

**NEWS**

**SECURITIES AND  
EXCHANGE COMMISSION**

Washington, D. C. 20549

(202) 755-4846



REMARKS BY

JOHN R. EVANS  
COMMISSIONER

TO

BOARD OF DIRECTORS  
NEW YORK STOCK EXCHANGE

New York, New York  
March 6, 1980

My Legal Assistant, John Granda and I appreciate your invitation to be with you today and to view the operation of various New York Stock Exchange ("NYSE") facilities. John has recently come to my office from our Division of Corporation Finance where he was Acting Chief of the Office of Tender Offers and Acquisitions. He has not had an opportunity to visit the New York Stock Exchange before, so this is a new experience for him.

Although I have had several visits, I am anxious to keep informed about new systems and those which are being developed or are under consideration. We are here primarily to listen, to look, and to learn. I agreed with Don Calvin's request, however, to take a few minutes at this luncheon to give you some of my thoughts on current issues which I believe may be important to you as board members of the New York Stock Exchange.

As you may be aware, my general approach to government regulation is that of a free market economist-- that the primary role of government is to provide an environment in which individuals and institutions may compete in offering goods and services. There is also a necessity, however, to temper competitive forces in order to maintain the minimum standards that society believes appropriate but which are not provided by private institutions. Recognizing,

---

The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for speeches by any of its Commissioners. The views expressed herein are those of the speaker and do not necessarily reflect the views of the Commission.

as I am sure you do, that we all desire the benefits of competition in the goods and services we purchase, but seek to obtain a monopolistic position for ourselves, government must be able to assure that barriers to competition not be established or maintained except in very unusual circumstances where it can be shown that the expected benefits of competition are outweighed by other public interests. I believe you will find that my actions on the Commission are in accord with this basic philosophy.

I was somewhat instrumental in the Commission's decision to require the removal of fixed minimum commission brokerage rates and believe that the public has received significant benefits from that decision. Obviously, the dire predictions that competitive rates would destroy our exchange market system were not well founded. But it is also disturbing to hear the claims that only institutions have benefitted from competitive rates, and that individuals are being required to pay higher commissions. As a matter of fact, individuals making larger purchases are obtaining rates similar to institutions. Moreover, based on our monthly Survey of Commission Charges, overall commissions on individual trades have declined 10.7 percent on a per share basis from April of 1975 to December of 1979. During this period, commissions on individual trades of less than 200 shares and between 200 and 999 shares did increase 7.8 percent and 8 percent respectively. This, however, does not mean that small investors have not benefitted from unfixed commission

rates. It is important to recognize that institutions such as pension funds, mutual funds, and bank trust departments, act as intermediaries for small individual investors. In addition, discount brokers which are not included in our Survey of Commission Charges, are offering significantly lower rates and finally, even posted full service rates where there has been an increase of about 15 percent since 1975, translate into reduced commission rates in real terms because the value of the dollar has been reduced by inflation of 45-50 percent during that period.

I also find no merit in the claim that competitive rates have weakened the securities industry and resulted in increased consolidation among firms. In fact, both your figures and ours indicate that the rate of consolidation has been declining. It is true that some firms have been unable to compete profitably, but sales offices, registered representatives and capital in the industry have all been increasing and on the basis of our monitoring reports during the last several weeks, the industry as a whole seems able to handle the significantly greater volume without critical problems. You and other industry participants are to be commended for your present capacity, surveillance activity, assistance to members who need it, and your efforts to significantly increase capacity for the future.

Figures you gave the Commission last December, indicate that your DOT (Designated Order Turnaround) System providing direct communication to specialist posts

from member firm upstairs offices for orders of up to 499 shares, accounts for as much as 45 percent of the trades on heavy volume days. That automated system has, no doubt, made it possible for the NYSE to handle the recent heavy trading volume. The planned use of mark-sense cards will also reduce reporting times for transactions and quotations, making the trading system more efficient.

The recent volume has focused additional attention on trading mechanisms. As you continue your efforts to improve efficiency, I believe you should give serious consideration to the possible benefits of a completely automated execution system, at least for small routine transactions. I realize this is a sensitive issue to many securities industry participants, but believe that significantly greater automation is inevitable not because it may be required by the SEC, but because it will be more efficient. I also believe that while you are now focusing on mechanisms to enhance limit order price protection among competing markets, it would be prudent to plan for a trading system that embodies both time and price priority because of the elements of best execution and equity among orders that are embodied in these principles.

Progress is being made toward a national market system, but looking back over the last eight years, one could conclude that it has been painfully slow. We now have a good system for displaying prices at which transactions in listed securities occur; exchange markets are inter-connected through communication facilities; and we have a nationwide

quote system. But on the negative side, quotes in that system are not always firm and current; we do not have an efficient system to route orders from the offices of brokers and dealers to any market that has the best price; we do not have system-wide limit order protection; exchange members are not permitted to engage in off-board dealer transactions in listed securities even though such transactions could be in their customers' best interests; and there are many securities which should be qualified for trading in a national market system in which there is no opportunity for investors' orders to be executed without the participation of a dealer.

Thus, while progress has been made, none of the five goals contained in Section 11A(a)(1)(C) of the Exchange Act has been fully attained. I believe my views as to how the Commission could have provided the greatest incentives for progress without becoming unduly involved in an attempt to determine the form in which the system should evolve, are rather well known. Although thus far for various reasons we have not chosen to pursue that route in all respects, it is important that progress be made.

An area on which I believe we can agree demands immediate attention is the implementation of an interface between the ITS (Intermarket Trading System) and both the over-the-counter market and the CSE system (National Securities Trading System of the Cincinnati Stock Exchange). The Commission's recent extension of the ITS for an additional three years was to provide the Commission and the securities

industry a better opportunity to evaluate its possible role in the evolving national market system. At the same time, however, the Commission noted that, while experience with the ITS to date indicates that it might be an appropriate market linkage system for connecting the floors of traditional exchange type markets, it must also be capable of linking the ITS participants with both over-the-counter markets and the CSE System. Accordingly, the Commission called for prompt action to establish computerized interfaces between the ITS and the over-the-counter market and the ITS and CSE System.

The NASD (National Association of Securities Dealers) has concurred in the Commission's call for an automated interface between ITS and its enhanced NASDAQ (National Association of Securities Dealers Automated Quotations) System and has requested immediate consultations with technical staff from the NYSE and SIAC (Securities Industry Automation Corporation) so that work can begin on creating such an interface. However, I understand that the NYSE has taken the position that an interface between the third market and exchanges should not await the NASD automation program, but should proceed immediately with a pilot program in which three third market makers would be provided direct access to ITS by placing ITS equipment in each firm's trading room. The NYSE has stated in its letters to the NASD that such a pilot program is desirable because it can be implemented in a very short period of time and therefore will permit the

NYSE and NASD to quickly begin to resolve certain policy concerns which the NYSE has regarding ITS linkage of the third market.

Whatever the benefits of a pilot program may be, it should not be permitted to delay progress toward the ultimate goal of a computerized interface between the ITS and the NASDAQ Systems. A computerized interface, by permitting over-the-counter market makers to send and receive ITS commitments through their existing NASDAQ terminals, would avoid the expense and redundancy involved in placing individual ITS terminals in the trading rooms of all third market maker firms and would eliminate the necessity for the ITS participants to create new computer systems to collect third market quotations and route commitments to third market makers. Nor should the NYSE's expressed policy concerns, which relate both to internalization and the timeliness and method of reporting transactions to the consolidated system, delay progress towards a computerized interface. Linking the over-the-counter market through ITS should not exacerbate any of those concerns and may actually ameliorate internalization concerns by enhancing the ability of over-the-counter market makers to route their customers' orders to an exchange floor which is disseminating a quotation superior to that of the over-the-counter market maker and permitting exchange members to have direct access to third market maker quotations. The Exchange's proposed pilot may be a useful interim step, but I believe a direct interface between the ITS and the

NASDAQ System is the only logical means of linking the third market with exchange floors and therefore must be pursued immediately by a meeting between the technical personnel of SIAC and the NASD to resolve any technical difficulties or design problems raised by a computerized interface.

Similarly, I believe that greater progress must be made towards creating a linkage between the ITS and CSE System. The NYSE and CSE have discussed the creation of a manual CSE/ITS interface. I urge you to take whatever steps are necessary to expedite such an interface, as well as to begin technical discussions aimed at establishing a computerized interface of the two systems. The NYSE, as well as a number of other commentators, have expressed concern over the potential for integrated retail firms to internalize their customers' order flow in the CSE System. However, an interface between the ITS and the CSE System is crucial to achieve the goal of nationwide protection, initially for limit orders and eventually for all displayed interest, and to permit the Commission and industry participants to evaluate what changes, if any, must be made in the present configuration of the CSE System and the ITS if either of those systems are to play a continuing role in the evolving national market system.

Another area in which progress must be made is in the implementation of the facilities necessary to provide nationwide price protection of all displayed limit orders. The NYSE and the other ITS participants must make every effort to reach an agreement on the characteristics which

the proposed LOIS (Limit Order Information System) will possess. While I recognize the difficulties involved in satisfying a number of interests, the deadline set by the ITS participants to provide the Commission with a complete description of LOIS has long since passed. An agreement must be reached soon if you are to meet your September 1980 deadline for an operating pilot program, a deadline which the Commission takes seriously.

There appears to be general agreement that LOIS would permit a broker, before crossing a block away from the market, to interrogate the system to determine the maximum number of shares contained in LOIS at a particular price, but apparently there is disagreement as to how a limit order in LOIS may be executed against. I understand that representatives of your "upstairs" firm membership objected to initial descriptions of LOIS which would have required that commitments be sent with a standard one minute expiration and that, as a result, the NYSE suggested that the ITS participants consider revising the design of LOIS to permit a broker to immediately execute against limit orders displayed in LOIS by sending a "binding report" of execution rather than a commitment.

I agree that the use of standard commitments in LOIS may be unnecessarily slow and inefficient. As a result, such an approach may create operational problems for block firms by delaying a report of how much stock has been lost to LOIS. Accordingly, I encourage the NYSE and the other ITS participants to seriously consider ways in which the final configuration

of LOIS could include an immediate execution capability without unnecessarily increasing the risks to specialists from limit order cancellations.

Although the Commission has set a near-term goal of nationwide price protection for all displayed public limit orders, we have also indicated that, at a minimum, nationwide price protection for all orders must ultimately be a fundamental characteristic of a national market system. Thus, while it is important to move ahead in the implementation of LOIS, it is equally important that the ITS participants take steps to eliminate all "trade-throughs" in ITS stocks.

I am encouraged by the steps the NYSE has already taken and will take, in connection with its floor modernization, to increase the number and enhance the display and order routing capabilities of ITS terminals in order to reduce response times. I am concerned, however, that even after these enhancements are in place, some floor participants, at least when trading is active, may continue to ignore superior quotations in other markets. Consequently, either the ITS participants or the Commission may have to consider additional measures if "trade-throughs" are ever to be eliminated.

I understand the Pacific Stock Exchange has suggested that each of the ITS participants might submit to the Commission rule changes which would prohibit "trade-throughs." In my opinion, voluntary joint action by ITS participants in this matter would be far preferable to rulemaking action

by the Commission. However, if the exchanges are unable to agree to take concerted action to effectively eliminate "trade-throughs" then the Commission may be required to engage in rulemaking to achieve that goal.

In addition to our common interest in fair, equitable and efficient securities markets, we share an interest in corporate governance and accountability to shareholders and the public. In light of the complexity and variety of issues raised in the corporate governance hearings we held in 1977, we have been proceeding in stages, the latest of which involved amendments to the proxy rules to provide greater opportunities for shareholders to exercise their right of suffrage by, for example, permitting shareholders to withhold authority to vote for each nominee for election to the board, and to obtain information and advice with respect to matters on which they vote. The next stage will be the publication of a comprehensive report dealing with issues raised in our corporate governance proceeding. It will include statistics and a discussion of the structure and operations of boards of directors and their committees from the 1979 proxy disclosure of a sample of 1200 registrants. It will also contain information with respect to transmittal of proxy material, the shareholder proposal rule, shareholder nominations, access to shareholder lists, disclosure of socially significant information, the impact of institutional investors on corporate governance, the role of various private and government organizations in promoting corporate

accountability, and staff recommendations to the Commission for possible further Commission action.

A final subject I would like to discuss for a moment is our recent activity with respect to tender offers. We believe that the tender offer rules which we recently adopted represent a significant advance in the scheme for filing, disclosing and disseminating relevant information regarding the offer as well as in the substantive protection provided to investors under the Williams Act. We are particularly concerned, however, by the growing tendency to capitalize on the present state of uncertainty as to the scope of the term "tender offer" by structuring transactions to avoid the application of the tender offer rules.

With some trepidation--due to our concern for loss of flexibility--we have proposed a definition of the term "tender offer" which is intended to provide more objective standards for differentiating transactions which, in substance, are tender offers from those which are truly privately negotiated or market transactions. Based on the comments received, including those of the NYSE, we recognize that the line we attempted to draw in this regard may not be ideal. Notwithstanding whatever defects there may be with our present proposal, in my judgment, any definition of the term must be capable of reaching purported privately negotiated transactions such as those in Wellman v. Dickinson as well as making clear that transactions are not immunized merely because they are executed on the floor of an exchange.

We are mindful of the difficulty of this task. For that reason, as well as other problems inherent in the present structure of the Williams Act, we recently submitted a legislative proposal in response to a request by Senators Proxmire, Williams, and Sarbanes, which involves a substantial restructuring of the Williams Act. Of particular note is our proposal to avoid the current definitional problems by narrowing the focus of Section 14(d) to the level of ownership rather than the particular manner in which the securities were acquired. Under this proposal, all offers to acquire the beneficial ownership of equity securities of a public issuer by a person who is or would become the beneficial owner of more than 10 percent of the class would be channeled into a regulatory mold similar to that now used to govern tender offers. Exceptions would be made, however, for offers pursuant to a statutory merger or acquisition, the solicitation of voting proxies, acquisitions of 2 percent per year, acquisitions from the issuer, and acquisitions from no more than 10 persons in any 12 months pursuant to privately negotiated transactions.

There are other subjects in which you and the Commission share an interest such as the lifting of the options moratorium, multiple markets for standardized options, proposed rules on corporate internal controls, our pending 19(c)(3) proposal, regulation of government securities, our processing of exchange rule proposals and many more. There are, of course, limits as to what can be said with respect

to some of these, but aside from such restrictions, I welcome your comments and questions.