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THE MARKETS: NATIONALIZATION OR CENTRALIZATION?

An Address By

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When I became Chairman of the SEC, my family wondered what they were now supposed to call me, at least in public. When Henry Kissinger was asked this question after becoming Secretary of State, he was quick enough to respond, "Just call me Excellency." I was not. Instead I said, somberly, that I did not believe there was any law on the subject, but that the custom was to address all SEC Commissioners and similar government officials as "Honorable." I could have easily forgiven them a little whimsy on receiving this information. But the degree of their amusement was wholly uncalled for. As I tried to explain, the appellation is at best an expression of presumption and hope, and the user is not under oath.

The origins of this "honorable" business seem obscure, but I presume it was carried over from the judiciary, where it had been used from the time when the memory of man runneth not to the contrary. Unfortunately, it has not been carried over all the way. Trial lawyers do not seem to be able to phrase any legal argument without beginning "Your honor...," whether or not they are addressing a judge. The rest of us find this pretty tedious, but maybe it is a desirable habit,

or at least one with protective features. I do not know whether judges get pleasure from being constantly "your-honored," but at critical moments, they might get marked displeasure from not being. In any event, this does not happen to me or, I presume, other non-judicial government officials.

Wherever we got the term, we apply it so broadly that it lacks distinction and reflects poorly on our collective imagination. Years ago, I read a delightful piece by some English writer attacking this subject. It was his thesis that the titles of civil officials in the United Kingdom, as well as here, were colorless, and he thought we might borrow from the customs of the Church of England, which has "right reverends," "very right reverends," "most reverends" and so on. Or from other sectors of English official life, where the mayor of a village is "His Worship" but the mayor of a city is "The Right Worshipful." (I wonder if Mayor Daley knows about that.) This has possibilities. We could have "The Right Regulatory Mr. Pollack," "The Most Meticulous Mr. Loomis," and so on.

Incidently, I hope I have the rank right. I assume that "The Most" ranks "The Right," since seniority is very important to us. Without rigid adherence to the principle of seniority we would not know where to sit or in what order we should walk into a room, and there would be confusion and bafflement over who should assume the chores of presiding in the absence of the Chairman.

I should hasten to add that seniority has nothing to do with the weight given to our respective views. That is governed by more substantive factors, such as persistency, pig-headedness, and vocal power.

Returning to the matter of forms of address, however, I have never before pursued the subject in public, because it presents certain dangers, and the search for accuracy might tempt some of our friends. For example, I might get introduced as "The Most Dilatory Mr. Garrett," or something worse. So I am not sure that I want to contribute to the further weakening of the foundations of the Republic by inviting this sort of disrespect for government officials. We have enough of other sorts of disrespect. But speculating about the idea for awhile serves more or less as an introduction

to some things I would like to say about the Commission and its relation to our capital markets.

First of all, as one of the independent Federal regulatory agencies, we are included in the current attack on regulation as an appropriate governmental response to the problems of modern business. It was surely inevitable that the time would come for a revisionist approach to the whole idea.

We and our fellow creatures of the New Deal have always been subject to particular attacks from time-to-time, either for challenges to policies being followed or suspected venality. Sometimes these have been healthy and needed correctives. The rules governing our formal procedures have been the subject of virtually continuous study, there being a permanent Administrative Conference concerned with these matters. Our combined functions of legislation, adjudication, and administration, cause us to occupy a curious niche in our Constitutional structure -- not clearly and for all purposes part of any one of our classical three branches of government -- and the search or struggle for a clearer definition of our proper slot in the scheme of things has been a recurrent reason for attention.

The present challenge, at least in some quarters, is broader and more fundamental. Regulation in general is being suspected as an undesirable encrustation upon our economy, doing more harm than good by stifling competition, protecting inefficiency, and generally contributing to inflation, not just through rate-making policies, but by adding significantly to the cost of doing business. There have, of course, always been business executives who have held these views. For them to become widespread in other circles, however, is new. It sometimes seems to be mostly a function of time and generations. Just as revisionist history of major wars requires a generation of young historians who have no memory of the conflict, a revisionist view of the regulatory apparatus which, though not invented by the New Deal, achieved its present prominence during those days, requires a certain lapse or absence of memory of the problems regulation was intended to solve. As the old evils fade from memory, the defects of the solution loom larger. Someone recently wrote, nothing helps nostalgia like a good wine and a bad memory. I would not accuse those who are rediscovering Adam Smith and the benefits of competition of indulging in good wine, but memories need refreshing from time-to-time.

If this seems like an introduction to a wholesale defense of all Federal regulation of business, it is not. The problem is so complex that a wholesale defense is no more intelligent than a wholesale attack. One cannot sensibly object at all to pressures to improve regulation. The paperwork and procedural burdens imposed on business by the totality of government regulation surely must be lightened. The conflicts of regulatory goals among differing bodies imposed on the same industry must be more effectively reconciled. There are without doubt many regulations that probably seemed like good ideas at the time but have long since ceased to serve any useful purpose. These should be removed, and the burden should be on anyone seeking to impose new regulation. All of these things are good and necessary, and any campaign to bring them about is to be applauded. In fact, the recurrence of such campaigns from time-to-time is quite essential to keep the process responsive to changing conditions and social standards.

Beyond that, however, one must stop and think. What are the alternatives? Are people now so enlightened and human nature and economic dynamics so altered that we can

recreate the world of Adam Smith -- if it ever existed? Or is all we need the free play of competition tempered only by antitrust law suits? I do not think it would work. In many areas, in my opinion, regulation -- good regulation, of course -- is, as a political reality, ultimately the only alternative to government ownership, with all of the inefficiencies and eventual tyrannies that that implies. We are seeing the process tested and strained right now in the field of public utility regulation.

The drive for government ownership of electric utilities was rampant when I was in college in the '30's. Many factors dampened the drive, not the least being the astounding achievements of our engineers during the years following World War II, but the imposition of effective regulation surely contributed. Whether this system can withstand the horrible effects of inflation and energy and capital shortages is a question of great urgency. But one way to produce government ownership overnight would be to remove the regulation.

What, if anything, does all this have to do with the SEC and the capital markets? We are not presently in the

main line of fire against regulatory agencies and their contributions to costs, largely because we do not fix rates or prices or impose requirements that add significantly to costs of production. Such rate-fixing as we have engaged in we are abandoning on May 1. Our reporting requirements do add to the overall cost of doing business, but not significantly nor, in our opinion, in an amount unreasonable in relation to the benefits. Our opinion in this regard may come under some critical reexamination, but even if it does, the effects are minor compared to those of some of the other agencies.

The present lively and public charges against us are not so much that we are raising costs in our capital markets, as that we are trying to seize those markets. As a result of our supporting proposed legislation that would permit the establishment of a national market board, the suggestion is now being made that the real aim of the Commission, heretofore veiled in secrecy, is to plan, implement and run a single, nationalized securities market, ousting the private sector from both authority and responsibility and abrogating forty years of heavy reliance on self-regulation. This is a serious charge, and, as usual, its lack of resemblance to the truth does not make it any easier to refute.

Let me go back a bit, for the benefit of those of you who are not concerned with these matters as part of your day-to-day business, but also for the benefit of those of you who are.

Neither the Commission nor the Congress created our securities markets. The major exchanges, and to a lesser extent the over-the-counter markets, were well established institutions, created and operated wholly by the private sector when Congress adopted the Securities Exchange Act of 1934. Based upon the findings of the Congressional investigations into securities activities, primarily on the New York Stock Exchange, from 1929 on, the Commission was, so to speak, superimposed upon the markets with the mission of curbing abuses that were contrary to the public interest and the interests of investors. The Act was a clear assertion of the proposition that the facilities on which our securities markets depend, while privately owned and operated, were and are affected with the public interest and must be conducted with that interest foremost in mind. The authority of the exchanges to adopt rules for the conduct of business, to police those rules, and to inspect and discipline their members was accepted and indeed regarded as a duty, subject to Commission review.

It would be more nearly true to say that the Congress created the National Association of Securities Dealers, but even that is not strictly accurate. What the Congress did in 1938, when it adopted the Maloney Act, amending the Exchange Act, was to provide a statutory foundation for the creation of such an association, which was in fact created by private initiative. The Maloney Act contemplated the possible formation of several such associations, but the NASD is the only one which has been formed.

The Maloney Act was an interesting phenomenon. In 1938, the Supreme Court had already declared the NRA to be unconstitutional, but the NRA philosophy was nevertheless applied anew in this limited area -- indeed, the NASD is the lineal descendant of an NRA Code authority. By virtue of this Act, the NASD has authority and responsibilities that are unique among otherwise private associations. It has an antitrust exemption for requiring that members grant discounts only to other members and not to the public. It establishes rules for its members financial condition and the conduct of their business, which it enforces through quasi-judicial proceedings that may lead to fines, suspensions or expulsions -- subject to appeal and review by the Commission. And its members elect its board

of governors, who, in turn, elect its officers. These persons are not government officials, but they have authority and responsibilities that are, in effect, at least quasi-governmental.

These bodies -- the national securities exchanges and the NASD and their affiliates -- constitute a truly impressive apparatus for self-regulation. In aggregate numbers of staff, they far exceed the SEC. Their total staffs number about 5,300 and of these, more than 1,000 are devoted to market regulation and to the inspection and supervision of member firms. The SEC, by way of contrast, has a total staff of almost 2,000, but of these only about 200 are devoted to market regulation and broker-dealer inspection and supervision. Our total enforcement staff is about 585, but broker-dealer cases are only part of their work.

Over the years, the Commission has had a sort of love-hate relationship with these self-regulators. We have criticized each other frequently. We have put pressure on them to make changes or improve their performance. Occasionally,

we have stepped in to change some of their rules, as we have recently done on the matter of fixed commissions. But we have never wanted them abolished or "nationalized," if that means brought into the government as Civil Service. They have been nationalized for many years in the limited sense that the Federal government recognizes their existence, imposes upon them a duty to serve the public interest, and relies upon them to do many things that would otherwise have to be done by the government.

We think this system has worked well. Superficially, it appears to save the taxpayers money, although I suppose if the government were to take over the whole business, a portion of the dues and fees that members now pay to the self-regulatory organizations would instead be paid to the Federal treasury, so that is not the major consideration. Far more important is the sense of responsibility engendered among the leaders of the industry, a greater degree of acceptance among the members at large, and the benefits of a multiplicity of centers for the making of decisions that would be lost under a system that became too monolithic -- private or governmental.

The current charge of nationalization arises from a recent development both in the Congress and from the deliberations of our advisory committee on the central market system.

The movement toward a national market system that takes full advantage of modern technology to create greater centralization, on the one hand, and freer competition, on the other, is an outgrowth of studies that have been going on, now, for many years. As one might expect, government concern has been largely in response to manifest inadequacies demonstrated by the industry. The difficulties on the AMEX some fifteen years ago, among other things, led the Congress to cause the monumental Special Study of the early '60's. The back office debacle of the late '60's led to staff studies by the Congress, both in the Senate and the House. During that same period, and just before it, the rapid growth of large institutional investors, who traded securities in bulk, in addition to unsettling the whole structure of fixed commissions, led to inquiries into rate-making policy as well as the adequacy of the market system to accommodate these new forces. In 1971, the Martin Report to the New York Stock Exchange and the Commission, in its Institutional Investor Study Report, both concluded that some species of central market system was needed.

The Congressional studies endorsed this idea, re-christened a national market system as desirable to handle the business of the future in a manner which would provide adequate liquidity for institutions and fairness to individuals and stimulate competition with respect to the making of markets. For its part, the Commission summarized its conclusions in March, 1973, in a paper entitled "Policy Statement of the Securities and Exchange Commission on the Structure of a Central Market System." The Congressional views are embodied, with some modifications, in bills now pending in both the House and Senate respectively.

Each of these bills would, from our point of view, rationalize and to some degree increase our authority over the rules of the self-regulatory bodies. They would urge, if not mandate -- the phrasing still being somewhat unsettled -- the Commission to use its rule-making authority to create, or cause to be created, a national market system consisting at least of a consolidated last sale reporting system for transactions in listed securities on all markets and a composite quotation system, providing concurrent information on the quotations for listed securities on all markets. The bills also have provisions relating to commission rates, but since our action of last January, that is not so contentious an issue, at least before Congress, as it once was.

While Congress has been completing its studies and deliberating over legislation, however, things have not stood still. In the simple mechanics of handling trades, the industry has made great strides. The problems that beset these facilities became apparent in the late '60's, on days when volume reached a level of 15,000,000 shares on the New York Stock Exchange. The industry has now handled a succession of days of over 20,000,000, and several over 30,000,000, with no apparent difficulty. There are still improvements forthcoming which will further increase the efficiency and decrease the cost of handling trades, but the worst of the problem has been solved, thanks largely to great effort and expense by the broker-dealer firms.

The financial condition of broker-dealer firms, in terms of net capital ratios, also has been improved greatly, as has the ability of the self-regulatory bodies and the Commission to receive early-warnings of possible danger. When one adds to this the protections of the Securities Investor Protection Act, insuring customers' accounts up to $50,000, subject to a limitation of $20,000 for claims for cash balances, it is safe to say that the securities industry has gone through a major revolution since 1969, to the great benefit of all investors doing business with these firms.

On the regulatory side, we also have been busy working toward a central market system and, I hope, learning as we go. The Commission's first move toward a consolidated tape was to propose a rule which would require self-regulatory bodies to present plans for their accomplishment.

In response to our rule, several of the stock exchanges and the NASD in due course produced a plan which we accepted, and formed a Consolidated Tape Association to administer the consolidated transaction reporting system contemplated by the plan. The pilot phase of this system now has been in operation since October 18, 1974, reporting transactions in 15 selected stocks. By this summer, comprehensive reporting for all NYSE listed stocks should be in operation. One would have to say that this has been a successful program, but it has taken a long time and caused the Commission, and especially its staff, to become deeply involved in the most technical aspects of the whole thing, leading naturally to accusations that we were trying to plan and run the whole market. The experience did not make us eager to repeat the same program for the development of a composite quote system.

Some time ago, our staff proposed that, as an alternative to developing a complete composite quote plan approved by the Commission in all its detail, we simply should cause the exchanges to remove the impediments to the dissemination of quotation information to anyone interested in paying a reasonable fee and to make such information available to all interested persons. At first, this seemed likely to produce all kinds of problems.

Several things happened to change our minds. Some members of the securities industry showed interest in this simpler approach. Companies in the computerized information business were eager to be turned loose, if only they could have access to the data. And we kept reflecting on the remarks of Professor Walter Werner at our rate hearings last fall. He advised us that we were not smart enough to plan a complete central market system and added, lest our feelings be hurt, that neither was anyone else. He suggested that these things must evolve through the ingenuity and self-interest of all parties

involved, and that we should simply remove the impediments and watch what happens. Any bad things that happened could be cured later. Meanwhile, we observed closely the deliberations of our advisory committee on the central market system, which was demonstrating how terribly difficult it is for even the most able men of good will to anticipate and resolve in advance all problems that might arise in this area. So we have changed course, and taken the simpler approach, and in so doing, we, in effect, have gotten out of the driver's seat, although we will continue to observe developments in this area closely from the back seat.

Now, what does all this have to do with the charges of nationalization? Simply this. In our paper of March, 1973, after describing the basic elements of a central market system, we had observed that consideration should be given to devising some new arrangement for its governance, since it would require the meshing of different markets, now subject to separate self-regulatory bodies, into a coordinated system. We had not, however, suggested anything in that direction as part of the present legislative program. Congressman Stuckey, of Georgia, who has been deeply involved in all of these deliberations, concluded that some new board or super self-regulatory body probably would be needed eventually, and that

legislative authorization for it should be provided now while Congress is acting in this area.

We have agreed in principle, although we have sought to retain maximum flexibility. We want to be free to learn from experience and to adjust to changing conditions. If our present approach to the quote business is successful, a new governing body may seem much less necessary than it did two years ago. The present Stuckey bill gives us that flexibility. It would require us to create promptly a National Market Board as an advisory board, but it does not require that that Board ever be given self-regulatory powers. Such a conversion, so to speak, is left up to later developments, if it ever happens.

We think this is a reasonable proposal for the present, and it must be, because we are being hotly assailed from both sides. Representatives of the self-regulatory bodies really see no need for the board at all. When they combine this bill with the recent recommendation of our advisory committee for the consolidation of all present exchange facilities into a single national securities exchange, they discern a move toward the complete absorption of the present exchanges into one

body, run by a board appointed by the Commission. This, they say, would be nationalization.

In fact, we have not expressed ourselves on our advisory committee's recommendation, and we have argued against the urgings of others in the industry who do want a Board that can compel the consolidation of exchanges, provided only that the Board is not appointed by the Commission and is dominated by people from the securities industry.

This only gives you the highlights of what all the present quarreling is about, and I hope in being brief I have not unfairly characterized anyone's position. The only reason for going into all this with this audience is our sensitivity to accusations of this nature. In the face of these suspicions from some industry quarters, it would be amusing, if it weren't tragic, that we have received some violent attention from one far-out radical group on the ground that we are tools of the capitalist-imperialist pigs. The truth is that we do not want the government to take over direct control of the operations of our securities markets. Instead, we are struggling to preserve the unique combination

of self-regulation with Commission oversight that has made our capital markets the envy of the world. We want to generate self-reliance rather than smother it. We want to encourage competition rather than stifle it. We want to tap the amazing resources and ingenuity of the private sector rather than play Big Brother. We do not want the soubriquet of "The Most Menacing" to free enterprise in our capital markets or anywhere else.