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REPORT TO CONGRESS ON

THE EFFECT OF THE ABSENCE OF FIXED RATES OF COMMISSIONS

(Pursuant to Section 6(e)(3) of the Securities Exchange Act of 1934)

December 1, 1975

U.S. SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF THE SECRETARY

President of the Senate
Speaker of the House of Representatives
Congress of the United States
Washington, D. C.

Dear Sirs:

Section 6(e)(3) of the Securities Exchange Act of 1934 (the Act), 1/ as amended by the Securities Acts Amendments of 1975, 2/ requires the Commission, until December 31, 1976, to file with the Speaker of the House and the President of the Senate information concerning the effect on the public interest, protection of investors, and maintenance of fair and orderly markets of the absence of any schedule or fixed rates of commissions, allowances, discounts, or other fees to be charged by members of any national securities exchange for effecting transactions on such exchange. Section 6(e)(3) was inserted into the Act in light of the Commission's adoption on January 23, 1975, of Rule 19b-3, prohibiting national securities exchanges from adopting or retaining any rule which required, or from otherwise requiring, their members to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchanges. That rule, which became effective May 1, 1975 (except for certain floor brokerage rates), ended an exchange practice dating from 1792. 3/

The enclosed report represents a continuation of efforts by the Commission to monitor the impact of various changes on the securities markets consistent with its responsibilities under the Act to maintain fair and orderly markets for securities and to facilitate the establishment of a national market system. The report sets forth data collected by the Commission through August 31, 1975, which indicates that, although commission rates paid by institutions declined after May 1, 1975,

1/ 15 U.S.C. 78e(e)(3).

2/ Pub. L. No. 94-29 (June 4, 1975).

3/ The 1975 Amendments confirmed the Commission's conclusion, embodied in Rule 19b-3, that fixed commission rates should be eliminated, but recognized that, under certain circumstances, there might be reasons for the Commission to determine to permit the reintroduction of fixed rates.

the overall financial condition of broker-dealers remained sound and there was no noticeable impact on self-regulatory organizations, securities marketplaces or "market quality." 4/ In expressing that conclusion, the Commission wishes to make three observations.

First, substantial differences have become apparent between rates being paid by individual and institutional investors for the execution of securities transactions of similiar size. That development could well reflect the free play of competitive forces and the fact that institutional investors generally provide a continuing and substantial volume of transactions. Some fear, however, it may reflect imbalances in market power or uninformed pricing practices.

Second, certain broker-dealers, particularly those performing brokerage functions for, and offering research services to, institutional investors, have experienced sharply reduced levels of revenues and net income. A few such firms have elected to merge or terminate their business, and there appear to have been substantial shifts in personnel. This development may reflect a changing pattern for providing and paying for research services.

Third, during the period covered by the report, securities trading volume was high and securities prices were generally rising in relation to levels which prevailed in 1973 and 1974 - events which have a positive influence on brokerage industry revenues.

The following sections briefly summarize the major points presented in the report.

COMMISSION RATE DATA

The most striking development reported is the reduction in commission rates paid by institutional investors - such as banks, insurance companies, mutual funds and pension funds - during the period ended August 31, 1975. 5/

4/ The enclosed report relates only to the period ended August 31, 1975, due to the lead time involved in collecting, processing, and analyzing data from different surveys and reports. Some elements of data are available for the post August 31st period indicating modest continuation of the trends observed through August.

5/ Transactions were classified as institutional if they were handled on a "C.O.D." or "delivery against payment" basis.

In May, the first month after elimination of exchange rate schedules, all New York Stock Exchange members doing a public business received 5.5 percent less in gross commission revenues than it is estimated they would have received under the fixed schedules; that percentage was 8.8 percent in June and July and, in August, increased to 10.9 percent. The corresponding percentages for members heavily oriented toward servicing institutional investors are 16.3 percent in May, 23.2 percent in June, 21.5 percent in July and 23.5 percent in August.

With the exception of the comparisons noted above, the report does not attempt to relate experience with fully competitive rates to former minimum rate schedules. As there is increased experience with competitive commission rates, the Commission anticipates that the comparisons of rates charged under current practices with old rates will become increasingly less relevant. The report, insofar as it relates to commission revenues, presents calculations of commissions as a percentage of principal amount and in terms of cents per share for various size transactions for both institutional and individual customers. For institutions, commission rates had by August been reduced by 26 percent when calculated as a percent of principal amount and by 19 percent in terms of cents per share. 6/ The reductions in commission revenues would appear to represent savings to investors who use institutional investment vehicles.

These reductions in institutional commission rates have prompted some observations that institutional investors have been obtaining undue advantages and a few suggestions that there is a need to return to some system of fixed rates. In light of prior experience under minimum commission rate schedules, changes in rate levels and structures were to be expected and, while the evolution in the rate structure will continue to need close observation, there do not appear to be grounds for contemplating any return to fixed commissions.

The Commission bases this conclusion on the following: (1) There was reason to believe that prior rate levels for large institutional orders, particularly when viewed as simply a charge for the execution function, were higher than would be expected to prevail under a competitive regime, and were to that extent vulnerable. (2) As might have been expected, the advent of unfixed rates led to a period of experimentation, both on the part of individual brokerage firms and of individual institutional investors, with various combinations of services and of rates for those services. There is no reason to believe that this process of experimentation has been completed. (3) Competitive pressures to reduce rates did not develop as quickly for individual investors who invest directly rather through institutions as they did for institutional investors, and, therefore, rates to individuals changed less rapidly. Particularly in the latter part of the period, however, there

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6/ Discussions with industry officials, reports in the press, and data which have been developed through informal surveys suggest that rates have declined further since August.

developed indications of differentials in the rates charged to individual investors probably in response to perceptions by brokerage firms as to the relative profitability of different types of individual accounts. (4) There continues to be some uncertainty as to exactly what services should be included within the basic commission charge, and what services should be charged for separately. Further developments in this area are to be expected. (5) As noted above, the period from May through August was generally one of relatively high volume and generally rising securities prices, and there is, therefore, a lack of experience to date with respect to the operation of competitive rates under less favorable conditions.

BROKER-DEALER
FINANCIAL CONDITION

New York Stock Exchange firms during the period January through August 1975 reported near record levels of revenue and income. With the exception of August, a month of low market activity, those firms have been profitable each month since September 1974. 7/ Although revenues were slightly higher for the four months following May 1, 1975 (May through August), than for the prior four months (January through April), net income before taxes was about 23 percent lower ($281.1 million compared with $364.0), reflecting higher levels of expenses. 8/ Furthermore, firms dealing principally with institutions experienced a 24 percent decline in commission revenues, a 17 percent decline in revenues overall, and a 46 percent decline in net income, from the first four months to the second four months of this year.

The total capital of NYSE member firms increased $197 million between April and August 1975, about 5.8 percent. This gain, most of which resulted from an increase in equity capital, is probably attributable to the overall profitability of the industry during this period.

TRADING AND
MARKET ECONOMICS

The Commission's monitoring of trends in the distribution of trading of listed securities among primary exchanges, secondary exchanges and the over-the-counter market indicates that trading in NYSE-listed securities

7/ For September, 1975, also a month of low market activity, the NYSE reported that member firms lost $4.6 million, as compared with a loss of $10.0 million in August.

8/ For the period from May through August, as compared with January through April, in the previous three years, revenues have been lower in each year and profits have been lower (or losses greater) in two of the three years.

has not undergone any major shifts since May 1. All self-regulatory organizations have reported higher revenues and income so far in 1975 as compared with 1974, and their aggregate revenues for the four months ended August 31, 1975, slightly exceeded those for the four months ended April 30, 1975.

QUALITY OF THE MARKET

Recognizing the difficulty in isolating variables so that a valid comparison can be made between a period with fixed rates and a period with competitive rates, and between periods with differing general levels of economic activity or investor confidence, the Commission undertook to review the best available data and analyze changes in spreads, liquidity and volatility before and after May 1, 1975. By these measures, the "quality of the market" appears to have improved during the period since May 1, 1975; nevertheless, because of the statistical problems noted, it would not be appropriate to infer that the improvement resulted from the shift to competitive rates.

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The Commission intends to file additional reports on the effect of the absence of commission rates to the Congress from time to time through December 31, 1976, pursuant to Section 6(e)(3) of the Act.

By the Commission.

Respectfully submitted,

George A. Fitzsimmons
Secretary

Enclosure

TABLE OF CONTENTS

LIST OF EXHIBITS

LIST OF APPENDICES

INTRODUCTION

In announcing adoption of Rule 19b-3 prohibiting exchanges from fixing commission rates, the Commission recognized the significant concern expressed by many responsible persons in the securities industry regarding the affect of competitive commission rates. In response to this concern, it undertook:

> To take steps to provide appropriate increased monitoring of the activities of brokers, and their financial condition and operations as well as possible shifts in patterns of trading for some period subsequent to May 1, 1975, in order to assure that the objectives of the Act, including the protection of investors and the maintenance of fair and orderly markets, are upheld during any transitional phase. 1/

Furthermore, the Congress has required the Commission to make reports on the impact of unfixing commission rates. The Securities Acts Amendments required that:

> Until December 31, 1976, the Commission, on a regular basis, shall file with the Speaker of the House and the President of the Senate information concerning the effect on the public interest, protection of investors, and maintenance of fair and orderly markets of the absence of any schedule or fixed rates of commissions, allowances, discounts or other fees to be charged by members of any national securities exchange for effecting transactions on such exchange. 2/

1/ Securities Exchange Act Release No. 11203 (January 23, 1975).

2/ Securities Acts Amendments of 1975. Public Law No. 94-29 (June 4, 1975), Section 6(e)(3).

The Commission invited comment on its specific plans for monitoring in its release concerning Rule 17a-20 and in its staff discussion paper "Monitoring Trends in Securities Markets, Trading and Broker-Dealer Activities.[3/]" Subsequently, the Commission has required certain broker-dealers to file revenue, expense and related financial information; collected information on commission rates paid by individual and institutional investors from a sample of about 100 broker-dealers, and obtained monthly reports on financial condition of self-regulatory organizations, and other statistical information on the operations of the securities markets in general.

This document summarizes data collected to date.

CONTENT OF THE REPORT

In general, this document follows the approach described in the monitoring paper.[4/] Specifically, the document's 5 chapters, 21 exhibits and 2 appendices indicate change during the period April-August 1975 in securities commission rates, broker-dealer financial condition, self-regulatory organization financial condition, and the quality of the market.

3/ The paper was issued in March 1975 and is available from the Office of the Executive Director.

4/ In some cases, the format or analytical approach described here does not follow that proposed in the discussion paper. Where this occurs, it is for one of three reasons: either the extensive public comments generated by the discussion paper suggested superior alternative approaches, or further review developed improved approaches, or the necessary data elements were not yet available.

The format of the exhibits and the content of the narrative sections attempt to place the information presented in perspective by comparison against prior periods. The staff is continuing to refine both format and content and invites comment on alternative approaches.

SECURITIES COMMISSION RATES
SINCE APRIL 1975

Exhibits 1 through 5 and the accompanying text summarize information obtained from a monthly survey of 70 firms representing 50 to 60 percent of aggregate commission revenues of New York Stock Exchange members, during the period of April through August 1975.

The exhibits report information in these areas:

1. Changes in overall reported commission rates (Exhibit 1).

2. Commissions paid as a percentage of principal amount (Exhibit 2).

3. Commissions paid in cents per share (Exhibit 3)

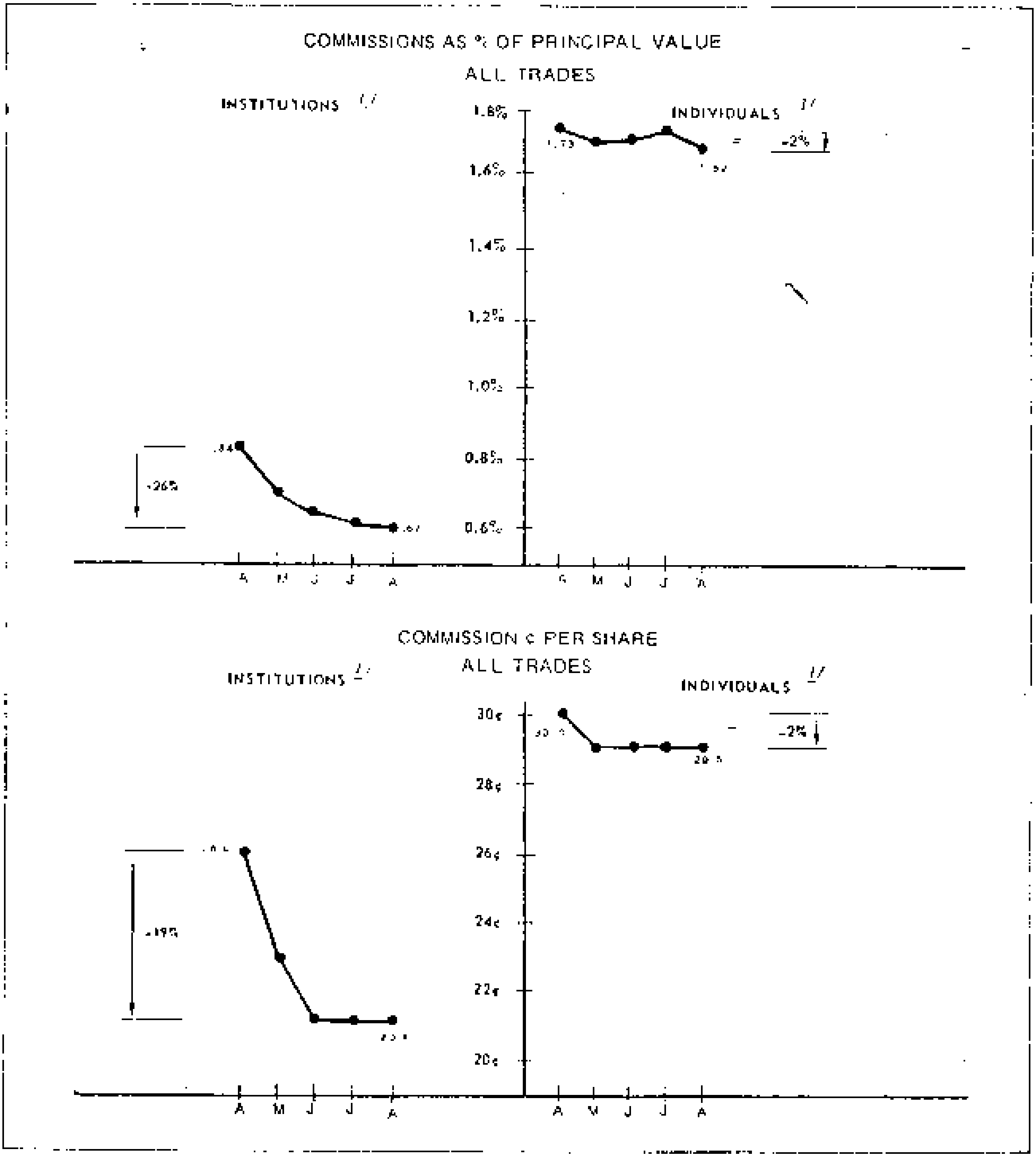
4. Estimated revenue foregone by the industry overall since elimination of fixed commission rates (Exhibit 4).

5. Estimated revenue foregone by type of securities firm (Exhibit 5).

Exhibit 1

EFFECTIVE COMMISSION RATES SINCE APRIL 1975

NYSE MEMBER FIRMS-OVERALL



1/ Where institutional and individual customers cannot be precisely identified, COD business is defined as institutional, and all other business as individual.

CHANGES IN OVERALL REPORTED COMMISSION RATES

Exhibit 1 shows the overall average commission rate paid by institutions and individuals to the sample firms since April 1975.[1/] The exhibit looks at commission rates two ways: first, as a percent of principal and, second, in terms of commission cents per share. Both measures, however, are affected by a wide range of variables such as order size and principal price.

In terms of commissions as a percent of principal value, the exhibit shows that institutions paid an average of 0.84 percent overall in April and 0.62 percent in August, a drop of about 26 percent. Conversely, individuals paid 1.73 percent in April and 1.69 percent in August, a drop of about 2.3 percent. Changes in cents per share show a similar pattern: institutions paid an average of 26 cents per share overall in April and 21 cents per share in August, a drop of about 19 percent; individuals paid 30 cents per share in April and 29.5 cents per share in August, a drop of about 2 percent.

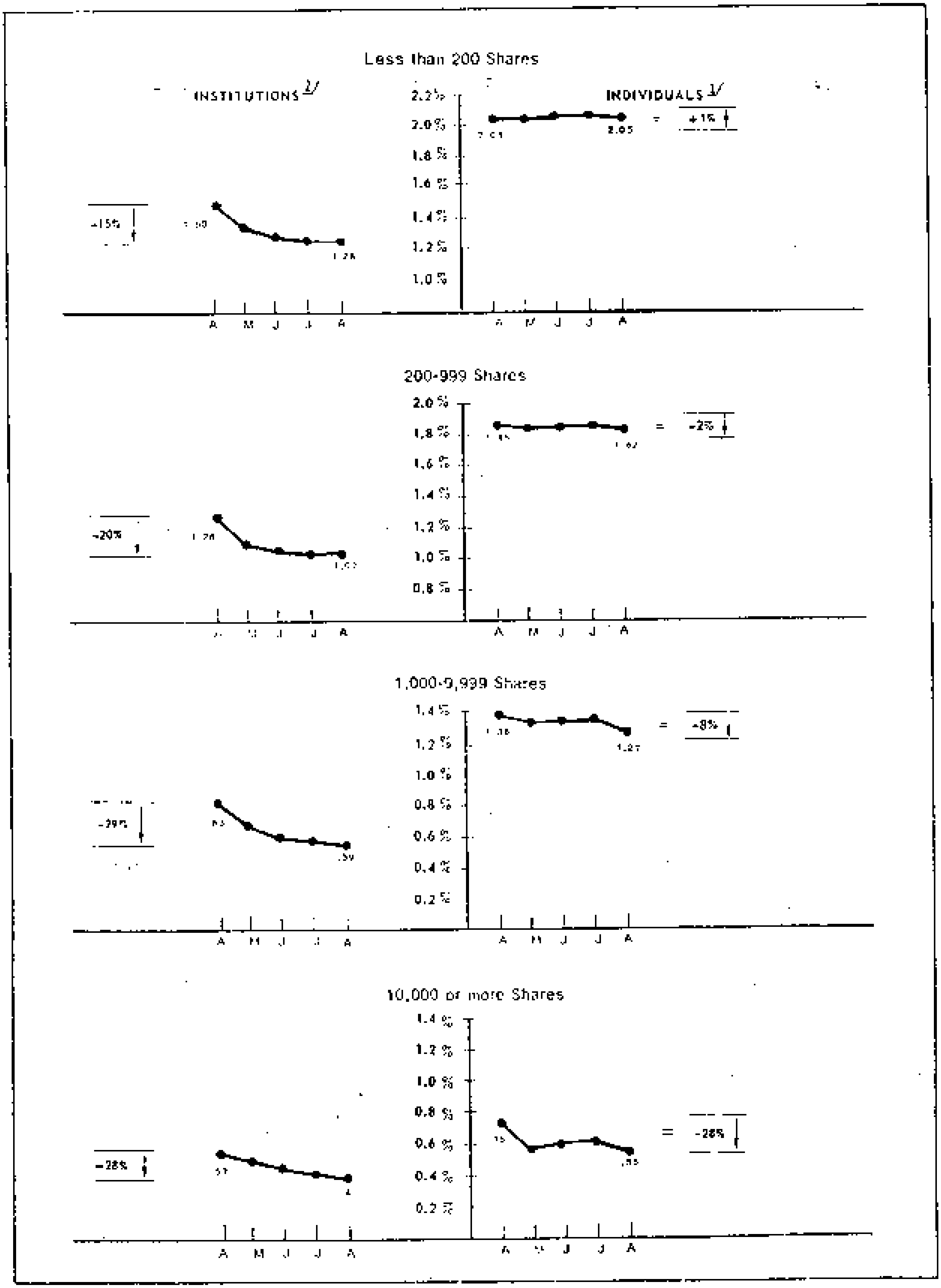
Although average daily volume on the New York Stock Exchange for August dropped to 13.5 million shares from 20 million shares per day in June and July, the sample firms showed no substantial drop in August from June and July discount levels for rates paid by either individuals or institutions.

1/ The SEC has also collected information on rates paid to a sample of non-NYSE member firms which shows that rates paid to these firms parallels very close those paid to NYSE members.

Exhibit 2

EFFECTIVE COMMISSION RATES SINCE APRIL 1975

NYSE MEMBER FIRMS COMMISSIONS AS % OF PRINCIPAL VALUE



1/ Where institutional and individual customers cannot be precisely identified, COD business is defined as institutional, and all other business as individual.

COMMISSIONS PAID AS PERCENT OF PRINCIPAL AMOUNT

Exhibit 2 expands upon Exhibit 1 by showing the commissions paid as a percent of principal by individuals and institutions on orders of various sizes.

Rates paid by institutions are lower for each order size category, declining about 15 percent for small orders and about 28 percent for the largest orders. Most of the drop in rates occurred in May and June with July and August representing only an additional 3 - 5 percent decrease, except that for orders of 10,000 or more shares, two-thirds of the 28 percent decline occurred in May and June and the remaining one-third occurred in July and August.

In contrast, rates paid by individuals have changed relatively little. Only for the very largest orders have rates declined substantially below April levels, with almost half of the decline occurring in August. For orders up to 10,000 shares, rates have remained approximately the same, although August has shown a slight decline.

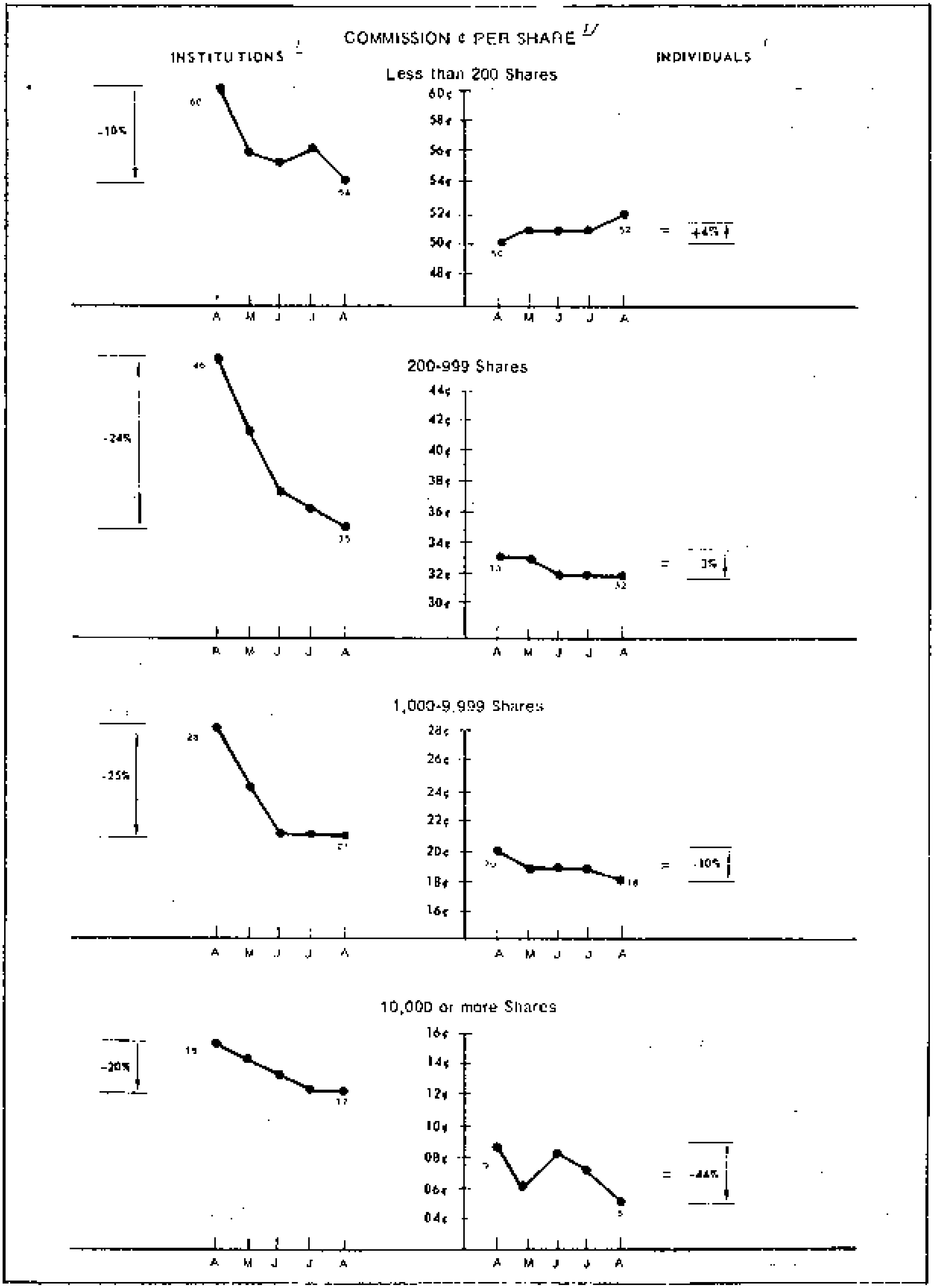
COMMISSIONS PAID IN TERMS OF CENTS PER SHARE

Exhibit 3 illustrates the second measure, commissions paid in terms of cents per share by individuals and institutions on orders of various sizes. Trends in changes in commissions calculated on this basis are similar to those calculated on the percent of principal

Exhibit 3

EFFECTIVE COMMISSION RATES SINCE APRIL 1975

NYSE MEMBER FIRMS-COMMISSION ¢ PER SHARE



1/ Where institutional and individual customers cannot be precisely identified, COD business is defined as institutional, and all other business as individual.

basis. Institutional changes have ranged from a 10 to 25 percent decline with the largest decreases for the medium-size orders. On the average, orders of less than 200 shares are down 10 percent (6 cents per share) while those of 10,000 or more shares are down 20 percent (3 cents per share).

Changes in rates paid by individuals are also parallel to those of the previous exhibit. Rates remain relatively stable except on the very largest orders. Rates have increased on small orders by about 4 percent (two cents per share) and rates are down almost 44 percent (4 cents per share, half of which occurred in August) for orders of 10,000 or more shares. However, due to the small number of individual orders in this order size group, the commissions per share is a very volatile number.

Comparison of Exhibits 2 and 3 shows that while institutions pay substantially lower commissions as a percentage of principal than individuals, individuals pay fewer cents per share on orders of each size. This difference appears to be caused by the fact that higher commissions, in cents per share, are generally paid on higher priced shares. As the table below shows, the price of the average share traded by individuals has been well below the price of shares traded by institutions in each order size category.

Order Size Range	Average Share Price	
	Individuals	Institutions
Less than $200	$ 24.65	$ 40.72
$200 - $999	$ 17.42	$ 35.30
$1,000 - $9,999	$ 13.96	$ 33.56
$10,000 or more	$ 11.42	$ 26.77
All	$ 17.07	$ 31.38

Exhibit 4

ESTIMATED REVENUES FOREGONE DUE TO COMPETITIVE COMMISSION RATES FOR ALL NYSE FIRMS, MAY-AUGUST 1975

All Markets

(Millions of Dollars)

May 1975

Value of Order Size – Ranges	Estimated Commission Revenue	Estimated Percent Discount from Effective Commission Rate Before May 1, 1975	Estimated Revenues Foregone
Under $2,000	$ 35.0	* %	$ *
$2,000 but less than $300,000	236.0	6.0	15.0
Over $300,000	30.0	7.7	2.5
Total	$ 301.0	5.6%	$ 17.6

June 1975

Value of Order Size – Ranges	Estimated Commission Revenue	Estimated Percent Discount from Effective Commission Rate Before May 1, 1975	Estimated Revenues Foregone
Under $2,000	$ 31.0	* %	$ *
$2,000 but less than $300,000	202.0	9.4	20.8
Over $300,000	22.0	14.4	3.7
Total	$ 255.0	8.8%	$ 24.5

July 1975

Value of Order Size – Ranges	Estimated Commission Revenue	Estimated Percent Discount from Effective Commission Rate Before May 1, 1975	Estimated Revenues Foregone
Under $2,000	$ 34.0	* %	$ *
$2,000 but less than $300,000	212.0	9.3	21.8
Over $300,000	24.0	14.9	4.2
Total	$ 270.0	8.8%	$ 26.0

August 1975

Value of Order Size – Ranges	Estimated Commission Revenue	Estimated Percent Discount from Effective Commission Rate Before May 1, 1975	Estimated Revenues Foregone
Under $2,000	$ 26.0	* %	$ *
$2,000 but less than $300,000	147.0	11.2	18.6
Over $300,000	17.0	15.1	3.0
Total	190.0	10.9%	21.6

* NO SIGNIFICANT CHANGE

ESTIMATED REVENUES FOREGONE
BY THE INDUSTRY OVERALL
SINCE THE ELIMINATION OF
FIXED COMMISSION RATES

To provide some additional perspective on the impact of negotiated rates, a number of individual firms, the New York Stock Exchange, and the Commission's Office of Economic Research have made estimates of the difference between commission revenue dollars actually paid to firms and what would have been paid if negotiated rates had not been introduced. None of such estimates have attempted to calculate the degree to which offsetting reductions in expenses occurred. The results of the Commission's analysis are shown in Exhibit 4.

The figures in Exhibit 4 were estimated by applying statistical techniques to the data filed by the 70 NYSE survey firms to approximate commission rate levels for all NYSE member firms. Based on this research, overall revenues foregone, without making any allowance for offsetting reductions in expenses, appear to have been $17.5 million in May, $24.5 million in June, $26.0 million in July and $21.6 million in August or $89.6 million for the four-month period. In absolute dollars, the largest revenue decrease appears to have been for orders in the $2,000 to $300,000 range, which accounted for between 55-60 percent of all orders. In percentage terms, the largest decline appears to have been for orders over $300,000, which accounted for less than one percent of all orders. 2/

2/ The SEC estimates of revenues figured in May are lower than those made by the New York Stock Exchange because of differences in data collection and sampling. Those interested in more detail on the estimating procedure or the difference from the NYSE estimate may contact James Burgess in the Directorate of Economic and Policy Research.

Exhibit 5

ESTIMATED REVENUES FOREGONE DUE TO COMPETITIVE COMMISSION RATES BY TYPE OF FIRM, MAY - AUGUST 1975

(Millions of Dollars)

Group Type	Estimated Commission on Equity Transactions	Estimated Percent Discount from Effective Commission Rate Before May 1, 1975	Revenues Foregone	Estimated Revenues Foregone as a Percent of Gross Revenue
		May 1975		
National Full-line	$ 88.0	1.9%	$ 1.7	-1.0%
Regional-local Full-line	7.5	2.6	.2	-1.2
Underwriter-General Dealer	33.7	[illegible]	3.6	-2.7
Institutional	16.4	[illegible]	3.3	-16.2
Commission Firms (Regional and Local)	$ [illegible]	8.[illegible]	$ [illegible]	-8.0%
		June 1975		
National Full-line	$ [illegible]	[illegible]	$ 2.5	-1.5%
Regional-local Full-line	7.8	4.6	.4	-2.3
Underwriter-General Dealer	32.7	12.6	5.2	-5.6
Institutional	11.2	23.2	3.4	-24.3
Commission Firms (Regional and Local)	$ 2.4	11.0%	$ .4	-9.0%
		July 1975		
National Full-line	$ 85.0	3.6%	$ 3.1	-1.9%
Regional-local Full-line	8.2	4.6	.5	-3.0
Underwriter-General Dealer	33.7	11.6	5.4	-6.6
Institutional	14.0	21.[illegible]	3.2	-2[illegible]
Commission Firms (Regional and Local)	$ *	*	$ *	*
		August 1975		
National Full-line	$59.2	4.9%	$ 2.9	-2.2%
Regional-local Full-line	[illegible]	5.6	.4	-3.0
Underwriter-General Dealer	29.3	16.5	5.6	-7.0
Institutional	10.5	23.5	3.2	-27.0
Commission Firms (Regional and Local)	$ *	*%	$ *	*%

* NOT AVAILABLE

COMMISSION RATE CHANGES BY TYPE OF FIRM

The 70 sample firms were placed into five categories[3/] developed to assist in estimating the impact of unfixing commission rates on different types of firms:

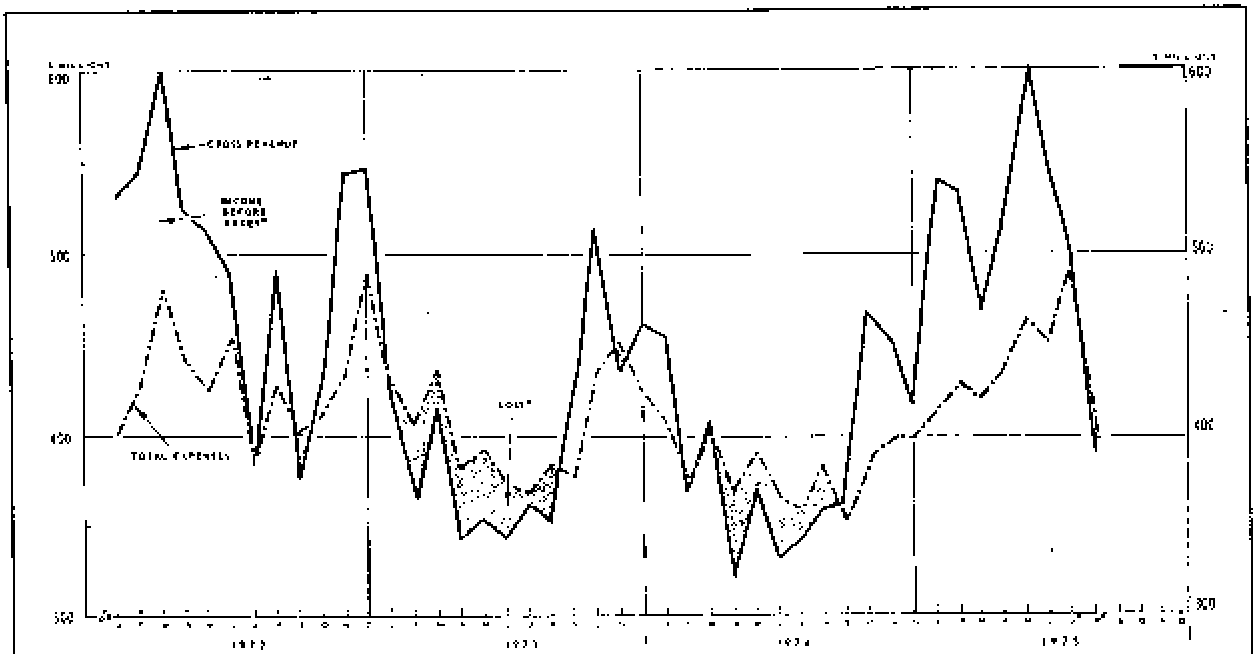
- o National Full-line Firms
- o Regional and Local Full-line Firms
- o Underwriters and General Dealers
- o Institutional Firms
- o Regional and Local Commission Firms

Exhibit 5 shows that discounts have been the largest percentage of gross revenues, by far, for firms classified as doing an institutional business. Using the published minimum commission rates on April 30, 1975 as a basis for comparison, estimated discounts for these firms ranged from 16.3 - 23.5 percent. Estimated commissions foregone (without offsets for reduced expenses) by these firms due to discounts increased from 24.3 percent of gross revenues in June to 27.3 percent in August. On that basis, total commissions foregone are estimated at $13.0 million on securities commission revenues of about $53.0 million (a 19.7 percent discount).

3/ These categories are a combination of categories on which the SEC has been working to represent widely different modes of doing business. A detailed presentation of the method of classification is described in a memorandum by Jeffrey L. Davis and Forrest E. Meyers entitled "Preliminary Report on Broker-Dealer Classification Scheme." This memorandum is available from the Directorate of Economic and Policy Research.

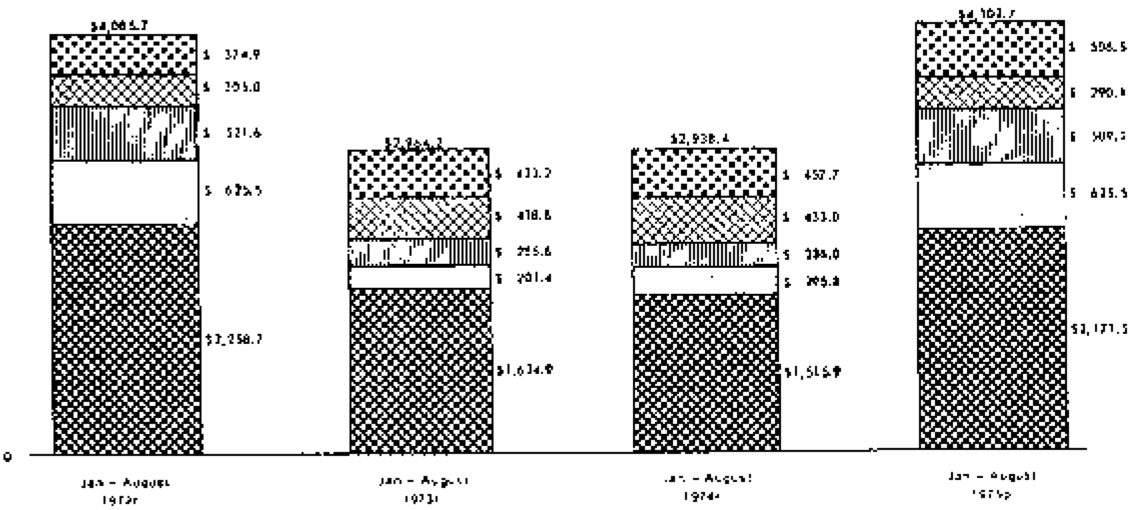
Exhibit 6

UNCONSOLIDATED REVENUES, EXPENSES AND INCOME [1/]

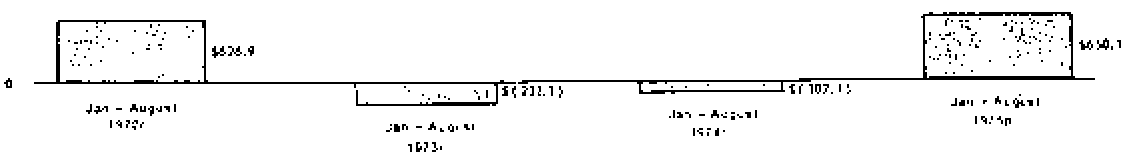


REVENUE 1975 YEAR-TO-DATE COMPARED TO PREVIOUS YEARS

MILLIONS OF DOLLARS



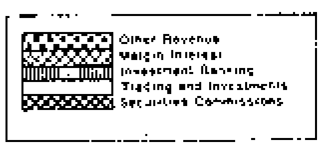
NET INCOME BEFORE TAXES* 1975 YEAR-TO-DATE COMPARED TO PREVIOUS YEARS



r = revised, p = preliminary

NOTE: *Individual Totals May Not Add Due to Rounding*

1/ For NYSE Member Firms Doing a Public Business



BROKER-DEALER FINANCIAL CONDITION

In addition to looking at changes in commission rates, the Commission is monitoring the financial condition of the securities industry overall and by firm type. Because of the monthly variability of securities commission income and overall broker-dealer revenues and expenses, both short-term and long-term comparisons of changes are made. The short-term comparison shows changes between the four months from January to April 1975, and the four months from May to August 1975. The long-term comparison shows changes between the eight months of January to August 1975 and the same eight-month periods in previous years.

The major areas reported on are:

1. broker-dealer revenues and income (Exhibits 6 and 7);
2. broker-dealer revenues, expenses, and income by type of firm (Exhibits 8, 9, and 10);
3. changes in broker-dealer capital (Exhibit 11); and
4. measures of broker-dealer profitability (Exhibit 12).

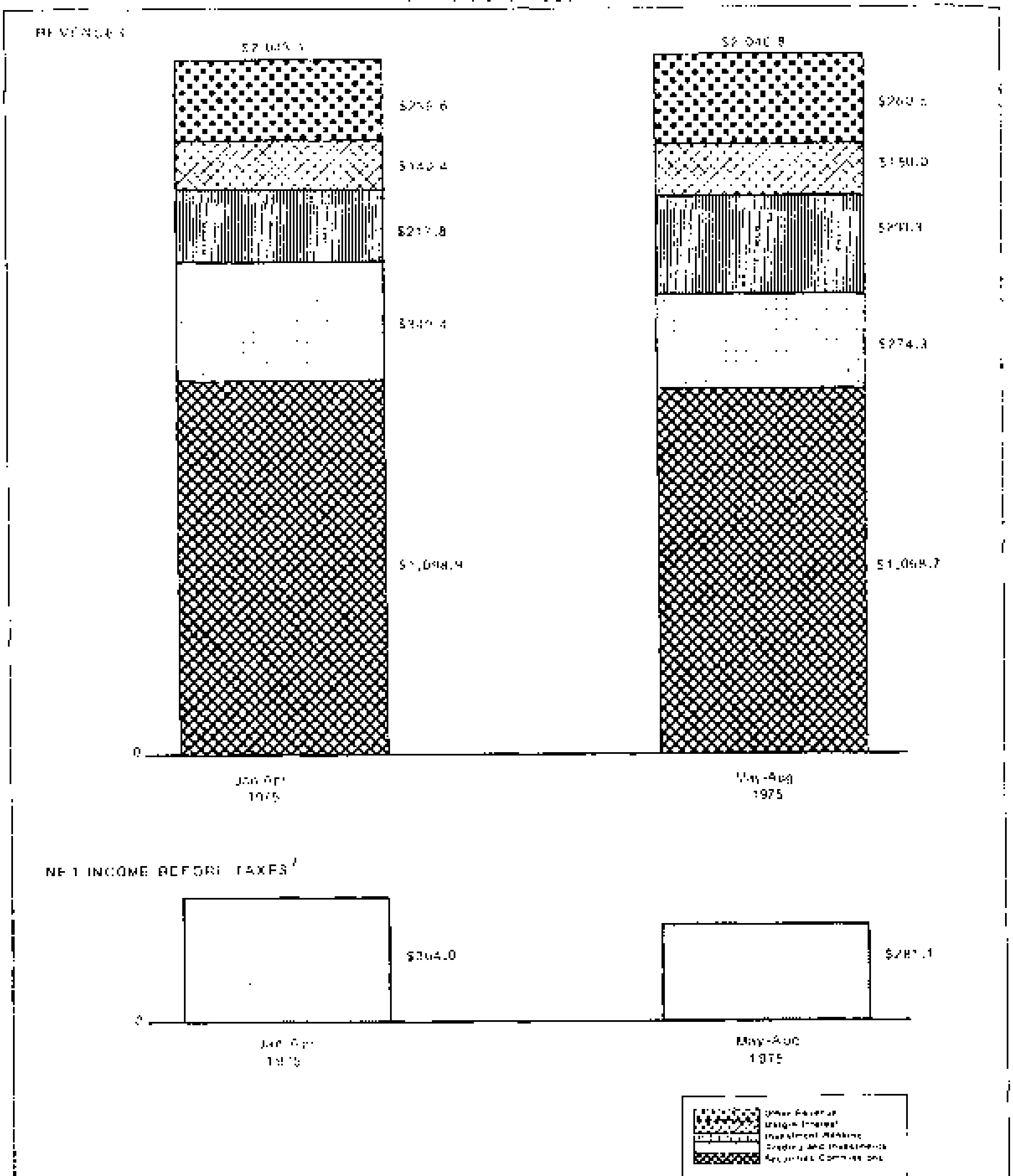
BROKER-DEALER REVENUES AND INCOME

The top part of Exhibit 6 shows gross revenues and total expenses on a month-by-month basis since January 1972 for NYSE member firms doing a public business. It indicates that revenues have been relatively high

Exhibit 7

UNCONSOLIDATED REVENUES AND NET INCOME

(Millions of Dollars)



for each month in 1975, setting a new record in May. With the exception of August 1975, a period of sustained profitable performance has existed among NYSE member firms since September 1974.

The middle section of Exhibit 6 compares five types of revenue for the first eight months of 1975 with the same periods for each of the last three years.[1/] Totals for 1975 are well above those of 1973 and 1974 and slightly higher than 1972. The slight decrease in 1975 from 1972 levels of securities commissions is more than made up for by the increase in Other Revenue. The three non-commission components of revenue are practically the same in 1975 as in 1972. The steady growth of the Other Revenue category is due to growth in commodities and mutual fund commissions, investment advisory fees, and dividends on firm investment accounts.

Finally, as shown by the bottom part of Exhibit 6, net income in 1975 is up sharply from the net losses of 1973 and 1974 and is about $25 million higher than 1972.

The top part of Exhibit 7 shows the five types of revenue for January - April 1975 and May - August 1975. Totals for the two periods are nearly equal, as are levels of securities commission revenues. The largest difference is the drop in trading revenue which is offset by

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1/ Information on the five components of gross revenue on a month by month basis is presented in Appendix A.

the increase in investment banking revenue. In the absence of unfixed rates, securities commission revenues earned during the May - August period would have been somewhat higher. Although share volume was about the same between the two four-month periods (2,244.9 million shares and 2,232.5 million shares, respectively), average share price rose (from $23.28 to $26.00), resulting in a higher dollar volume of market trading.

The bottom part of the exhibit shows a decline in aggregate profitability of $82.9 million, or 23 percent, between the two periods even though revenues were about the same. The sharp earnings decrease resulted from an $86.6 million increase (5.2%) in broker-dealer expenses. Changes in the categories of compensation to registered representatives and to partners and officers, along with higher clerical and administrative expenses accounted for almost 60 percent of the increase, while higher communication and interest expenses accounted for another 25 percent. This caused net income before tax as a percentage of gross revenues to drop from 17.8 percent in January - April to 13.7 percent in May - August.

REVENUES, EXPENSES AND INCOME BY TYPE OF FIRM

To improve its understanding both of the causes of changes in revenues and income and of the impact of unfixing commission rates on different types of broker-dealers, the staff grouped broker-dealer firms into categories which correspond generally to a common-sense understanding of the business. Further, the staff has endeavored to develop accurate historical financial data by firm category.

Considerable difficulty has been experienced in developing satisfactory categories and in assigning firms to them. Therefore, the staff views the findings developed to date as preliminary. However, it also views the topic as sufficiently important and the findings to date sufficiently interesting to warrant publishing preliminary results.

After considerable effort on firm categorization, the staff tentatively grouped New York Stock Exchange member firms into seven preliminary firm categories.[2/] These are:

- National Full-line Firms
- Regional and Local Full-line Firms
- Underwriters and General Dealers
- Institutional Firms
- Regional and Local Commission Business Firms
- Traders and Market-Makers
- Commission Introducing Firms

Having established these categories, the staff worked with historical firm income statement and balance sheet data to attempt to make the categories comparable over time. Historical data for firms which have since combined were restated to account, to the greatest extent possible, for significant mergers and combinations which occurred between 1972 and 1975. As a result, the seven categories of "classified" firms now consist of 366 firms whose

2/ A detailed presentation of the method of classification is described in a memorandum by Jeffrey L. Davis and Forrest E. Meyers entitled "Preliminary Report on Broker-Dealer Classification Scheme." Anyone interested in the memorandum or additional information on the categories can obtain it from the Directorate of Economic and Policy Research at the SEC.

Exhibit 8

REVENUES & REVENUE CHANGES BY FIRM TYPE*

January to August 1975 compared with 1972

(Millions of Dollars)

REVENUES BY CATEGORY	ALL CLASSIFIED FIRMS		NATIONAL FULL-LINE		REGIONAL & LOCAL FULL-LINE		REGIONAL & LOCAL COMMISSION BUSINESS	
	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD
Securities Commission	2083.7	6	844.7	10	210.0	1	131.7	9
Investment Banking	499.8	5	202.6	20	35.9	-29	3.6	-37
Trading & Investment	607.7	6	176.2	-5	46.2	-6	6.4	-5
Margin Interest Income	286.6	7	173.4	5	29.3	28	22.2	27
Other	471.4	52	178.3	43	28.9	3	9.1	11
TOTAL	3949.2	12	1575.1	11	350.4	-2	173.0	17
Number of firms	366		14		51		39	

REVENUES BY CATEGORY	INSTITUTIONAL		UNDERWRITERS		INTRODUCING		TRADERS & MARKET MAKERS	
	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD	1975 YTD	% Change from 1972 YTD
Securities Commission	137.8	18	552.5	9	47.8	8	159.2	-7
Investment Banking	3.4	-13	227.3	10	.4	-89	26.6	12
Trading & Investment	2.5	-47	208.6	29	5.5	24	162.3	17
Margin Interest Income	3.5	-39	51.4	26	.1	-76	6.7	-36
Other	10.7	24	151.6	71	26.7	30	66.1	230
TOTAL	157.9	13	1191.5	19	80.6	9	421.0	13
Number of firms	29		89		68		76	

REVENUES BY CATEGORY	NON-CLASSIFIED FIRMS
	1975 YTD
Securities Commission	83.9
Investment Banking	11.3
Trading & Investment	16.0
Margin Interest Income	3.8
Other	25.7
TOTAL	140.7
	3.4% of Total

NOTE: Figures may not add to totals due to rounding

**For NYSE Member Firms Doing a Public Business* total revenues of $3949.2 million for the first eight months of 1975 account for 96.6 percent of the revenues of the New York Stock Exchange members doing a public business. 3/ For 1972, the 366 firms and their predecessors accounted for 87 percent of revenues of member firms doing a public business.

Exhibit 8 provides preliminary information on the relative growth of revenues by firm category, broken into five revenue sources, during the period of January - August 1975 for each firm type. The percent change from revenues earned by these same firms for the same period in 1972 is also shown. As a group, the classified firms experienced a 12 percent increase in total revenues since 1972, contrasted with revenue growth of only 0.1 percent for all New York member firms doing a public business. This reflects some increased concentration in New York members as does the decrease by about 80 in the number of members doing a public business.

The exhibit shows substantially different patterns of revenue changes by firm type, and by revenue type within firm type. For example, securities commissions have risen 8 percent overall since 1972 with changes ranging from an 18 percent increase for Institutional firms (over 1972) to a 7 percent decline for Traders and Market Makers. Similarly, "Other Revenue" increased 52 percent overall with increases ranging from 230 percent for Traders and Market Makers to 3 percent for Regional and Local Full-line firms.

3/ Some classified firms could not be included in Exhibit 8 because of incomplete data. Such firms are included in all the other analyses.

Exhibit 9

REVENUES & REVENUE CHANGES BY FIRM TYPE*
January to April 1975 compared with May to August 1975
(millions of dollars)

REVENUES BY CATEGORY	ALL CLASSIFIED FIRMS		NATIONAL FULL-LINE		REGIONAL & LOCAL FULL-LINE		REGIONAL & LOCAL COMMISSION BUSINESS	
	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April
Securities Commission Income	1049.1	-3	427.9	3	105.4	1	66.0	1
Underwriting	287.2	35	107.3	12	22.6	70	2.2	66
Trading & Investment	269.9	-21	80.2	-16	19.7	-10	2.7	-30
Margin Interest	149.0	7	90.2	8	14.3	-5	11.0	0
Other	249.3	8	97.4	21	16.4	33	4.8	13
TOTAL	2004.5	0	802.9	4	178.4	4	86.9	1

REVENUES BY CATEGORY	INSTITUTIONAL		UNDERWRITERS		INTRODUCING		TRADERS & MARKET MAKERS	
	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April	May Thru August	% Change from Jan Thru April
Securities Commission Income	79.1	-24	273.4	-2	22.6	-10	74.7	-12
Underwriting	3.1	310	136.5	50	.3	252	15.2	32
Trading & Investment	1.5	-49	92.1	-21	1.3	-69	72.4	-20
Margin Interest	2.9	12	27.9	18	.1	37	2.6	-38
Other	11.7	55	79.5	10	12.9	-6	26.6	-33
TOTAL	98.4	-18	609.4	5	37.2	-14	191.4	-17

REVENUES BY CATEGORY	NON-CLASSIFIED FIRMS	
	May Thru August	% Change from Jan Thru April
Securities Commission Income	19.6	9
Underwriting	6.1	36
Trading & Investment	4.4	-53
Margin Interest	1.0	43
Other	11.2	84
TOTAL	42.2	9

NOTE: Figures may not add to totals due to rounding

*For NYSE Member Firms Doing a Public Business

These statistics suggest, among other things, that Regional and Local Full-Line firms have had well below average revenue growth, showing an overall decrease of 2 percent below levels in 1972, while Regional and Local Commission Business Firms, Institutional Firms, and Underwriters have had above average growth. Total revenues for Institutional firms increased 13 percent over 1972 levels due mainly to the 18 percent increase in securities commissions (almost $21.4 million).

Exhibit 9 contrasts these longer-term revenue growth patterns with more recent experience by indicating revenues earned by the classified firms during May - August 1975 and the percentage change from January - April 1975. Total revenue for all firms was essentially the same between the two periods, but widely varying patterns of change are apparent by type of revenue and type of firm. Securities commission revenues changes ranged from a 3 percent increase for National Full-Line firms to a 24 percent decline for Institutional firms. All firm categories experienced higher underwriting revenues and lower trading revenues. Institutional, Trading, and Introducing firms experienced sharp drops in overall revenues, while other categories showed small increases.

Finally, Exhibit 10 provides additional insight into the 23% net income drop referred to above by showing revenues, expenses, and net income before taxes for each of the seven categories of classified firms and for the unclassified firms for the two periods. The three categories of firms with substantial retail commission business (National Full-Line, Regional and Local Full-Line, and Regional and Local Commission Business) showed small revenue increases, but their larger percentage increases in expenses reduced net income

Exhibit 10

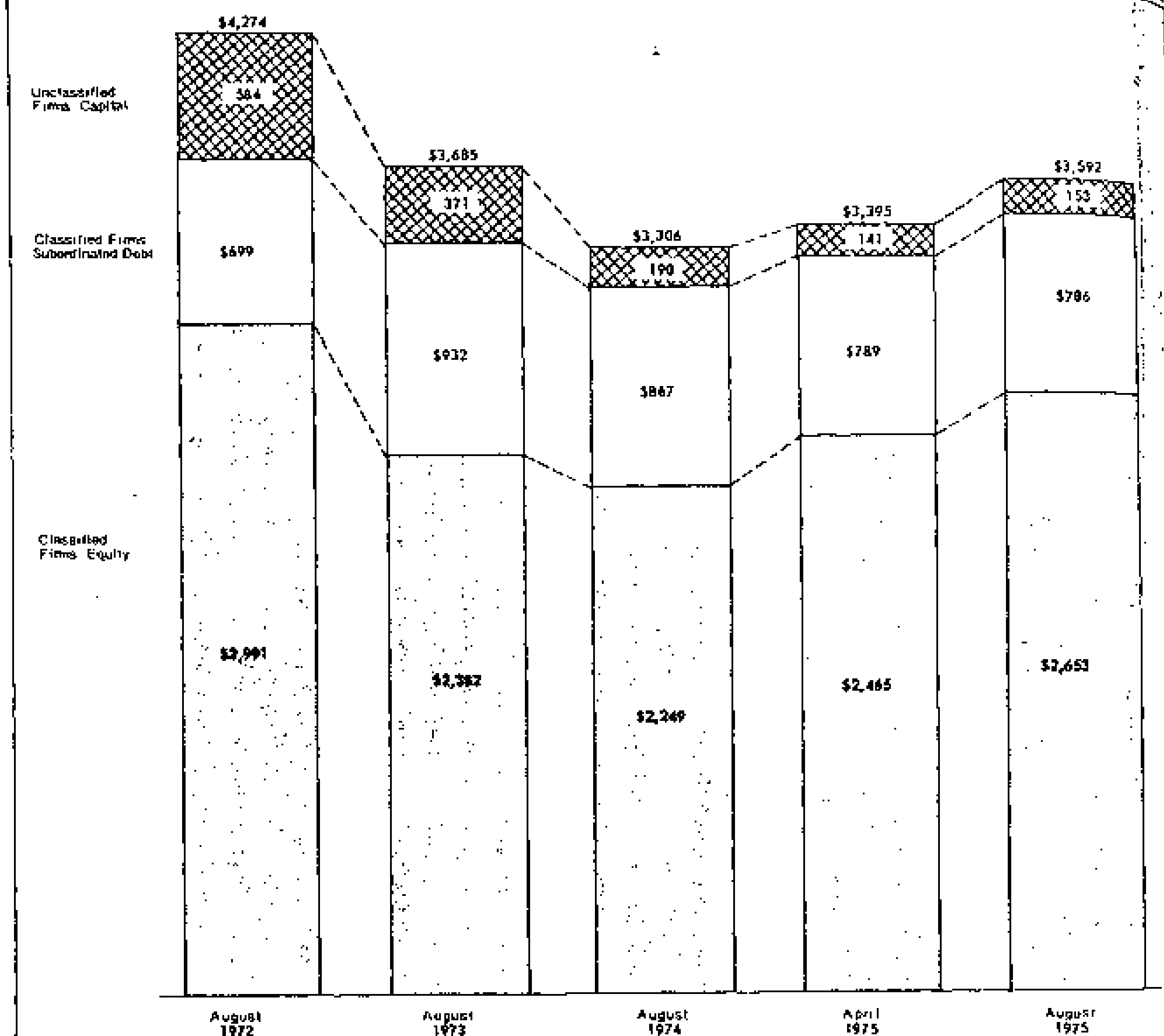
CHANGES IN REVENUES, EXPENSES, AND NET INCOME BY FIRM TYPE*
January to April 1975 compared with May to August 1975
(millions of dollars)

TYPE OF FIRM	REVENUES		EXPENSES		NET INCOME BEFORE TAXES		NUMBER OF FIRMS
	May-Aug	% Change from Jan Thru April	May-Aug	% Change from Jan Thru April	May-Aug	% Change from Jan Thru April	
National Full-Line	802.9	4	692.1	7	110.8	-10	14
Regional and Local Full-Line	178.4	4	155.8	6	22.6	-10	51
Regional and Local Commission Business	86.9	1	78.3	5	8.6	-27	39
Underwriters	609.4	5	516.3	7	93.1	- 5	89
Institutional	98.4	-18	87.3	-11	11.1	-46	29
Traders & Market Makers	191.4	-17	172.2	3	19.2	-69	76
Introducing	37.2	-14	31.2	- 4	6.0	-44	68
Other	42.2	9	32.5	29	9.7	-27	48-56
TOTAL	2046.8	0	1765.7	5	281.1	-23	414-422

* *For NYSE Member Firm Doing a Public Business*

Exhibit 11

CHANGES IN CAPITAL 1972-1975*



			August 1972	August 1973	August 1974	April 1975	August 1975
%Change from previous period	Unclassified Firms	Total Capital		-36.5%	-48.8%	-25.8%	8.5%
	Classified Firms	Total Capital		-10.2%	- 6.0%	4.4%	5.7%
	Equity			-20.4%	- 5.6%	9.6%	7.6%
	Subordinated Debt			33.3%	- 7.0%	- 9.0%	-0.4%
Number of Firms			496	457	423	414	422

*For NYSE-Member Firms Doing a Public Business by 10 to 27 percent. The two categories which include large numbers of institutionally oriented firms (Institutional and Introducing) showed substantial revenue declines which were not matched by expense declines, reducing net income by 46 and 44 percent. The two remaining categories, which are dealer oriented, showed mixed results. Traders and Market-Makers experienced a sharp decline in revenues and an increase in expenses which resulted in a 69 percent drop in net income. On the other hand, Underwriters and General Dealers showed a small increase in revenues and a slightly larger increase in expenses, resulting in a drop in net income of 5 percent - the smallest loss for any category.

Summarizing, the comparison suggests that firms classified as institutional have shown the largest percentage revenue decreases since May due to sharply lower commission and trading revenues, and Traders and Market-Makers the greatest decline in net income before taxes due mainly to losses in trading and investment accounts.

LEVELS OF BROKER-DEALER CAPITAL

To be aware of the amount of capital resources available to the securities industry, and to allow the calculation of trends in profitability measured in terms of return on those resources, the Commission is monitoring changes in capital resources of reporting broker-dealers.

Exhibit 11 includes the total capital of NYSE member firms doing a public business in August of each of the years 1972 through 1975 and in April 1975. It segregates total capital into three pieces: capital of "unclassified" firms; equity of the 366 "classified" member firms doing a public business at the end of August 1975 which were also in business in August 1972; and subordinated debt of this latter group of classified firms. Overall, total capital dropped $968 million (22.6 percent) from August 1972 to August 1974. By April 1975 total capital had recovered $89 million (2.1 percent) and during the first four months of unfixed rates recovered an additional $197 million (about 4.6 percent). As a result, total capital as of August 1975 was 16.0 percent below the August 1972 figure. However, the rise from April indicates the that unfixing of rates does not appear to have affected substantially the rebuilding of NYSE member firm capital.

The table below provides some initial insights into the reasons for longer-term capital shifts by showing the changes in capital for the 366 classified firms, the firms on which detailed information is available, as well as some details on the sources and uses of equity capital. The top half of the table shows that the overall decline of

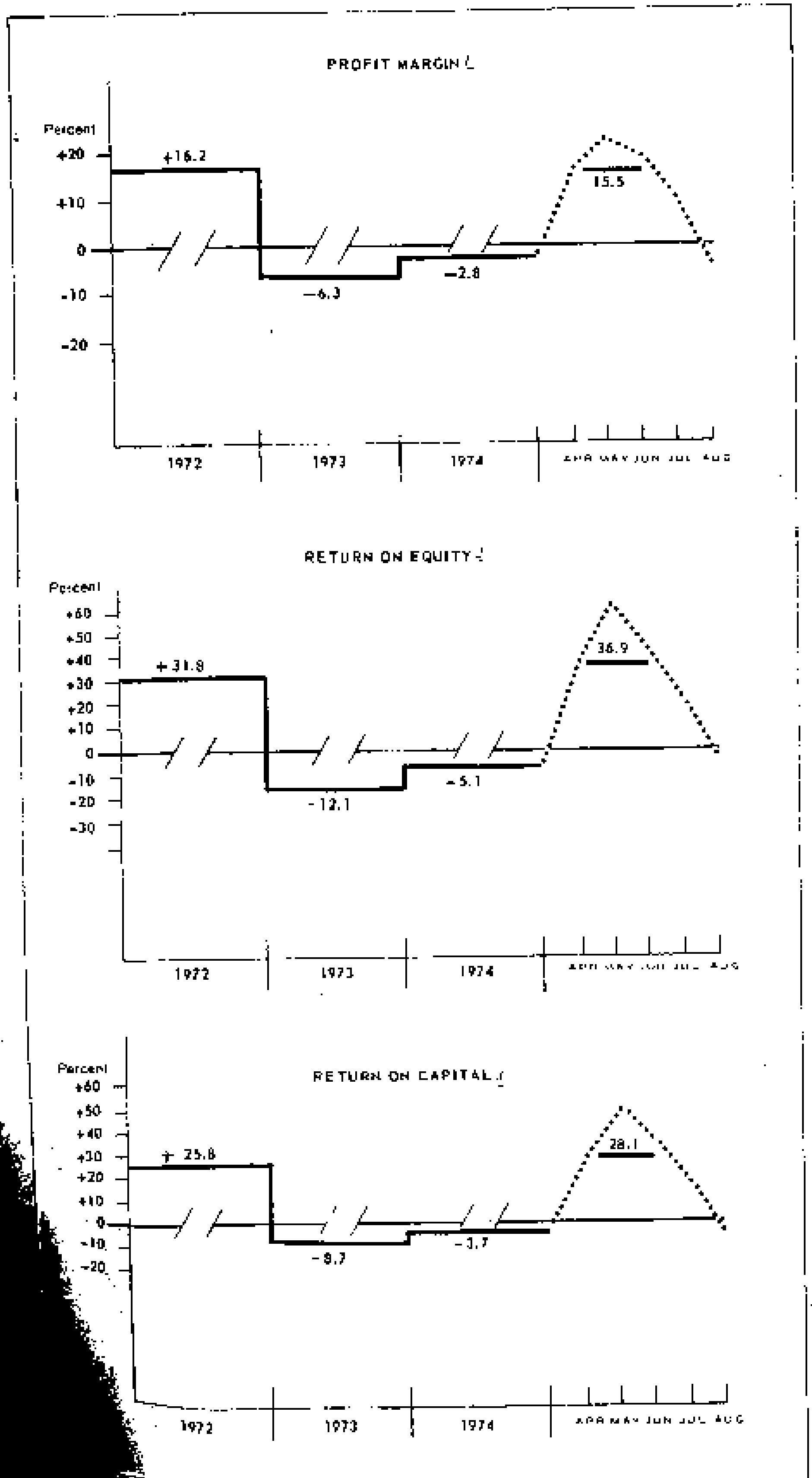
SOURCES AND USES OF BROKER-DEALER CAPITAL 1972-1975*

		Sept 72-Aug 73	Sept 73-Aug 74	Sept 74-Aug 75	Total
CAPITAL SHIFTS	Change in Total Capital	-376.0	-198.9	+323.3	-251.6
	Change in Subordinated Debt	+233.2	- 65.1	- 80.8	+ 87.3
	Change in Equity Capital	-609.2	-133.8	+404.1	-338.9
SOURCES & USES OF EQUITY	Net Income	- 31.6	+ 78.2	+565.3	+611.9
	Dividends Paid	- 36.0	- 36.4	- 35.0 (e)	-107.4
	Change in Seat Prices	- 63.0	- 6.3	+ 34.3	- 35.0
	All Other	-478.6	-169.3	-160.5	-808.4

*For NYSE Member Firms Doing a Public Business

Exhibit 12

MEASURES OF BROKER-DEALER PROFITABILITY*



[illegible]lied NYSE Member Firms Doing a Public Business

[illegible]margin is defined as the ratio of income (after partners' compensation [illegible]ore taxes) to gross revenues.

[illegible]on equity is defined as the ratio of income (after partners' compensation [illegible]ore taxes) to ownership equity.

[illegible]capital is defined as the ratio of income (after partners' compensation but [illegible]) to total capital. Total capital is defined as the sum of ownership equity [illegible]nated borrowings. Figures are annualized.

$338 million in equity from September 1972 to August 1975 was made up of a major drop from September 1972 to August 1973, a smaller drop to August 1974 and a significant increase in the last period. The reasons for the changes in equity capital are partially explained by the data in the lower half of the exhibit. For the total three-year period, dividends paid used $107 million, changes in seat prices accounted for $35 million, net income provided $612 million and "all other" used $808 million.

The "All Other" category includes a number of items: partnership draws and distributions, net capital contributions and withdrawals, net stock issued and retired, and assorted less significant items. Although no breakdown of "All Other" is available for the August 1972 to August 1975 time period, some information is provided by the brokers' 1973 and 1974 annual reports to the SEC. These reports show that "All Other" capital declined in these two years by nearly $600 million. Of this decline, 69 percent was partnership draws, 25 percent was net of capital additions and withdrawals, and 6 percent was stock retirement.

In summary, both total capital and equity capital of the 366 firms have grown since the unfixing of commission rates and are at higher levels than any time since 1972.

MEASURES OF PROFITABILITY

Finally, the staff combined elements of the income and capital information discussed above to monitor the performance of the industry in terms of some common profitability measures: profit margin, return on equity, and return on capital. Exhibit 12 shows these measures for the

366 classified NYSE member firms for the first eight months of 1972 - 1975 (the solid lines) and for the individual months of April to August 1975 (the dotted lines). The definitions of the three measures also appear on the exhibit.

Although the calculation of the measures for 1972 and 1973 required some assumptions (primarily because monthly information was not available to create eight-month figures), the patterns appear clear. Each of the three measures shows relatively high profitability in 1972 declining to significant losses in 1973 and continued losses in 1974.

Finally, while the averages for the eight months of 1975 are relatively high, at or near the levels of 1972, all show significant declines since June. In May and June, the first two months of negotiated rates, profits and returns were above the overall eight-month average for 1975. However, July showed a decline on all measures and August, a loss.

TRADING AND MARKETPLACE ECONOMICS

The third area that the Commission has been monitoring is trading and marketplace economics. Monthly data has been collected on self-regulatory organization revenues and expenses, and on the distribution of trading activity in NYSE-listed securities.

The major areas monitored are:

1. Distribution of trading among the NYSE, regional exchanges and the third market (Exhibits 13 and 14).
2. Self-regulatory organization revenues and net income (Exhibits 15 and 16).

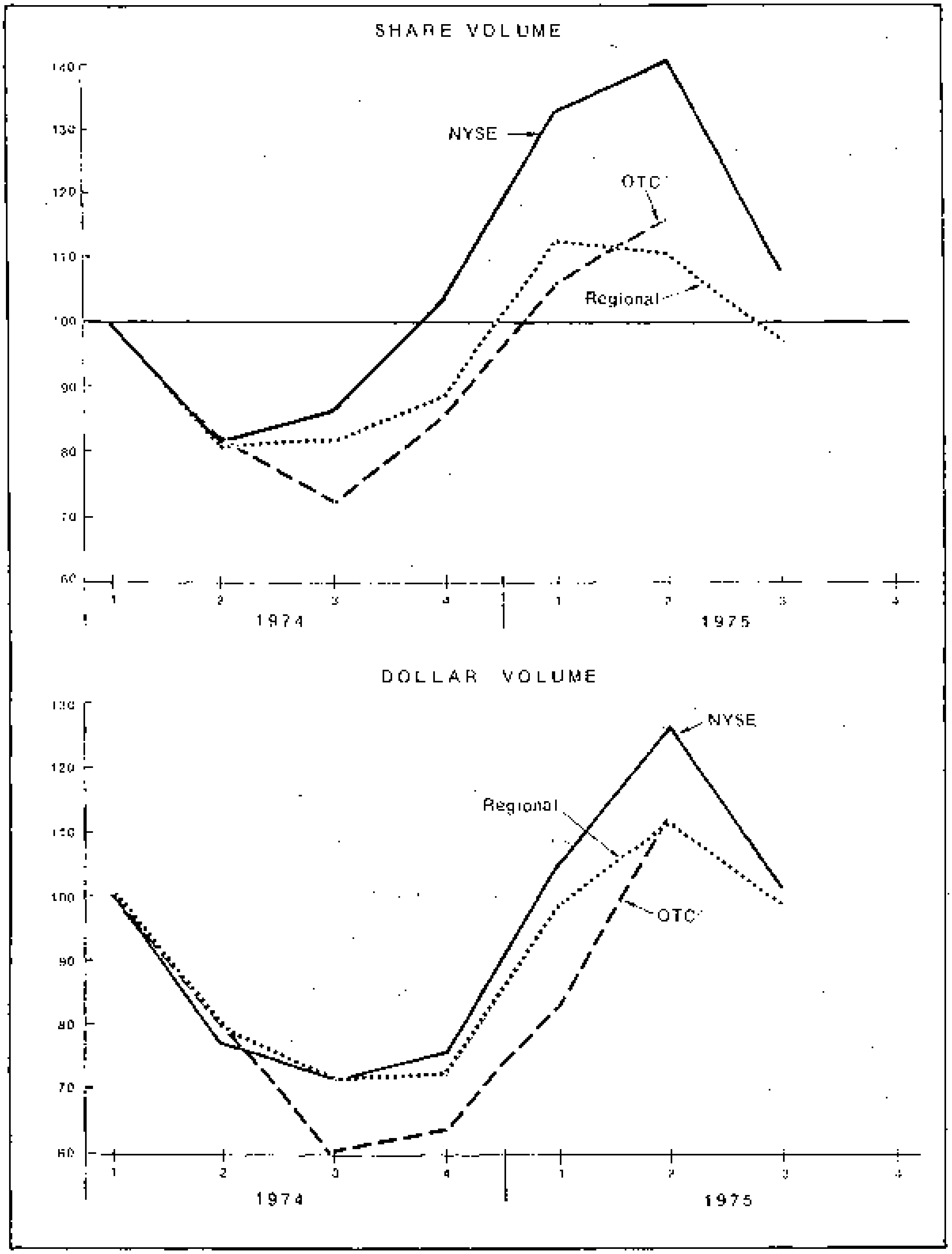
DISTRIBUTION OF TRADING IN NYSE-LISTED SECURITIES

To monitor shifts in trading patterns of NYSE-listed securities, the Commission has collected trading information from the registered exchanges and the NASD on aggregate share and dollar volume as well as data on selected individual stocks. The information from January 1974 - June 1975 is from data filed with the Commission while the July - September 1975 data is unedited preliminary information provided by the Consolidated Tape Association.

Exhibit 13

CHANGES IN NYSE-LISTED TRADING MARKET SHARE

(AS % OF FIRST QUARTER 1974 LEVELS)



* Third Quarter figures not available

Exhibit 13 presents the information on distribution of exchange trading. It shows the share and dollar volume on the New York Stock Exchange, on the regional exchanges, and in the over-the-counter market for each quarter since January 1974, using an index system.

If trading on regional exchanges is the same percentage of New York Stock Exhange trading in listed stocks as in the past, then parallel changes in trading volume between New York and the regionals would indicate that there has not been a dramatic shift in distribution of listed security trading between those two market centers. The exhibit shows this to have been the case. Likewise, for the over-the-counter parallel patterns again lead to the conclusion that there have been no dramatic shifts.

Although the NYSE accounts for 85 percent of trading in all NYSE-listed securities, it often accounts for only 70-75 percent of trading in higher volume securities. Accordingly, changes in the trading patterns of these stocks are of particular interest.

Exhibit 14 indicates the distribution of trading volume for three trading centers of the ten NYSE-listed stocks with the highest six-month volume.[1/] The NYSE market share in January - March ranges from 76.9 percent for Southern Company to 70.4 percent for Gulf Oil. The April - June market share range is 84.1 percent also for Southern Company to 68.8 percent for Citicorp.

1/ Volume is compared for the periods January - March and April - June. Precise data which would allow comparison after May 1 is not available.

Exhibit 14

CHANGE IN TRADING DISTRIBUTION OF SELECTED NYSE-LISTED STOCKS

(Percent of Total Trading)

		NYSE	REGIONAL	OTC
American Tel & Tel	Jan-Mar Apr-Jun	71.6% 76.4%	19.6% 18.4%	8.8% 5.2%
Citicorp	Jan-Mar Apr-Jun	73.5% 68.8%	14.5% 14.4%	12.0% 16.8%
General Electric	Jan-Mar Apr-Jun	72.2% 72.7%	19.5% 16.1%	8.3% 11.2%
General Motors	Jan-Mar Apr-Jun	73.2% 70.8%	19.4% 19.3%	7.4% 9.9%
Gulf Oil	Jan-Mar Apr-Jun	70.4% 72.2%	19.8% 19.8%	9.8% 8.0%
International Tel & Tel	Jan-Mar Apr-Jun	72.5% 79.2%	24.1% 19.0%	3.4% 1.8%
Kresge	Jan-Mar Apr-Jun	72.7% 71.5%	18.7% 17.0%	8.6% 11.5%
Southern Co	Jan-Mar Apr-Jun	76.9% 84.1%	19.2% 12.9%	3.9% 3.0%
Texaco	Jan-Mar Apr-Jun	72.4% 77.8%	21.6% 16.4%	6.0% 5.8%
Westinghouse	Jan-Mar Apr-Jun	74.0% 81.0%	20.9% 16.8%	5.1% 2.2%

☐ NYSE MARKET SHARE INCREASED

Exhibit 15

SELF-REGULATORY ORGANIZATION REVENUES

(Thousands of Dollars)

	Self-Regulatory Organization*							
	NYSE	AMEX	MSE	NASD	PSE	PBW	BSE	Total
Total Revenues								
1975 Jan-Aug 1/	76,394	16,195	14,852	14,415	8,129	2,666	2,586	134,837
Ratio 2/	122%	121%	114%	107%	119%	123%	126%	120%
1974	93,698	19,770	19,473	20,267	10,271	3,261	2,556	169,246
1972	98,002	26,011	18,813	20,455	9,985	4,145	2,045	179,456
Transaction Fees								
1975 Jan-Aug 1/	15,220	2,836	1,026	--	679	445	248	20,453
Ratio 2/	134%	185%	137%	--	114%	144%	199%	139%
1974	17,026	2,302	1,123	--	896	463	187	22,001
1972	19,474	5,986	1,404	--	1,492	647	207	29,210
Listing Fees								
1975 Jan-Aug 1/	14,713	3,251	343	1,731	541	70	62	20,711
Ratio 2/	117%	118%	156%	204%	152%	104%	116%	122%
1974	18,938	4,162	330	1,273	535	101	80	25,401
1972	20,053	5,183	422	--	622	71	65	26,414
Communications Fees								
1975 Jan-Aug 1/	6,892	6,983	2,253	--	--	--	--	16,128
Ratio 2/	132%	113%	95%	--	--	--	--	117%
1974	7,855	9,304	3,553	--	--	--	--	20,712
1972	8,399	8,981	1,211	--	--	--	--	18,591
Clearing Fees								
1975 Jan-Aug 1/	11,728	1,445	1,952	5,613	2,229	1,553	900	24,920
Ratio 2/	127%	122%	180%	110%	133%	103%	137%	124%
1974	13,275	1,776	1,629	7,638	2,507	2,257	988	30,070
1972	15,466	2,876	3,022	7,621	3,412	2,853	998	36,248
Depository Fees								
1975 Jan-Aug 1/	17,499	--	783	--	726	5	--	19,013
Ratio 2/	127%	--	97%	--	146%	--	--	126%
1974	20,738	--	1,211	--	747	--	--	22,696
1972	19,773	--	0	--	196	--	--	19,469
Tabulation Services								
1975 Jan-Aug 1/	--	22	6,021	--	2,468	--	440	8,952
Ratio 2/	--	254%	108%	--	151%	--	145%	119%
1974	--	13	8,347	--	2,450	--	454	11,264
1972	--	18	9,130	--	2,815	--	71	12,034
All Other Revenues								
1975 Jan-Aug 1/	9,858	1,669	2,474	7,071	1,486	593	536	23,706
Ratio 2/	93%	112%	113%	93%	72%	202%	95%	95%
1974	15,866	2,233	3,276	11,354	3,085	440	847	37,102
1972	15,336	2,969	3,624	12,834	1,448	574	704	37,489

* In order of 1972 revenues; includes only organizations with 1972 revenues of more than $1 million.

1/ Year-to-date figures include January thru August based on information available in early November.
2/ 1975 revenues to date as a percentage of 1974 revenues to date, which are estimated by multiplying assumed equal revenues in each 1974 month times the number of months to date. This method ignores seasonality factors, but should provide a satisfactory estimate of trends.

The NYSE market share increased in the second quarter for seven of the ten stocks, and decreased for three. Of the seven stocks where NYSE market share increased, no consistent pattern of either the regional or the over-the-counter markets losing volume was apparent.

SELF-REGULATORY ORGANIZATION REVENUES AND NET INCOME

Exhibit 15 indicates the revenues of the seven self-regulatory organizations having 1972 revenues of $1 million or more. Total revenues and the six major revenue items (those common to most of the organizations) are shown for the full years 1972 and 1974, as well as for January-August 1975. In addition the ratio of 1975 eight-month revenues to those estimated in 1974 is shown.

As shown by the last column of the exhibit, total revenues for all organizations are nearly 20 percent higher than for the similar period last year. In almost all individual categories, revenues are ahead of 1974 levels, and in many cases ahead of 1972 levels as well.

Exhibit 16 compares aggregate revenues for 1972, 1973, 1974 and each month of 1975 to aggregate expenses for the same periods. Total expenses for all organizations increased from $160 million in 1972 to $170 million in 1974, while total revenues dropped from about $179 million to $169 million, causing a loss of approximately $1 million in 1974 compared to a net income of $19 million in 1972.

Exhibit 16

AGGREGATE SELF-REGULATORY ORGANIZATION* REVENUES AND EXPENSES

(Thousands of Dollars)

	1972	1973	1974	1975 Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.
Revenues											
Transaction Fees	$ 29,210	$ 26,027	$ 22,030	$ 1,761	$ 2,092	$ 2,812	$ 2,734	$ 2,782	$ 2,961	$ 2,665	$ 2,615
Listing Fees	26,616	26,458	25,305	2,440	2,076	2,401	2,302	3,166	2,945	3,017	2,714
Commission Fees	17,591	21,314	20,732	1,875	1,953	1,996	2,003	1,997	2,054	2,121	2,128
Clearing Fees	36,243	32,523	30,032	2,465	3,201	3,150	3,257	3,358	3,314	3,477	2,170
Depository Fees	19,469	23,556	27,696	2,360	2,303	2,475	2,481	2,428	2,339	2,557	2,115
Tabulation Services	12,034	10,452	11,254	1,051	1,078	1,070	1,118	1,199	1,157	1,191	1,079
All Other Revenues	37,491	37,854	37,102	2,969	2,882	2,942	3,139	2,933	2,797	3,095	2,874
Membership Dues	9,853	10,010	10,706	874	880	977	965	834	833	880	895
Registration Fees	5,622	6,366	4,775	375	370	362	435	357	337	415	340
Floor Usage Revenue	4,655	4,662	4,555	545	532	531	549	576	535	541	552
Corporate Finance Fees	2,216	1,207	850	39	76	102	134	150	57	87	130
Other	15,144	15,009	16,225	1,037	1,026	1,070	1,056	995	1,033	1,160	961
Total Revenues	$179,457	$178,267	$169,248	$15,425	$15,591	$16,791	$17,217	$17,843	$17,668	$18,150	$15,199
Expenses											
Employee Costs	70,301	$ 77,035	$ 78,531	$ 6,945	$ 6,209	$ 6,483	$ 6,650	$ 6,725	$ 6,625	$ 6,997	$ 5,312
Occupancy Costs	7,911	10,538	12,240	982	934	1,093	1,027	924	1,029	1,039	1,116
Equipment Costs	1,696	1,632	1,993	164	184	206	185	204	213	239	297
Professional and Legal Services	7,317	8,265	5,182	384	387	437	542	469	680	830	805
Depreciation and Amortization	3,764	3,299	3,722	335	348	354	358	357	357	356	357
Advertising, Printing and Postage	4,165	5,007	4,341	361	285	221	288	217	297	193	341
Communication, Data Processing and Collection	49,831	56,757	57,290	4,783	4,795	4,648	4,837	4,946	5,380	4,599	4,284
All Other Expenses	16,596	14,949	11,671	812	1,039	1,053	1,002	1,961	1,072	1,154	1,073
Total Expenses	$180,332	$175,400	$169,977	$14,566	$14,190	$14,494	$14,859	$15,801	$15,411	$15,506	$15,165
Net Income Before Income Tax	$ 19,125	$ 2,660	$ (732)	$ 858	$ 1,400	$ 2,297	$ 2,358	$ 2,040	$ 2,257	$ 2,644	$ 34

* Table has been revised to reflect the Depository Trust Company financial data. The organizations included were: American Stock Exchange; Boston Stock Exchange; Midwest Stock Exchange; National Association of Securities Dealers; New York Stock Exchange; PBW Stock Exchange; and the Pacific Stock Exchange.

NOTE: Totals may not add due to rounding.

The 1975 figures show substantial profits were experienced for the group during the months of January through July. However, August showed only marginal net income; even though August revenues were near those of January and February 1975, expenses were $1 million higher.

QUALITY OF THE MARKET

As indicated in the staff discussion paper, "Monitoring Trends in Securities Markets, Trading and Broker-Dealer Activity", the Commission has been evaluating the impact of competitive rates on the "quality of the market" even though it views quality of the market as difficult to define and even more difficult to measure. Staff efforts have concentrated on attempting to develop meaningful measures of spreads, price volatility, and liquidity - the factors which are most commonly discussed as being important to market quality.

SECURITY
SPREADS

As suggested in the monitoring paper, changes in spreads appear to be one of the most important elements to monitor. However, isolating the specific impact of competitive rates (or of any other single regulatory change) on spreads is particularly difficult because so little knowledge is available about what variables affect spreads and how those variables of significance cause spreads to be what they are. 1/

Since the staff's review of the academic research indicated that share price, share volume, and institutional interest in a stock are among the major determinants of spreads, the initial plan was to use these factors to define categories of "similar" stocks, and compare changes in spreads for stocks having about the same prices, share volume and institutional interest in one period as in the next.

1/ In addition, available information on spreads reflects limit orders on the book as well as specialists dealing for their own accounts. Changes in spreads, therefore, may be affected by changes in the flow of limit orders.

Exhibit 17

CHANGE IN AVERAGE SPREAD BY STOCK CATEGORY

SHARE VOLUME	SHARE PRICE	INSTITUTIONAL INTEREST		
		High	Medium	Low
HIGH	HIGH	-7.1%	-6.6%	-*
	MEDIUM	-*	-8.3%	-6.3%
	LOW		-11.2%	-14.1%
MEDIUM	HIGH		-8.2%	-*
	MEDIUM		+*	-*
	LOW			+*
LOW	HIGH			-*
	MEDIUM			-*
	LOW			-8.9%

*Percentage change between March 1975 and June 1975 average spreads for stock category. Only changes of 5% or more shown.

= No stocks in this category

= Average Spread Increased

Exhibit 17 illustrates the results of this approach. Each stock was placed in one of 27 categories defined by price, volume, and institutional interest. Spreads as a percent of security prices were computed for every stock traded for each month January-June 1975. The average of the spreads for all the stocks in each category for each month was then calculated.

The exhibit shows the percentage changes in average spreads in each category between March and June 1975. (Other month-to-month comparisons are possible; this was selected as being representative.) Only two categories show wider average spreads; all other categories of stocks show narrower spreads, often by large percentages. The largest changes occurred for high volume stocks with low prices and low institutional interest where average spreads dropped a little over 14 percent.

Although some insights were provided by the analysis leading to Exhibit 17, spreads did not manifest the relationship which would seem to be suggested by the research. The assumption was that spreads for stocks in the same category would be much the same, but different from the typical spreads in other categories; in fact, the range of spreads for stocks in many categories was quite large, and it was difficult to distinguish adjacent categories.

For these reasons, the staff decided to augment the analysis with a second approach. The average (mean) spread for each stock was calculated for the 12 weeks prior to May 1 and for 10 weeks following May 1. Each stock was then placed in a category (slightly different from

Exhibit 18

NUMBER OF STOCKS CHANGING SPREADS

SHARE VOLUME	SHARE PRICE	NUMBER OF STOCKS HAVING SPREADS		
		INCREASE	SAME	DECREASE
HIGH	High	49	4	65
	Medium	60	2	64
	Low	16	4	16
MEDIUM	High	53	1	61
	Medium	127	6	166
	Low	68	4	56
LOW	High	24	1	34
	Medium	205	9	157
	Low	162	8	118
TOTAL		764	39	737

[illegible]

those for Exhibit 17 due to sampling requirements) and the number of stocks in each category for which the average spread changed or stayed the same between the two periods was counted.

Exhibit 18 shows the results of this approach, overall and by category of stock. For each category, it indicates the number of stocks whose average spreads increased, decreased or stayed the same. In six of the nine categories, the majority of the stocks had narrower spreads after May 1st. In three categories (stocks having both low volume and low or medium prices), spreads widened more often than narrowed. Overall, about as many stocks had wider spreads (764) as had narrower or unchanged spreads (776).

Although work to date indicates that no major changes have occurred in spreads, it is clear that to obtain a precise understanding of why changes in spreads occur and to what extent they are attributable to changes in regulatory procedures or market dynamics, considerable additional work must be done.

STOCK PRICE VOLATILITY

To measure volatility (the second of the announced quality of market measures) the staff revised measures proposed in the monitoring paper for both of the variables of interest: overall market volatility and volatility by stock category. 2/

2/ A paper describing the market measure in detail is available from Raymond Marcotte of the SEC's Directorate of Economic and Policy Research.

Exhibit 19

AGGREGATE MARKET VOLATILITY

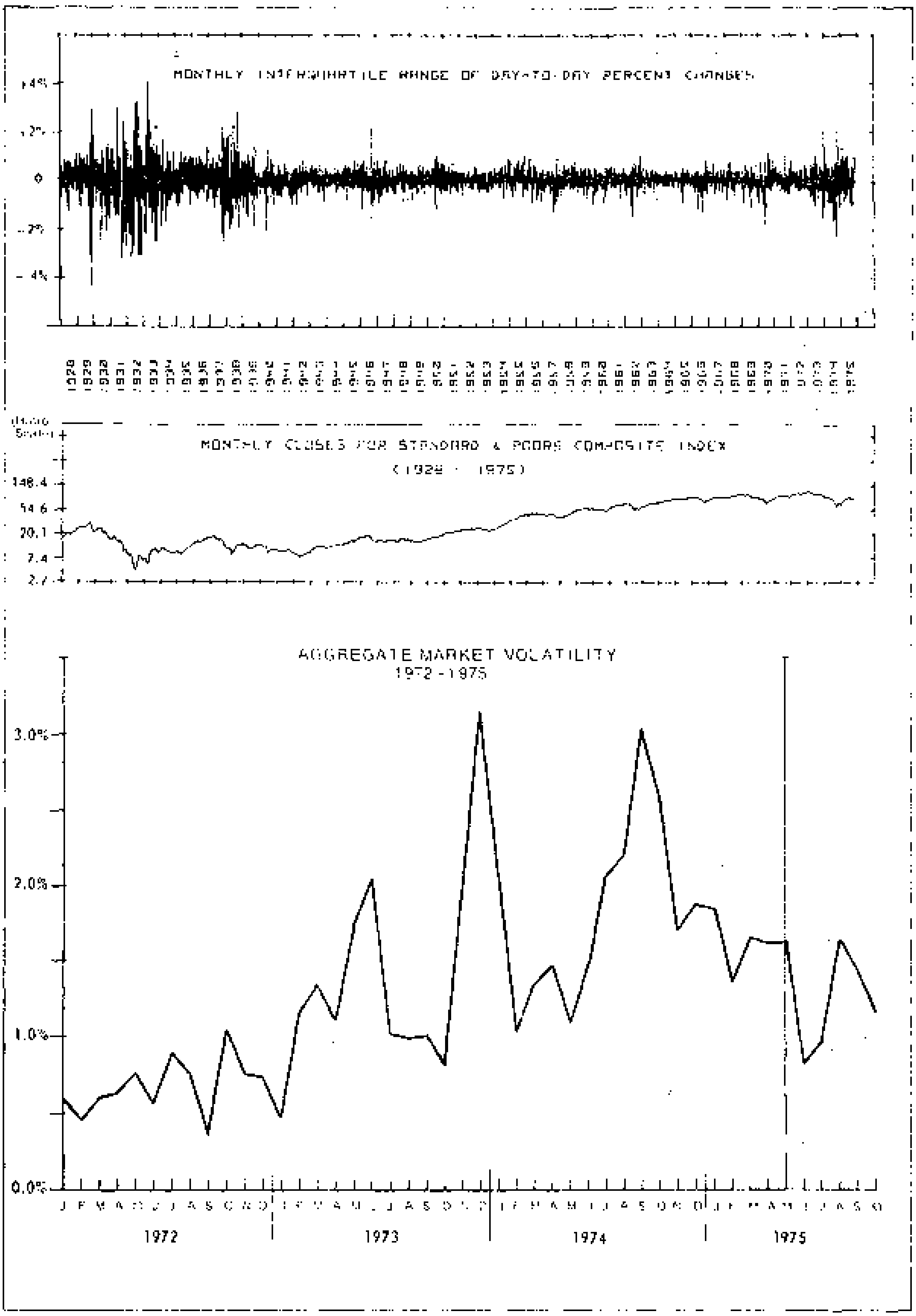


Exhibit 19 shows the results of the analysis of aggregate volatility, in which recent volatility of the market is compared with both short-and long-term trends. As a measure of aggregate volatility, the monthly interquartile range of daily percent changes in the Standard and Poor's Composite Index was used.[3/]

The top of Exhibit 19 shows the interquartile range, centered on zero, for each month since 1928. Stocks were quite volatile in the period 1928 - 1940 and then settled down with occasional peaks from 1940 - 1972. In 1973 and 1974, the years immediately prior to unfixed rates, the number and magnitude of highly volatile months and the size of the shifts increased significantly, representing relative high points in volatility which had not been exceeded since 1946. (For comparative reference the middle portion of Exhibit 19 shows monthly closes, on a ratio scale, of the S & P Composite.)

The bottom of Exhibit 19 highlights volatility since the unfixing of commission rates. (The vertical line represents May 1975.) From relatively low levels in 1972 volatility increased in 1973, peaked in December

3/ The monthly interquartile range was obtained by ranking the daily changes for a given month from smallest to largest and finding the daily change value at the 75th percentile and the 25th percentile. (For example, if 100 values were ranked from 1 (the smallest) to 100 (the largest), the value at rank 75 was the 75th percentile and the value at rank 25 was the 25th percentile. The daily change at the 75th percentile minus the daily change at the 25th percentile was the interquartile range.)

Exhibit 20

VOLATILITY BY TYPE OF STOCK
(Jan–April 1975 vs May–July 1975 1/)

1/ [illegible]

1973, and sustained significantly high levels during 1974. Levels in 1975 are well below the 12 highest months of 1973 - 1974, and are lower on balance since the beginning of May.

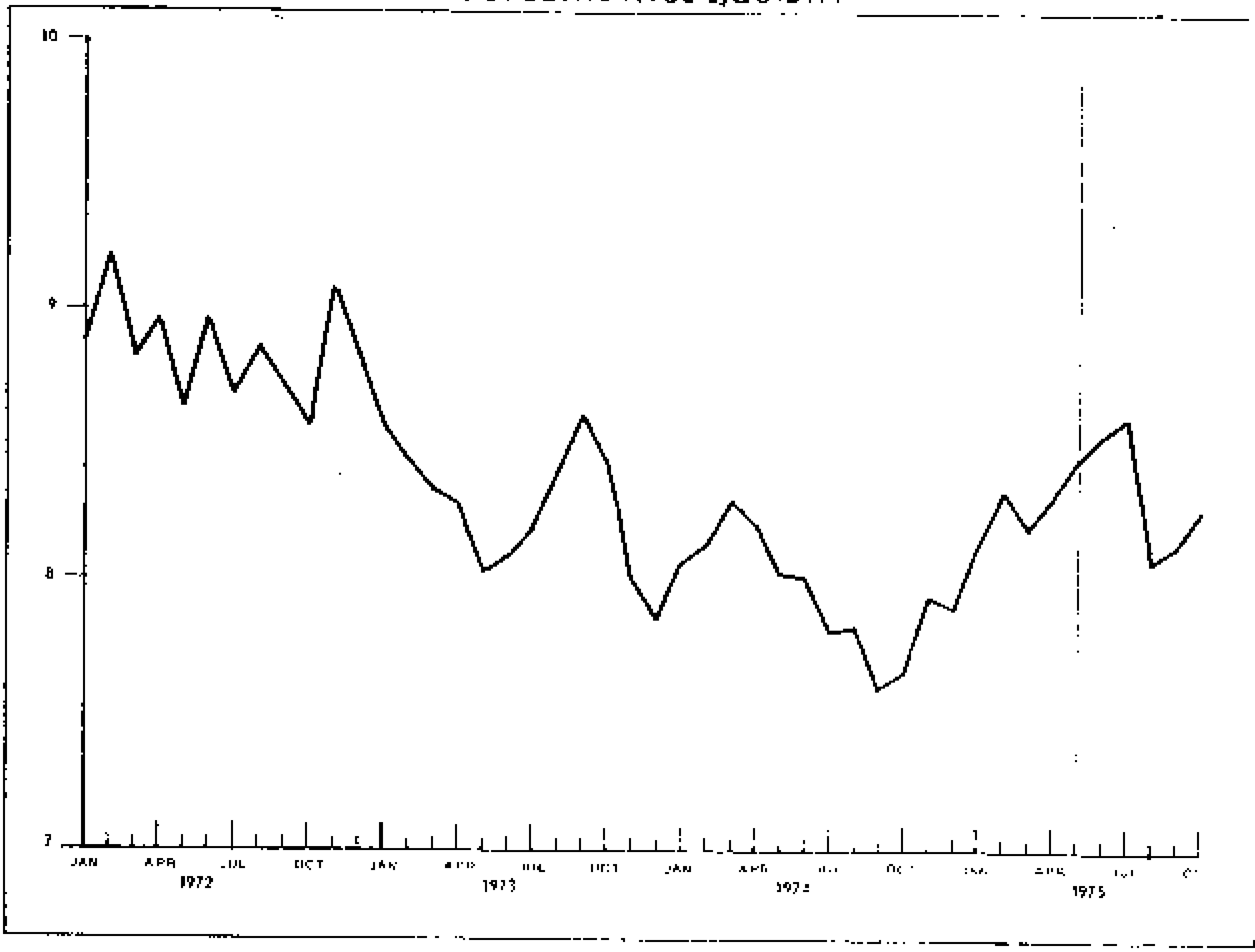
To measure the volatility of different categories of stocks, the percentage of trades within a category which differed in price from the previous trade was calculated. Exhibit 20 shows the difference from the last trade for nine categories of stocks (based on trading volume and trade size) in the period January - April 1975 and the differences for the same stocks in the period May - July 1975 . Higher volatility would be indicated by more trades further away from the last trade.

The exhibit shows that very little change occurred in any of the percentages irrespective of the size of trade or the daily volume in the stocks. For example, 13.3 percent of the 100-share trades in low volume securities were made at one-quarter or more away from the last trade prior to May 1 compared to 13.5 percent following May 1 (8 trades per day more). Similarly prior to May 1, 9.1 percent of all 600-share or more trades in high volume securities were made at one-quarter or more away from the last trade, compared to 8.5 percent following May 1 (25 less trades per day).

Thus, both the aggregate and individual measures of price volatility indicate very little change following the introduction of negotiated rates. Volatility seems to have decreased relative to levels existing in most of 1973 - 1974, and the number of trades close to the last trade has remained nearly the same.

Exhibit 21

AGGREGATE NYSE LIQUIDITY



MARKET LIQUIDITY

To monitor liquidity, the third quality of the market factor, the staff again used measures different from those discussed in the monitoring paper.

Aggregate market liquidity was measured by comparing price changes in the NYSE composite index and NYSE volume.[4/] Exhibit 21 indicates the monthly liquidity of the market since January 1972, in terms of an index derived from this comparison. Liquidity fluctuated in a narrow range in 1972, and then declined steadily in 1973 and 1974 reaching a low point about September 1974. Liquidity improved sharply during the first two months of 1975 and rose steadily through July. A drop in August occurred, but liquidity was up again through October. Overall, liquidity before May was not statistically different than after May, and negotiated rates appear to have had no impact on the liquidity of the market overall.

To measure the liquidity changes in particular categories of stocks, the staff used the measure of price changes between trades, previously discussed as a measure of volatility (Exhibit 20). Since liquidity is a measure of the ability of the market to absorb large trades with

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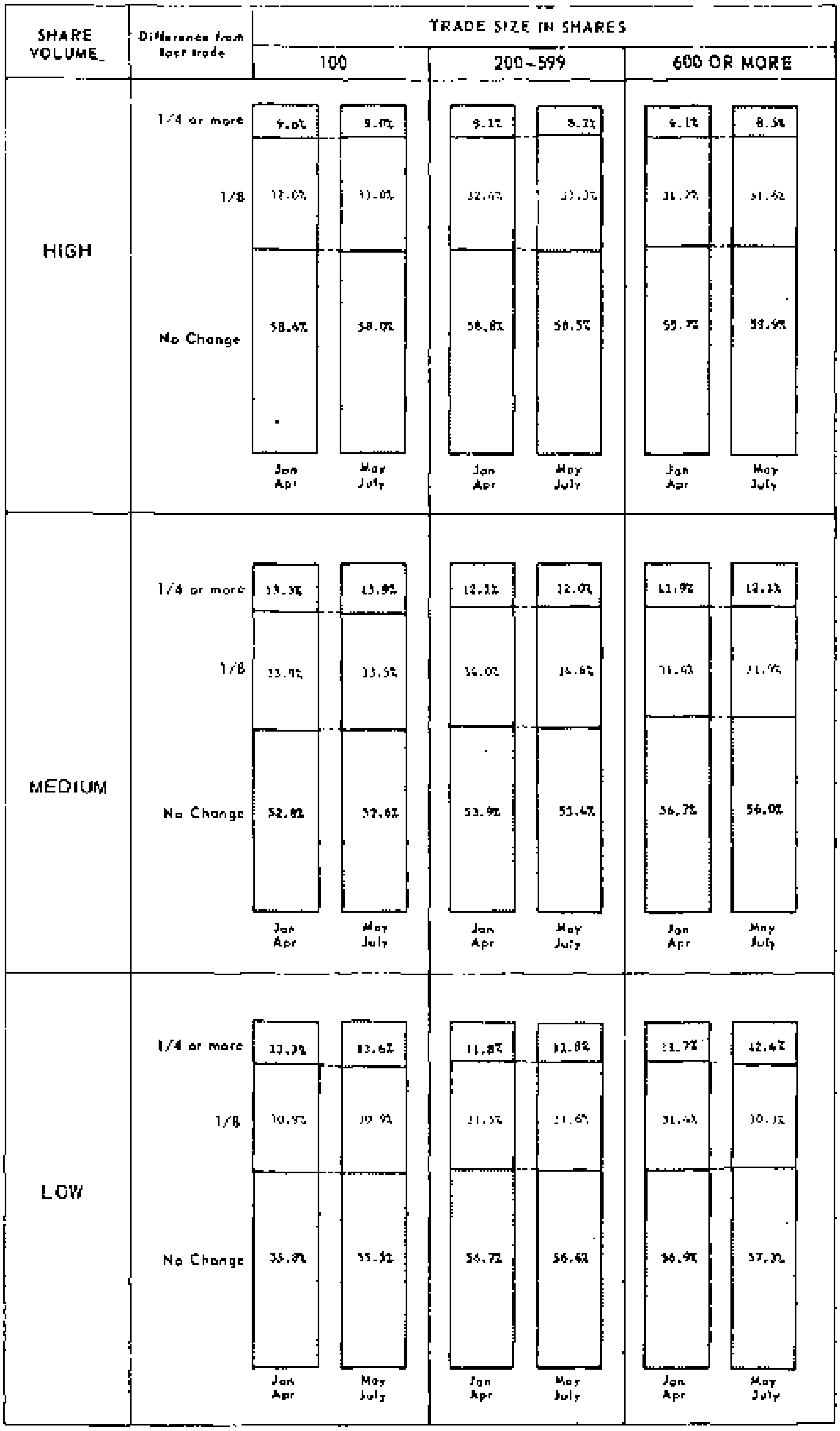
4/ After testing several different formulations, Peter Martin of the SEC's Directorate of Economic and Policy Research used the change in the price index squared divided by the volume which was shown to be a statistically reliable measure. His paper is available upon request.

Exhibit 20

VOLATILITY BY TYPE OF STOCK
(Jan-April 1975 vs May-July 1975 1/)



1/ Based on all trades for each Wednesday during 12 weeks before May 1 and 10 weeks following.

little change in price, changes in liquidity could be measured by shifts in the percentage of large trades which did or did not cause major price movements. (To account for the possibility that what has changed is liquidity rather than volatility, it is also important to check the relationship between large and small trades at one-quarter or more away from the last trade.)

Looked at in this context, Exhibit 20 shows that the number of large trades done at one-quarter or more away from the last trade increased after May 1, 1975 by about 0.7 percent for low volume stocks and by only 0.2 percent for medium volume stocks. For high volume stocks, there was a decrease of 0.6 percent. The relationship between large and small trades one-quarter or more away from the last trade has also remained very stable for all three categories of stocks, decreasing slightly for low volume stocks, increasing slightly for medium volume stocks and remaining the same for high volume stocks.

Summarizing then, liquidity seems unaffected either in the aggregate or on individual stock category basis by the introduction of negotiated rates.

Appendix A

UNCONSOLIDATED REVENUE OF NYSE MEMBER FIRMS DOING A PUBLIC BUSINESS