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"IT WAS THE BEST OF TIMES"

An Address By

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I appreciate this opportunity to be with you this evening for your first Educational Dinner of 1974. The beginning of a new year is traditionally a time to reevaluate past experiences, present conditions, and make plans for the future. I hope my remarks this evening might contribute to that process. As I considered such an evaluation of the securities industry and its participants, I recalled a quote from the Tale of Two Cities, by Charles Dickens, which states:

It was the best of times, it was the worst of times,  
it was the age of wisdom, it was the age of foolishness,  
it was the epoch of belief, it was the epoch of incredulity,  
it was the season of Light, it was the season of Darkness,  
it was the spring of hope, it was the winter of despair,  
we had everything before us, we had nothing before us,....

In this quote, Dickens was trying to depict emotions of the French Revolutionary period two hundred years ago. Although I do not intend for the analogy between that revolutionary period and what is occurring in the securities industry to be carried any further than the thoughts expressed in the quote, I am well aware that some in the industry consider efforts in Washington to bring about a central market system, including competitive commission rates, to be revolutionary and some believe

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that by requiring competitive commission rates the Commission is readying the guillotine for the 30th of April next year. Your individual attitudes on prospective events leading to these results depends in part on your present participation in the securities industry. What to one participant may seem to be the "spring of hope" might bring the "winter of despair" to another. At the Commission, we recognize this. We also recognize that although we try to consider wisely all of the implications before taking action, there will be some who will say it is the "age of wisdom" and others who will say it is the "age of foolishness." Since no one and no group has a monopoly on wisdom, we at the Commission continue to seek your best thinking and solicit your rational, constructive analysis and criticism.

Because of the major change in the membership of the Commission since the process of formulating a policy for the development of the market was started, you can be sure that we have had many searching discussions as to our goals and the means of achieving those goals. In broad terms, we would like to assure that our securities markets are responsive to the needs of those seeking equity capital while assuring that all investors who provide that capital are protected from

dishonest practices, have equal information on which to make wise investment decisions and that their orders, regardless of size, are exposed to all market interests through an efficient market mechanism. To seek anything short of this would not be worthy of our efforts.

I disagree with those who say that the Commission's purpose is primarily to administer a disclosure system and to prevent fraud in the sale of securities and that it does not have a responsibility to foster a market system which promotes public confidence and operates efficiently.

Our responsibilities are not limited to the purposes of the Securities Act which deals primarily with disclosure and the prevention of fraud in the sale of securities. The preamble to the Securities Exchange Act states that it is an Act to "provide for the regulation of securities exchanges and of over-the-counter markets" and for the prevention of "inequitable and unfair practices on such exchanges and markets." Section 2 of the Act states specifically that transactions on our securities markets "are affected with a national public interest" and that one of the major purposes of the Act is to "insure and maintain fair and honest markets."

I do not deny that, over the years, the Commission's attention has been focused more on responsibilities other than the structure of the marketplace, in part because of the urgency of action on other issues. Now, however, considering the regulatory framework which has been established and in view of market developments perhaps the most urgent area of need is a reshaping of the mechanism and the institutions through which securities are traded. I fail to see how we can protect the public interest without meeting this responsibility, and the Commission is devoting a major share of its time to the accomplishment of this task.

The Commission believes strongly in self-regulation and would prefer to see the private sector play the principal role in such a reshaping with Commission involvement only to the extent necessary to prevent fraudulent or manipulative practices and to assure an efficient, competitive system providing access to its facilities on a reasonable, non-discriminatory basis. Perhaps we have been expecting too much of private participants with competing economic interests. But frankly, we have been somewhat disappointed in the progress that has been made thus far.

In 1934, when the Exchange Act was being considered by Congress, the House Committee Report stated:

The fundamental fact behind the necessity for this bill is that the leaders of private business, whether because of inertia, pressure of vested interests, lack of organization or otherwise, have not since the war been able to act to protect themselves by compelling a continuous and orderly program of change in methods and standards of doing business to match the degree to which the economic system has itself been constantly changing ... The repetition in the summer of 1933 of the blindness and abuses of 1929 has convinced a patient public that enlightened self-interest in private leadership is not sufficiently powerful to effect the necessary changes alone--that private leadership seeking to make changes must be given Government help and protection.

This statement seems as true of the industry today as it was forty years ago.

There was general acceptance by the industry of the concept of a more competitive central market system until generalities were changed to specifics, and individual self-regulatory bodies and firms realized that it could require a major change in their operations and could result in the disappearance of competitive advantages presently held.

Each of us as individuals considers an event or a proposition from our individual vantage point. Our point of view is colored not only by our past experiences but also by our present activities. Consequently, there is a natural

tendency for those engaged in various segments of the securities industry to honestly believe that their own self-interest or the interest of the institution with which they are associated is synonymous with the public interest. Thus, the contradictory voices of the industry are reminiscent of Dickens' words as they declare:

Competitive rates will save the industry--  
Competitive rates will destroy the industry;

Segments of the central market system must evolve--  
All segments of the central market system must be  
implemented simultaneously;

The third market must be retained to provide essential  
competition--  
The third market must be eliminated or a dismantling of  
the auction market will occur;

Members will leave exchanges--  
Members will not leave exchanges;

The composite tape will increase disclosure--  
The composite tape will be misleading;

Regulation must be equal before operation of the tape--  
Regulation can only be equal after experience with the  
tape;

The industry has nowhere to turn for policy direction--  
The SEC is assuming not only policy direction but also  
operating responsibility for the central market system.

Indeed, it may well be an "age of wisdom" and an "age of foolishness."

What is the most appropriate action for a responsible agency which believes in free enterprise, competition, and self-regulation to take under these circumstances? In my opinion, the only acceptable course is for the agency to use its authority to persuade segments of the industry to work out their differences in a way which advances the purposes for which the industry exists. Failing in that effort, unless it is to shrink from its responsibilities, the agency must provide leadership and require action consistent with the self-regulatory concept established by Congress. Such action, when dealing with the capital raising mechanism which underpins the entire corporate structure of this, the greatest of all industrialized nations, is an awesome responsibility for the Commission and, speaking for myself as well as what I believe to be the feelings of the other members, I can assure you that this responsibility is considered to be a sacred trust and is approached with great reverence.

In this spirit, and knowing that it takes time to adjust business plans and operations, the Commission is attempting to stimulate the necessary change in an evolutionary fashion providing lead time for planning and emphasizing maximum



self-regulatory and private industry self-determination. On the basis of a series of hearings and special studies, extending over 3 1/2 years, the Commission issued a statement on the "Future Structure of the Securities Markets" in February of 1972. Shortly following that statement the Commission proposed Rule 17a-14 which would require registered exchanges and the NASD to make quotations of listed securities traded in those markets available on a continuing real-time basis, and Rule 17a-15 which would require the exchanges, the NASD, and certain broker-dealers to make last sale transaction information available on a current and continuing basis. This information on transactions and quotes is necessary for a composite tape and a composite quote system which, along with a set of rules to regulate trading and govern the relationships among various components of the listed securities markets, comprise the basic elements of a central market system.

In November of 1972, after considering the recommendations made in a report of the Commission's advisory committee on market disclosure and numerous public comments, the Commission adopted Rule 17a-15 which called for self-regulatory bodies to submit a plan for the dissemination of reports of listed

security transactions in all markets. The Commission considered this composite last sale reporting system to be an important first step toward a central market and, because facilities were already in place which could be used for that purpose, it was thought to be a most modest first step. However, it hasn't worked out so simply.

In response to the Commission's rule, a group composed of the New York, American, Midwest, Pacific, and PBW Stock Exchanges, and the NASD filed a plan in March of last year. On June 13, after considering public comments on the proposal, the Commission requested a number of changes in the plan. Substantially all of the changes were acceptable to a majority of the parties comprising the sponsoring group, but individual parties have had strong objections.

The major remaining differences have now been reduced to four areas:

1. the hours during which the tapes should be in operation;
2. whether a suspension of trading of a particular security in the primary market for regulatory purposes should automatically preclude trades in that security in other markets from appearing on the tape;

3. whether the plan should provide for the Commission to approve amendments to the plan proposed by its sponsors and to require amendments it deems necessary or appropriate in the public interest; and

4. the degree to which all markets should be subject to equal regulation before the tape begins operation.

Because the composite tape is the most imminent step in the evolution to a central market, I would like to discuss the Commission's basic position on these four issues.

The first two issues are related. The Commission strongly believes that a reporting system purporting to show all market trades in specified securities should do exactly that. If the tape is to function as an effective and comprehensive disclosure device, it does not seem appropriate to allow cessation of the tape's operation while exchange trading is taking place in many of the stocks reported on the tape. The result of such an early close of the tape might well be to provide an after hours haven for trades seeking to avoid prompt disclosure. The primary exchanges argue that to keep the tape running until trading ceases on the Pacific Stock Exchange will require them, as a practical matter, to extend their trading day by two hours. This,

they assert, will raise obvious manpower and administrative problems. We are most sympathetic to these problems; however, we are confident that a solution can be reached which will not compromise the need for full disclosure. From the same basic reasoning, we believe that if trading of a particular security is suspended on any market for reasons which do not require that it be suspended on other markets, the reporting system should continue to show trades which are taking place on those markets.

Of greater importance than hours of trading and suspension of trading is the procedure through which the composite tape plan may be amended. In adopting Rule 17a-15, the Commission intended to make clear its determination to exercise its authority and responsibility to oversee the development and administration of a composite last sale reporting system. For this reason, the Rule provides the Commission with flexibility to vary the terms of a plan submitted pursuant to the Rule. Authority to approve a plan's terms would have little meaning without authority to approve proposed changes to the plan and also to initiate changes.

The plan submitted to us by the self-regulatory bodies established a system whereby the New York Stock Exchange and the American Stock Exchange would each, by virtue of their market activity in securities to be reported on the tape, have veto power over amendments to the plan which could be submitted to the Commission. The Commission does not believe that it is in the public interest to permit the more powerful exchanges to have what some regard as ultimate control over the composite last sale reporting system. On the other hand, it does not seem appropriate that the exchanges on which most of the reportable transactions take place and which presently own and operate the only nationwide tape facilities have no more to say about their operation than some of the smaller participants who have much to gain from having their trades reported on a system with nationwide coverage.

We have suggested that a reasonable solution to this dilemma is to permit the voting scheme contained in the plan to remain, but with Commission oversight and authority to approve amendments to the plan proposed by the plan's sponsors and to require changes in the plan which we deem to be necessary or appropriate for the maintenance of fair and orderly markets, the public interest, or the protection of investors.

I believe our authority in this regard has ample foundation in the Securities Exchange Act and is no different from the kind of residual authority which Congress has repeatedly mandated us to exercise in virtually all phases of the self-regulatory process that has governed the securities industry successfully for 40 years. For us to fail to exercise our traditional oversight role in an area as critical to the fairness and effectiveness of the markets as the composite tape, in my view, would be an abdication of our responsibility.

The remaining issue, equal regulation and the timing or sequence in which it should occur, extends beyond the composite last sale reporting system and must be considered in the context of a more complete central market system. The Commission has repeatedly committed itself to the proposition that regulation of equals should be equal. It follows that regulation of competing market participants should be equalized in direct proportion to the degree that they are able to provide competition, as barriers are removed and as central market facilities become operative.

This notion has led some to assert that because the primary markets have a more stringent and comprehensive

regulatory structure than the regional exchanges and the third market this structure should become the norm for all competitors. There is no doubt that primary market regulation is broader and more rigorous. In planning a new regulatory structure for the central market system, however, it should be recognized that some of these more rigorous rules imposed on the primary markets may not be necessary if the unique status which primary markets have in today's system is shared by others in a more competitive central market system.

As an advocate of regulation by competition wherever possible, it is my considered judgement that increased competition will reduce and perhaps eliminate the need for some existing rules and that it would serve neither the public interest nor the interest of the securities industry to extend to all markets, rules which may not be necessary. For example, the NYSE and AMEX rules governing floor trading were designed to prevent primary exchange members from obtaining unfair advantages over public investors as a consequence of their presence on the exchange floor and their concomitant ability to observe trading developments first-hand and to gain a "feel of the market."

To a great degree, the non-primary markets base their prices on the primary market price and it is because primary market trading influences other trading so significantly that the information or "feel" a member can obtain on the NYSE or AMEX floor compels tight regulation of its use. Under present conditions it is unlikely that a floor trader on a regional exchange could take advantage of the public by virtue of his presence on the floor. The question which remains to be answered is whether the advent of a central market system can be expected to change these circumstances so as to require that all existing, primary market floor trading rules be applied uniformly to all market centers.

Similarly, in the case of specialist regulation, the rules of the primary exchanges are tailored to take account of the fact that such exchanges are at the center of activity in the stocks they trade. Rules establishing the affirmative obligation of a primary exchange specialist to contribute to maintenance of a fair and orderly market might be unfair if the specialist were not in a position to exert considerable influence on the course of the market and if he did not have the exclusive benefit of his unique view of the ebb and flow of trading in each of his specialty stocks, including both



orders originating from the crowd and those left on his book. By the same token, some exchange rules designed to prevent overreaching by specialists could become unnecessary if the specialist's privileged access to the flow of orders were to be shared with other market makers.

It is important to keep this background in mind when considering the kinds of rules which should be made applicable to all competing markets. In formulating a central market regulatory structure, our focus must be two-fold: the actual regulatory needs of the system and our desire to apply rules with sufficient uniformity to prevent any class of competitors from obtaining an unfair advantage through less stringent regulation.

Equally important as the nature of the regulation to be adopted, is the question of the timing of its adoption. It is anticipated that the communications network and rule changes which are the real substance of the central market system will greatly enhance the ability of weaker market centers to compete with the primary exchanges. Because it would be unfair to improve significantly the capacity of such market centers to attract business from the primary exchanges while permitting the present differences in regulatory structures to continue, and because of the increased

opportunities for manipulation and other abuses which would then exist in those market centers, we have concluded that at the time the composite quotation system and the central limit order repository are implemented--steps which we believe will place all market centers on a more comparable competitive footing--it will be appropriate to significantly adjust the regulatory pattern.

Uniformity in some areas of regulation, such as the net capital rule and broker-dealer financial reporting, may be appropriate for immediate implementation. However, to require market participants on the regional exchanges to operate by all of the same regulatory standards prevailing on the primary exchanges before the quotation system and the repository are operational would be to provide a significant competitive benefit to the primary exchanges without providing offsetting benefits to the regional exchanges.

Many have disagreed with our views on the question of timing and have argued that equalization of regulation must take place prior to the introduction of the composite tape. While we believe that there can be agreement on most of the groundwork for the central market system's regulatory structure prior to the introduction of the composite tape,

we cannot agree that implementation of the entire panoply of regulation must precede the tape's introduction. Our reasons are twofold. As I have noted, equalizing the regulatory structure is in part an attempt to provide fair treatment for equal competitors, and few would claim that the composite tape alone will make equal competitors of the various market centers. Secondly, equality of regulation must be based on demonstrated regulatory need. Since the composite tape is simply a disclosure device for publicizing what already has taken place (for use by the investing public as well as the broker-dealer community), its potential for misuse lies principally in its ability to be used for manipulative purposes--that is, for artificially inducing trading activity by others. In view of this potential, operation of a composite tape will require each market center to have and apply substantially similar rules governing short sales and other potentially manipulative activities.

Accordingly, I agree with the Commission's central market advisory committee that a uniform rule governing short sales in all markets and a uniform anti-manipulation rule (to supplement the Commission's rules), together with a means for coordinating trading halts, should fulfill all

regulatory prerequisites for implementation of a composite tape. The Commission has assured participants that it will require these rules to be in place before full operation of the composite tape.

The New York Stock Exchange has initiated a commendable effort for a self-regulatory body task force to work out additional uniform rule proposals. You can be sure that the Commission supports such cooperative action because agreement by the parties involved could facilitate more rapid movement toward a central market system. It is important, however, to realize that competitive economic considerations make such agreement very unlikely until other elements of the central market system, in addition to the composite tape, are also agreed upon and unless there is agreement that implementation of rule changes will be concurrent with the implementation of other elements of the central market system.

Fully recognizing the opposition to the Commission's position on the composite last sale reporting system, I believe the time has come to stop the quibbling and get on with the tape. Even after the plan is agreed upon or declared effective, it is contemplated that it may require as much as twenty weeks to begin Phase I in which fifteen stocks will be carried on a composite basis on the NYSE ticker system.

According to the schedule, Phase II, which is full operation of the tape, would begin twenty weeks later. This provides a period of about ten months to work out regulatory as well as technical problems.

Unless the industry group finds it possible to move forward on the composite last sale reporting system on terms acceptable to the Commission in the very near future, I would support direct action by the Commission and I believe that the Commission, in the public interest, will take measures requiring the parties involved to establish such a system.

In the interest of self-determination by the industry and its self-regulators, I sincerely hope that this will not be necessary.

Some who disagree with our proposals and our actions on competitive commission rates and the central market system have criticized the Commission as not understanding the industry or being interested in its health. I do not believe I need to remind you that there are other financial institutions competing for both institutional and individual savings. You cannot be isolated or insulated from this economic fact. There are also other financial institutions which are anxious to fulfill the functions for which this industry exists.

The health of the securities industry depends not on protective Commission action but on the industry's ability and willingness to effectively and efficiently meet the demands of those who are seeking capital as well as those who desire to use their savings to provide that capital through financial intermediaries.

The Commission is trying to assist the securities industry to rise above intramural infighting and reshape its institutions to meet these demands.

It is a time of change.

It can be the best of times.

It can be the age of wisdom.

It can be the spring of hope.

Those who plan for the future have everything before them.

Those who are unwilling to adjust to a more competitive environment have nothing before them.