Report from the NASD

by Joseph R. Hardiman, President and CEO
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Thanks, Howard (Clark)...

I'm truly happy to be here. I'm coming off some recent surgery, which makes me appreciate, all the more, this annual pilgrimage—and the opportunity to actively participate in a superb industry of which I'm proud to be a part.

Because of the surgery, this is my first opportunity to publicly comment on what one NASD Board member—who likes to keep a positive attitude—has referred to as all the "attention" being given to The Nasdaq Stock Market and the NASD.

Although I can report that the operation was a total success, my doctor doesn't know how wrong he was when he told me I wouldn't be probed again any time soon.

Seriously, you realize just how dramatic the pace of change is when you're away from its whirlwind for even a short time. The American public gave control of Congress to the Republicans for the first time in forty years...two Republican vacancies in the SEC quickly became one Republican and one Democratic vacancy...and the Board of the NYSE elected Dick Grasso its new Chairman.

It's too early to judge the wisdom of the American electorate. But it's not too early to acknowledge the wisdom of the NYSE's Board in choosing someone of Dick's capabilities and experience to succeed Bill Donaldson as its Chairman.

And since this is perhaps the last time I'll have the privilege of sharing a dais with Bill Donaldson in his present capacity, it's the perfect time to recognize the outstanding job he's done at the NYSE during his tenure as Chairman, particularly as a spokesperson for U.S. capital markets around the globe.

Speaking out as Bill has done is important. Like every one of our institutions, America's financial markets have always had their critics and skeptics. And—for the most part—that criticism is a healthy thing. It is part of the openness that makes our society so vital and our economy so vigorous.

But if energetic critics are desirable, so too are energetic stewards and defenders—to check the critics when they are wrong...to protect what is strong and good about our institutions...and to keep improving these institutions even when no critics are around to prod them.

In recent weeks, I've had plenty of reason—and time—to think about that role of steward and defender. It means being realistic and clear eyed about The Nasdaq Stock Market. It means taking actions to defend that market where needed...and to improve the market whenever possible.

It means following through with the NASD's mission to regulate and operate securities markets in such a way that balances the interests of all market participants—investors, issuers, and intermediaries...but with the interest of investors foremost in our minds.

In the case of The Nasdaq Stock Market, this has been accomplished by moving forward throughout our short 23-year history with market improvements that have made Nasdaq the highly visible and highly efficient market it is today.

Nasdaq's success did not happen by taking unfair advantage of anyone—and its future depends upon ensuring a fair market for everyone.

Toward that end, the NASD has appointed a Select Committee to review how the NASD has been operating and overseeing Nasdaq—and to examine whether any changes are needed in the way both Nasdaq and the NASD are governed.

The seven-member panel is headed by Warren Rudman, the former Senator from New Hampshire whose name is synonymous with independence and integrity.

Mr. Rudman's committee includes highly respected individuals with a public perspective and securities industry knowledge. It's charge is to conduct an independent review of the NASD's role as regulator and operator of The Nasdaq Stock Market. We welcome the review. We owe it to investors, issuers, and our members to undertake it. And they can be assured we will take seriously the recommendations made on their behalf by the committee.

In the meantime, investors should benefit by a number of recent NASD actions.

The NASD Board has acted to require market makers to place customer limit orders ahead of trading for their firms' proprietary accounts. It did so by eliminating—in a two-step process—a disclosure safe harbor contained in a conditional rule that had been in place for a number of years—the so-called "Manning" Rule.

The first phase—which the SEC approved in June—applies to firms that accept limit orders directly from their customers. The second phase—approved by the NASD Board in November—will extend that protection to customer limit orders sent by one firm to another.

Investors will also benefit from major reforms that the NASD Board recently approved for a new small order system to be known as NoPROVE.

An improved system for the small investor has been an NASD priority for several years. When it is launched in the second quarter of 1995, NoPROVE will allow investors to have their limit orders in Nasdaq securities displayed simultaneously to all markets makers and, where the order is priced within the quotation spread, publicly disseminated through information vendors. All market orders entered in the NoPROVE system will receive prompt executions with opportunities for price improvement between the spread.

These are positive actions that will make investing in Nasdaq even more efficient. But a market's responsibility—and the NASD's mission—extend beyond efficient pricing to facilitating the capital-raising process. Markets may do many things, but if they do not help issuers meet their needs for capital then they fall short.

This is true whether those markets are equity or debt...auction or dealer...screen-based or floor-based.

Measured against the yardstick of capital formation, U.S. securities markets are the envy of the world.

To understand just how successful our markets have been on the capital formation front consider this: in 1993, 73 percent of worldwide taxable debt and equity issuance was done in the United States—$1.1 trillion* * against a total global issuance of $1.5 trillion. And through the third quarter of 1994, $589 billion—or 69 percent—of the capital raised around the world was raised in the U.S.

The majority of this capital has been raised in a dealer-market environment. It's an environment where capital is raised because capital is put at risk—to facilitate both the underwriting process and secondary market trading.

Through their actions, dealers help get roads built and bridges repaired. They help our children get educated. They help turn the idea of the entrepreneur into a thriving enterprise. They help the small companies grow into bigger companies. They help turn the American Dream into reality.

Dealers help make these things happen, whether they are operating in the municipal, corporate, or government debt markets...whether they are Nasdaq market makers—or NYSE member firms acting as specialists or principals for their own account in trading listed securities, which occurs in transactions accounting for over 43 percent of the share volume on the New York Stock Exchange.

Wherever they operate, dealers provide immediacy - the assurance that investors can obtain the best publicly quoted price...and liquidity—the assurance that large numbers of shares can be traded at that price.

They also work nonstop to attract investors to securities, helping to stimulate demand, which in turn generates improved pricing.

All of which translates into the one thing that securities markets can and must do, which is assist in the formation of cost-effective capital. This is a job Nasdaq performs exceedingly well.

Since January 1984, 3,675 companies have gone public on Nasdaq, raising more than $75 billion and creating millions of jobs. For many of these companies, Nasdaq was the only option for getting started as a public company.

Most are still with us. Some have been acquired. Some have moved to other markets. Since 1990, almost 400 companies that initially listed in the Nasdaq SmallCap market have graduated to the Nasdaq National Market. And all have benefited from the support provided by Nasdaq's market makers.

We are committed to continuing to take steps to increase investor participation in The Nasdaq Stock Market. Such steps, however, must be carefully designed to enhance—not detract—from the market liquidity and capital-formation functions so critical to our securities markets.

Like all services performed by the securities industry, the activities of dealers take place under an umbrella of regulation which has helped make U.S. markets not only the deepest and most liquid in the world—but the most respected.

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* Includes all taxable debt and equity securities, including convertible debt, non-convertible debt, asset-backed securities, and taxable municipal bonds, common, preferred, straight, and convertible stock. **Source**: Securities Data Company.

One of the best things Congress ever accomplished in the financial services sector was to adopt a regulatory partnership that harnesses the talent and energy residing in our industry.

This partnership is called self-regulation. It was described by Senator Francis Maloney—the architect of the legislation that authorized the NASD—as a "two-way street in which members of the industry, subject to federal supervision, exercise as large a measure of authority as their natural genius permits." And as we all know there is a lot of creative genius in this industry.

The Congress, and indeed the SEC, have allowed the industry to "take the wheel" and patrol our markets and our members under their watchful eye. The SEC has historically recognized the advantages of working WITH the securities industry and not simply imposing rules UPON it.

The industry has not abused this responsibility. To be effective, self regulation can be neither short-sighted nor self-serving. It must take the long view. It must put the investor first among our valued constituencies. At the same time, it must work to balance the interests of all constituencies for the good of the capital-raising process.

Recent actions by the NASD offer evidence that the watched can also be a watch-dog—and that investors can benefit by industry actions.

- We initiated the concept and helped mold a continuing education program designed to ensure a high level of competency on the part of securities professionals. This will become a reality in 1995, even though there are still several open issues to resolve.

- We have worked closely with the SEC to educate investors, most recently through the publication of the brochure, "Invest Wisely," which was written and widely distributed with the help of the SRO community.

- The NASD is moving aggressively to ward off the potential for confusion on the part of investors being offered securities products and services on bank premises. We have proposed a set of rules specifically geared to activities of our members operating on bank premises. The proposal addresses issues of how investments must be advertised...disclosures that must be made to investors about risk...and payment of referral fees to unregistered persons.

- And it is with the investor squarely in mind that the NASD has proposed a rule that would prohibit the receipt of non-cash compensation for the sale of mutual funds and variable products.

To these actions must be added the day-to-day enforcement of the rules and regulations that govern our industry—and the continuous oversight of all aspects of its activities.

Last year alone, the NASD conducted 3,500 main and branch office exams. We responded to over 4000 customer complaints. We provided arbitration services for over 1,300 customer cases, more than half of which were decided in favor of the investor. We administered more than a quarter of a million qualifications examinations. And we reviewed almost 37,000 different pieces of advertising distributed by our members. In almost all cases, we expect these numbers to be equaled or exceeded in 1994.

Our efforts—and those of other SROs—are underpinned by significant compliance activities undertaken by the securities industry at the firm level. Neither they nor any of the SROs receive one penny of tax dollars to carry out these responsibilities. They are funded by an industry committed to keeping markets efficient and investors well served.

All our efforts are supported by diligent oversight by the SEC. This oversight—combined with successful self governance—has given our industry an unsurpassed record of effective regulation. It's a partnership more valuable today than ever given the growing gap between Main Street and Wall Street...and given the funding challenges being faced by federal regulatory agencies.

It's certainly a partnership that has helped The Nasdaq Stock Market grow and prosper. The same willingness of regulators and self regulators to address and respond to even the most contentious issues has helped Nasdaq continuously move forward.

In less than a quarter century, an environment hampered both by a lack of transparency and a lack of automation has been transformed into one known for its abundance of sunshine and pioneering technology. This has been accomplished not by being resistant to change, but by being responsive to investors, issuers and our members.

And it has come not by taking criticism lightly, but by taking our critics seriously when warranted and countering that criticism aggressively when necessary.

We must—indeed we will—preserve, protect and defend the reputation of our market and those who make it work so well. The first step to doing so is making sure that reputation is deserved.

This means that we will continue to respond in ways that foster investor confidence, the lifeblood of our industry. It means that we will continue to respond in ways that enhance capital formation, the lifeblood of our free enterprise system.

To do anything less would be to fall short not just of fulfilling the NASD's obligation to investors—but our responsibilities to our issuers and to you, our members.

Thank you.