Comments on Proposed Rule 10b-10

from

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<u>Comments on Proposed Changes in Commission Rules Governing Commission Rates</u>

Our reaction to the proposed modification in rules relative to "give-ups" is that the problem arises because control of the commission structure is an attempt to regulate prices and to keep them from going to the levels they would assume on an unregulated market. There are, no doubt, often good grounds for disquiet with the prices that "free market forces" produce, and in such cases it is always tempting to institute a system of price controls in which more palatable rates are imposed by some regulatory mechanism.

Unfortunately, we know of no case involving any significant number of buyers and sellers in which such price controls really work. There are always ways to avoid them, and there are always those who are willing to do so. Whether in regulation of the prices of theater tickets, of consumers' goods in wartime or of commission rates, the results are always the same. And then there inevitably follows the dreary task of regulatory patchwork in which rules are amended, supplemented and penalties added, each such change generally compounding the difficulties produced by the last.

In this area the securities market seems so far to have been unusually fortunate. The evasion mechanism that it has developed the system of "give ups", has apparently avoided bringing in the unscrupulous elements that run the black markets which usually accompany price controls. But modification of the rules to specifying more closely what can and what cannot be done -- e.g., circumscribing the purposes for which give-ups can be used -- only invites far more serious problems.

It seems to us that the commissioner should therefore consider very carefully and hesitate very long before embarking on a program which bases itself on such supplementary rules. Once it starts on this path it may find itself with little choice but continuous escalation, each step producing results basically no more satisfactory than the last.

We would suggest that, instead, one examine whether a more satisfactory answer is not some program designed to make more effective use of competition and the market mechanism. Clearly we are not in a position to evaluate all its implications, but a procedure permitting greater freedom of entry into the various professions involved in the exchanges might prove far more effective in providing an acceptable structure of commission rates than is the most elaborate complex of regulations. Of course, we recognize that on the other side of the market the large institutional sellers cause greater difficulty by virtue of their sheer size. But even they are perhaps sufficiently numerous to be subject to some extent to the effects of countervailing power. At any rate this side of the subject requires considerable thought and study, for here too hasty imposition of a set of plausible modifications in the system of price controls may well lead to unexpected and unpleasant consequences.

To be more specific: what the New York Stock Exchange is proposing seems to be, in effect, to trade the establishment of volume discounts for the abolition of "give ups". The Securities and Exchange Commission should at least consider the alternative of allowing some sort of competition in commission rate levels on both the New York Stock Exchange and the regional exchanges. This alternative would permit Stock Exchange members to compete with the regional exchanges on equal terms and would allow the New York Exchange to recapture some of the business that has been lost to the regional exchanges. It would have the added advantage of allowing member firms to compete with each other by altering prices as well as by differentiating the services they offer.

The latter point is particularly important in view of the recent academic literature on the random walk theory. As you know, many academics have concluded that the value of investment advice is virtually zero. There seems to be no evidence that the selections of professional investment men are superior to selections that are made by throwing darts at the <u>Wall Street Journal</u>. One need not go all the way in accepting the conclusions of these analysts. Nevertheless, it does seem reasonable to conclude that the value of <u>some</u> investment advice is small, and that many brokerage firms might well find that they would prefer to drop their extensive research departments and to compete, instead, by offering the customer lower costs. These firms then could still compete via the price mechanism with brokerage houses offering a wide range of research services. Investors would still have the choice of paying regular commissions to firms which also offered them research services. But they would have the option of utilizing a lower commission rate of firms that are simply in the business of executing transactions. It seems to us that this kind of alternative should be rather thoroughly examined before promulgating any rules that would have the effect of limiting the possibilities of price competition.