got two more questions. Carter, you want to --

CARTER BEESE: Thank you. Carter Beese, private citizen. [Laughter.] As I hear about all these issues, it's wonderful having four children, and you listen to four markets and it's like which one are you more proud of? These are wonderful problems to have. But as I hear about the types of volumes that have just been growing exponentially, I also think about another side of the equation which I long have, which is our market share globally which continues to shrink even at a billion four in daily volume, and will probably continue to shrink over the next decade, and I wonder if the panel could just comment on two scenarios. One, if we do nothing and just continue on like we are and where we will be in five years as a

globally competitive country in the securities business, and secondly, if we felt this were an issue that we should address as a country and as markets collectively, and if we thought we could marshal a program among our markets to make ourselves more competitive than we would be five years from now, what would that program be among the markets?

DUKE CHAPMAN: I don't see any hands going up here on the panel.

BILL MORTON: I'll start.

DUKE CHAPMAN: Okay, Bill.

BILL MORTON: We just can't do nothing, Carter, and I agree with you. Our market share is shrinking globally, and I think the answer has to be found in just that magic word of "competition," in we've got to get over this period we're going through where there's been investigations, problems, and to some degree, scandals, and we've got to move on and we've got to pull together. I've always been a proponent of a national market system in the U.S. and that we compete together but we pull together on a number of issues, and I think that this is part of the mandate that was given to Congress by -- given to the SEC by Congress, excuse me, and I think they have to help pull this together and lead us. Because we do have the greatest markets in the world, and when the going gets tough, you know, everybody comes. And I think it's a great national asset and it's something we should fight as hard as we're fighting to improve regulation to keep moving.

DON STONE: I'd like to second that, Carter, if I may. And you never can stay still. The world is changing and you have to change proactively with it. When you talk about markets growing elsewhere, China is a perfect example. They are the big market of the future, and for us to -- our companies are trying very hard to get a foothold over there and to get involved in that market. As far as the stock markets are concerned, which is really what we're talking about I guess, they will have their own stock market eventually and so too will India, where they will be very large. And as we keep shipping jobs overseas they will grow very quickly with the economics going in their direction, and the numbers you look at, in terms of the markets, will grow elsewhere where they don't exist today. So it's inevitable that as the world grows so too will the markets there grow.

But the key thing is that we keep growing our market, and as the dollar flows, so too will dollars flow into equities here. That's how it seems to go. And as our economy goes, so too will dollars come into

this country. I mean, you can egress as quickly as you can come in, so we've got to keep these markets open, visible, and strong. And I think we're doing that, and we've just got to keep at it and maybe go faster than we are, as you suggest.

DUKE CHAPMAN: Carter, I think part of the answer to your question is, I don't see how we can stop our market share of the global market shrinking. As capitalism has been spreading around the world and economies have been taking off, and you look at the billions of people in India --

DON STONE: Duke, we can on the margin, depending on how we position our markets.

DUKE CHAPMAN: Well, home markets, starting from where they are in size, are going to grow dramatically faster than our developed market is going to grow from its size. And I think it's -- we have all of the eastern European countries that never had a stock market until the Cold War ended, may have had it beforehand, but hadn't had it for many years. Looking India that's exploding, they've had four or five stock markets but they've been fairly small but now they're expanding dramatically. China has its markets, it's experimenting. I just think we can do everything we want, but statistically I think it's going to be hard for us.

BILL MORTON: No, but we have in the past, legislative markets offshore. We did that with the Interest Equalization Tax of 1963 and September of 1963 the --

DUKE CHAPMAN: Right. I can remember it well.

BILL MORTON: And we can do it in the past, and I wonder if this isn't the time in history to have the good-natured competition that we have amongst our national markets, not focused outward towards -- not just focused from our borders inward, which I think most of our regulation does and most of our competition does among markets and realize the globally competitive marketplace that we are in today and maybe on the margin effect where we might be in five or ten years.

DON STONE: I have a little different view of the seriousness of that problem. I agree with what's been said here, that as everybody grows, the biggest is going to grow less percentage-wise. Fine. I serve on the board of a number of the Templeton Funds and can literally watch the flow of capital into some of these countries and the good it's doing with some of the local industries. So if you're saying there's

going to be a big global expansion in financial markets and our share is bigger or smaller or whatever -- in my opinion it's inevitably going to be smaller -- that there's going to be a big expansion in the fluidity of these markets and money being able to move around, I think that's tremendous. And I think our job is to have the best systems we can have to participate. So I don't see it as a big problem if we do it right.

DUKE CHAPMAN: David?

DAVID COLKER: My name is David Colker, I'm CEO of the National Stock Exchange. I have a question along the lines that Duke raised with respect to the tensions in and within the realm of regulating your customers. I see a lot of experience up there. My question is, if you look at your own experience in terms of facing times of crisis where your self-regulatory status was questioned maybe because you're perceived fairly or unfairly having favorite customers or whatever reason, what are the values or management protocols that you've applied that have helped you weather that crisis and make decisions in those situations and to retain or enhance your statuses in SRO?

GORDON MACKLIN: There are a lot of answers to that, but I really believe that the right religion is if you run your business according to what's best for your customer you're a winner, and some of these losers that are out there are going to find that out.

BILL BRODSKY: David, I agree with Gordon. I think that when something important happens, it has to become priority number one. You have to recognize when these things happen, that no matter what other competitive issues are out there, that you have to attend to these things both in terms of the reputation of the organization and the relationship with your regulator. And when these things happen, these become a very, very important priority that has to be addressed, and they are the kind of things you can't plan for. They happen and you just have to find ways to deal with it.

DUKE CHAPMAN: David, I think that the critical thing is to create, in your institution or whoever it is, create a culture which says we're going to do the right thing and we're not going to bend the rules, and we're going to treat people equally and equally harshly, depending on what they do that breaks the rules, and you have to create that culture within the membership and within the staff of the institution. It's pretty easy to do it within the staff of the institution. It takes a lot more hard work to create that environment with the membership, with the people who are the business operators. I think that's the key thing you have to just keep working on. Make it clear that the staff is going to be backed up, that their job is to enforce the rules, and make it clear to the membership that those roles are going

to be enforced and it's in everyone's interest to follow the rules. It's easy to say that. To instill that in an institution is a lot of hard work.

BILL MORTON: I was going to say the same thing, Duke, that I agree with your culture comment but, David, it's tough to do. And when your smaller exchanges like you represent and I represented, and you're out dealing, trying to attract order flow from large customers, and you're the regulator at the same time, it's tough to bring bad news to big customers. But I think if you establish the culture at the beginning that something in the regulatory side comes first, and that's the right thing to do, they'll understand it when the time comes.

DAVID COLKER: Thank you.

BILL MORTON: A fine line.

DUKE CHAPMAN: Thanks, David. Anyone else who has -- there's somebody I think either leaving or going for the mike, I'm not sure which. Go ahead.

GREGORY MORRIS: Yes, hello. My name is Gregory Morris. I'm an individual investor, and my question is, all five of you and probably most people in this room agree on the merits of self-regulation. What, however, are you doing individually or as organizations to communicate those virtues to the individual investors? Because if we don't believe it -- I personally do -- but if all the rest of us don't believe it, we're going to leave our money in the bank or put it into a larger house or something like that. So you're competing in the national markets against other ways of individuals spending their money.

DUKE CHAPMAN: That's a good question. Who wants to take the first crack at it? Bill?

BILL BRODSKY: I'm the only one here that actually has a day-job, I think. [Laughter.] I think you raise a very important question and, depending on which organizations you're addressing it to, I think the answer varies. I'm in an options exchange and we communicate primarily to our customers through the Web because we tend to deal with a more narrow group of customers. I think as an industry we probably haven't done as good a job as we should in communicating broadly, particularly because we've come through a period of, I'd say, big problems and scandals. And I think you're challenging us to find a better way to communicate than we have.

The SIA is a very good vehicle because that is our industry trade group for the individual investor, and I will pledge to communicate that to them because I think that the SIA is probably a very good place. Another group is the American Association of Individual Investors which is a private organization. But these are outlets to communication, and I think one of the most important ways to communicate is to somehow stop the bleeding of the scandals, get whatever it is that we've had out there behind us, and hopefully go through a period where we don't have these problems. It is a very difficult thing.

I can tell you that from the conversations I've had with investors, at least in our business, it hasn't been as much of an issue. I think it's been more on the corporate side and a lot of that's been dealt with through Sarbanes-Oxley and the Financial Accounting Board that Bill McDonough is running, but it's not something you can ever say you're done with. It's something that's part of what I had said earlier about economic education. These are things that have to be done on a regular basis and I appreciate your comment.

DUKE CHAPMAN: Those of us who don't have a day job. [Laughter.]

BILL BRODSKY: I think he had a good comment, good criticism, and thank you for raising the question. I think we need to do a better job.

DUKE CHAPMAN: It's a difficult uphill fight and, as Bill says, until the newspaper headlines stop being headlines about malfeasance and corporate malfeasance, or mutual fund malfeasance, or market malfeasance, or specialist malfeasance, or whatever it may be, hot issue allocation malfeasance. I mean, we've had two years of headlines that paint a not pretty picture for investors like you, and I think it's probably good. Maybe that will give us a shot. Bill?

BILL MORTON: Good question, because we all agree that it seems to me each day the public votes. It votes with their dollars, and you can see the figures of their confidence or lack of confidence in a market or, I always thought for politicians, if they made a proposal and there was a reaction nationally, they could read how the public voted the next day in the marketplace. And as long as you watch the volume figures of our various market centers, you can see the public voting as to whether or not they choose to be there or they would rather not be there. And so far, I think the public has given a confidence factor to the markets.

GORDON MACKLIN: I was going to make essentially that same point. There's more money gone into mutual funds since the mutual fund scandal than at any other time. And even in the month following the revelations, there were more money put into mutual funds. I think the New York Stock Exchange's volume records say a lot about the American people's confidence in the self-regulators that they will deal with these problems on an ongoing basis and that the SEC will deal with them. There's been a lot of negative publicity. There are some situations where fraud artists are out there running Ponzi schemes and trying to tell people that they can't invest and they shouldn't invest in New York Stock Exchange stocks and mutual funds because they have these special little hedge funds which are Ponzies which they can invest. But by and large, I think the investors in the United States have great confidence in self-regulation and they spoke by keeping the money flowing into the financial industry.

DUKE CHAPMAN: Thank you. We have about four minutes left. I'm going to ask if any of the panelists have a last word they'd like to give the audience here and the audience on the Webcast. Gordon?

GORDON MACKLIN: I'd like to ask the last speaker to use our last four minutes. I think his message was just right and the proof of the pudding is in the eating. Stocks are not dirt-cheap. They are trading in heavy volume. We do have lots of work to do to accomplish in the way of scandals and press and what have you. We could spend a long session on the practice of the press during these scandals. We could spend a long session on other factors relating to these. We do have a problem, we are pledged to work on it, and I think that last speech was very profound.

DUKE CHAPMAN: Bill, a last comment?

BILL BRODSKY: I would just say that notwithstanding all the kind of dire things we've spoken about, that we do have an incredibly dynamic capital market system and it works, and as Don Stone said, it works very, very well. We have to learn by our mistakes and come out better and stronger. But if you do watch what's happened in terms of the flows and the markets and even some of the very positive things, I mean, Paul spoke a few minutes ago about more money going to mutual funds. They're going to the mutual funds where they have confidence. They're not going to the mutual funds where they don't have confidence. So even though I've spoken about the need for investor education, those that are investors can be very, very wise in how they deploy their money, and so people are going to get rewarded by doing the right thing and we should always remember that.

DUKE CHAPMAN: Bill?

BILL MORTON: I'll try to do it in 25 seconds.

DUKE CHAPMAN: Okay, it's your commercial. [Laughter.]

BILL MORTON: I'm for responsible self-regulation and continuation of. I think we've got to do better. I think a step in the right direction has been taken, as I mentioned, by the NASD and the New York Stock Exchange. I think there has to be more separation between the two with more emphasis on regulations, but let's not forget, as Carter Beese raised the question, the competitors to our markets internationally, and let's not throw the baby out with the bathwater.

DON STONE: I just briefly would like to say that we've been through many, many crises in the markets before. Bill mentioned the break in '87. Go back further -- Kennedy, Eisenhower, Zolitis, blockading of Cuba, paper crunch, whatever -- the Exchange and the exchanges work competitively together, they lock arms during times of crisis, and we come back and we look at this as a period from which we grew and made changes and became stronger in the years ahead, and that's what's going to happen here.

DUKE CHAPMAN: And just maybe from my point of view, I think obviously I'm an advocate of self-regulation, but I think it wouldn't work without strong oversight from the regulatory authorities from the Commission. I think that the industry, with its strong economic motivations, needs to have a strong somebody looking over their shoulder. I think we've had that for a long time and we have it now, and I think that's a very important part of making self-regulation work.

We're down to the end here, and I'd like to thank Bill Brodsky. Gordon, thank you. Bill, thank you. And Don, thank you very much. I'd also like to thank Don Calvin and Carla Rosati who is the executive director of the Historical Society. It wouldn't have happened without them. They've done all the hard work. And thank you.

Today's program is now archived in the Securities and Exchange Commission Historical Society's Virtual Museum at www.sechistorical.org, so you can listen again to the discussion. A transcript of the program will soon be archived.

And thanks again to Pfizer, Inc., the McGraw-Hill Companies, for sponsoring today's program, and the Securities and Exchange Commission Historical Society, the Museum of American Financial History, and the National Council on Economic Education for coordinating it. And we want to thank all of you for being with us today. Without you we wouldn't have had as much fun. I think the questions were very pointed, and I noticed that we had trouble coming up for an answer for one or two, so we've got some things to work on. Thank you all. [Applause.]

(END)