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OPENING STATEMENT

Eugene H. Rotberg

This is a public investigatory hearing conducted pursuant to Section 21(a) of the Securities Exchange Act of 1934. That Section provides that the Commission may investigate facts, conditions, practices or matters which it determines necessary or proper to aid in the enforcement of the Exchange Act, to prescribe rules and regulations or to provide a basis for recommending legislation concerning the matters to which the Act relates.

The Exchange Act places an obligation and a responsibility, both on the national securities exchanges and on the Securities and Exchange Commission, to assure that rules applicable to the trading markets are fair to the public and are necessary and appropriate for the protection of investors. Among other things, the Securities and Exchange Commission has the responsibility and authority, under the Exchange Act, to request the stock exchanges to change their rules in a number of designated and specified areas, if necessary and appropriate for the protection of investors. Section 19(b) of the Act gives the Commission this authority and consequent responsibility with respect to the "fixing of reasonable rates of commission". Pursuant to that Section, the Commission has requested the New York Stock Exchange to adopt, as an interim measure, a new rate schedule for transactions executed on the New York Stock Exchange pending the development of longer term solutions to the various problems which have arisen under the existing standards.

This hearing is designed to examine and study a far wider range of subjects than is covered by the Commission's letter to the New York Stock Exchange requesting an interim change in the commission rates, and will explore fully the subjects covered in the Commission's letter of May 28, 1968 to all national securities exchanges.

It should be emphasized that this is a fact-finding inquiry; it is not an adversary proceeding. There are no plaintiffs -- there are no defendants or respondents. In its initial stages this hearing is designed to obtain facts relevant to the structure and level of commission rates on the nation's stock exchanges. It should provide a basis for identifying and balancing the policy and other considerations which lay behind that structure, the facts which led to the practices which have developed as well as an opportunity to assess proposals for change. We hope this hearing will assist in asking and resolving meaningful questions. What are the relevant considerations in the development of an appropriate rate structure? What are the objectives to be served? What standards need to be developed to meet these objectives and how can that be done?

The staff will elicit information concerning the nature and operation of existing commission rates, the practices which have developed for the sharing of commissions among members and with non-members of stock exchanges and the implications of institutional membership, i.e., membership on our national securities exchanges of financial institutions (or their managers) who are now customers of those who

presently operate in those market places. We will show what services the minimum commission was intended to and, in fact, does cover and what it was intended to and, in fact, does exclude, how commissions are shared, with whom and why they are shared, and at whose direction. We will ask members of exchanges and others to present these facts. We will also elicit information relating to access to those exchanges by nonmember brokers and by institutions or their managers.

We expect to develop the facts concerning the nature and levels of intra-member rates, i.e., the minimum rates members must charge each other for execution of orders. We expect the hearing to produce facts essential to the development of standards for determining the reasonableness of both the level and structure of commission rates. We will explore the effects of current practices and rules on the flow of orders to, and the execution of transactions in, the several stock exchanges and other markets.

This hearing will explore the position of the clearing and the non-clearing firm, the "regional based" firm, the role of regional exchanges, the function of the so-called "third market", access to exchange markets for nonmembers, and restrictions on member firms in the execution of orders in competing markets. Finally, we will examine the standards which may be appropriate to measure and define the reasonableness of commission rates and the propriety and implications of negotiated and scheduled minimum commission rates.

These are broad issues, consideration of which necessarily involves many initial and intermediate questions. For example, what services does the commission pay for? Should the minimum commission applicable to listed securities cover the actual cost of execution, clearance and servicing of a customer's account plus a profit high enough to attract the talent and capital necessary to provide efficiency? Should the minimum be high enough to pay, and provide a shelter from the normal impact of price competition, for a wider variety of services? Thus, should it be high enough to provide an excess which may be used to create incentives for selling mutual fund shares? Should it be high enough to keep in business all firms who pay the entrance fee, no matter what their product mix and irrespective of their operating efficiencies or their competitive environment? Is it appropriate to take into account the contribution made by commission business to other activities of the firm or vice versa? Is the least efficient or the most efficient to be the benchmark; or is it to be the integrated firm, i.e., the firm which makes over-the-counter markets in securities, underwrites securities, deals in municipal bonds, and also retails securities to the general public? Is it to be the large firm, or the small firm?

I expect that various persons or organizations in the securities industry will attempt to present meaningful standards for judging the reasonableness of commission rates. As a basis for discussion, and to assist those persons and organizations, we must bear in mind that it is not enough simply to argue that reasonable rates are those which bring

about a "fair return". "Fair return," standing alone, is not a standard; it is a conclusion economists and lawyers reach after the real standards are identified and tested and after policy decisions have been articulated.

We expect the evidence submitted in the course of this hearing will not be limited to statements which simply state how particular proposals would increase or decrease gross commission income for the industry as a whole or for certain groups or how operating profits may be increased or decreased. We expect the presentations will be based on fact or reasoned assumptions, and will contain standards which responsible men can use as a rational basis for evaluating the levels of commission rates.

Admittedly, the job is complicated because of the diversity in efficiency, size and the mix of business or firms, reciprocal dealings, the use of loss leader practices, varied uses of capital, etc. Indeed, the term "member firm" does not describe a particular line of business -- it covers all conceivable kinds and degrees of involvement in the securities business. Firms with identical operating ratios have significantly different returns on capital and those which enjoy a similar return of capital have varied operating ratios. Indeed, an unresolved issue is whether return on capital, a specified percentage of gross business, or any one of a number of other tests should be the standard against which to measure commission rates. A crucial question for this hearing, in short, is not only what is a reasonable rate but whether one or more objective standards can be developed for determining the reasonableness of exchange commission rates.

Apart from this question, it is important to determine whether particular aspects of an exchange rate structure may have adverse consequences for the public or for various elements in the securities industry. This will be considered in terms of whether the rate structure may distort incentives to sell one security rather than another, or whether it creates unnecessary barriers in the use of competing market places or gives inappropriate advantage to some segments of the securities industry over others.

In view of the statutory mandate requiring reasonable rates, it is not useful to suggest that all this business about commissions and standards of reasonableness is a preoccupation with nickels and dimes; nor is it useful to say it is of no concern to the Commission if member firms "give away" tens of millions of commission dollars paid by investors which might otherwise be retained by, or returned to, them.

Some of the proposals which have been made to deal with these problems raise other questions, such as whether there should be multiple securities exchanges on which the same security is listed or traded. Statements concerning the fragmentation of the auction market or leakage of trades or commissions will have to be supported by fact and reasoned argument and also will have to demonstrate that this would contradict the public interest. Similarly, suggestions that commission rates should be freely negotiated and that competition between and among markets is desirable require ^{the} same support. Thus, the matter of competition among exchanges and among exchanges and other markets will require careful analysis of the

relevant economic, legal and policy factors. We will develop facts which may make it possible to distinguish (1) between securities market places which compete with each other for business because they actually provide different or better markets for the same securities and (2) between market places which basically compete only because of a difference in the rates, or the manner in which the commission income may be used. This distinction should not be lost.

It will be urged in the course of these hearings that there is already competition in the securities markets: competition in services offered; competition for customers; competition for earnings; competition for salesmen; and competition for performance. We should examine the facts to determine who obtains the benefits of the competition and the form in which such competition is made available and whether and to what extent competition is necessary or desirable. These questions contain within them others. Will open competition destroy regional exchanges or materially affect or dilute the principal markets? Will it have major adverse effects on regional based firms or other firms? If so, is this consistent with the public interest? What is the proper role of the exchanges and the Government in this area?

The New York Stock Exchange has recently advised the Commission that it is prepared to abolish customer directed give-ups. This hearing will enable us to explore the various definitions and kinds of give-ups so that all of us can be reasonably confident that any definition of prohibited give-ups will, in fact, do what it is designed

to do and will not merely restrict practices peculiar to certain markets.

On the question of institutional membership, I understand the securities industry is anxious to deter or to prevent institutional membership (even if the institution does not intend to act as its own broker) because such development makes members of customers and, in addition, places them in a stronger competitive position for the merchandising of their product vis a vis the traditional broker-dealer. The import of institutional membership will be explored in these hearings. In short, we will have to examine the facts respecting, and decide whether to preserve the traditional distinctions between who is a customer and who is a member, who can negotiate, who can't, who should have the power to negotiate and who shouldn't.

The staff of the Commission is aware that there are differences within the industry as to many of the issues here to be explored and as to priorities and basic economic beliefs with respect to the role and responsibility of the exchanges and the Government. We will, hopefully with the cooperation of the industry, develop all of the relevant facts so that the Commission and the exchanges can weigh their significance. Our job, in this hearing, is to "tell it like it is". We will make every effort to do so as objectively as humanly possible.