PUBLIC CONFIDENCE IN A CHANGING BUSINESS ENVIRONMENT

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One thing the legal profession and the securities business have in common is that people like to tell funny stories about us.

I'm not going to tell any jokes about lawyers this afternoon. But I do want to discuss with you some ideas about other, more important, concerns that the corporate section of the legal profession has in common today with the securities business -- and particularly with the New York Stock Exchange. Those concerns focus primarily on the matter of investor confidence in corporate equities. They involve two very substantive categories of issues --corporate governance and the structure of the securities markets-- that are very much in the news today.

But first, by way of preamble, I would like to take a few minutes to describe some of the things we have been doing at the New York Stock Exchange to dispel some of the lingering public perceptions of a private club fighting to maintain the status quo.

Let me say at the outset that I would not be at the Exchange today if I thought those perceptions were valid. At the same time, they are not likely to be changed by mere rhetoric. So let's take a brief look at the evidence.

The past two years have brought dramatic changes to the entire securities business. Fixed commission rates are a thing of the past. Federal legislation enacted in 1975 --calling for new high levels of competition throughout the industry-- was replete with implied challenges to the

New York Stock Exchange's traditional status as the nation's principal securities marketplace. We are operating in a new environment in which none of the old traditions and practices can be regarded as sacred. We have faced up to the fact that the New York Stock Exchange will continue to be the nation's principal securities marketplace only if it is also the highest quality, most cost-effective marketplace. And that has prompted a firm new commitment to constructive change based on the awareness that our policies and operations must be in tune with the realities of our new environment.

In mobilizing all our resources to achieve that objective, we have tried to develop fresh insights into the fundamental role of our marketplace in the national economy. And we have begun making some significant changes -- both with respect to our basic function of maintaining markets for the stocks of some 1,550 of the nation's leading corporations and, internally, in terms of our management style.

EMPHASIS ON QUALITY

The unique feature of the New York Stock Exchange marketplace is, of course, the complex and very closely regulated specialist system -- our principal vehicle for maintaining fair and orderly markets in listed stocks. Various aspects of the specialist system have been criticized by corporate officials and others, and an important part of our new commitment to quality control in the marketplace has focused on addressing many of those criticisms. Instead of automatically defending something because it has worked well in the past, we have tried to identify, as objectively as possible, the potential for improvement.

This has been a very instructive process -- and it has led to some very basic changes.

For example, we have adopted a formal job description and a code of acceptable business practices for specialists, so there is no longer any question as to what is expected of them. And we have urged all listed companies to become familiar with both of those documents.

We have strengthened the Exchange's procedures for measuring, evaluating and, if necessary, improving specialists' performance.

Perhaps most important to listed companies, we have established highly visible new procedures for allocating stocks to specialists -- based on high performance levels. And stocks may now be reallocated if a specialist turns in a sub-standard performance, regardless of whether or not disciplinary measures are warranted.

We have also endorsed a system of competition among specialists and are taking steps to make it much easier for qualified people to become specialists.

In a related area, we have established a new category of competitive traders on our trading floor. These people are also closely regulated professionals who both bid for and offer stock in competition with specialists. Thus, they bring an important additional element of competition and liquidity to the auction trading crowds which are such an essential component of the unique pricing mechanism that determines the market value of listed stocks.

Moreover, for the past 17 months, oversight of our markets has been vested in a hard-working, Board-level Quality of Markets Committee chaired by one of our public directors, Gavin MacBain, who is a former chairman of Bristol-Myers Company.

At present, that committee is actively studying additional ways of maximizing competition on the floor of the Exchange. In fact, the committee is examining the possibility of changing the mechanics of the trading process and the ways in which brokers and dealers participate in the trading process. The committee's charter makes clear, as I have already indicated, that nothing --no matter how time-honored-- need be considered as sacred.

If further evidence that we mean what we say is needed, I would call your attention to the precedent-shattering action taken by our membership last month in approving a proposal for establishing new forms of annual membership on the Exchange that would broaden broker-dealer access to our marketplace.

How do you judge whether these changes are evidence of much more than the cosmetic applications that the most skeptical critics might expect from the Exchange?

Perhaps the most persuasive judgments have been made by others --particularly by some major U.S. corporations which, in the past, have made no secret of their belief that satisfactory markets elsewhere precluded any need for them to list their shares on the NYSE. Over the past year or so, a number of those corporations --BankAmerica and American Express are two of them-- evidently decided that the market-making and other advantages of listing tens of millions of shares are now worth the considerable expense and obligations that such listings entail.

QUALITY OF MANAGEMENT

These substantive improvements in the quality of our markets have gone hand-in-hand with important changes in management style, aimed at assuring that the Exchange is operated as a business, in accordance with accepted modern management methods -- rather than as support for a private club, as some of the old perceptions would have it.

Again, what is the evidence to back up these assertions?

To begin with, we have extensively restructured and realigned management, at all levels, and we are strengthening our use of proven corporate techniques --such as management by objective, long-range strategic planning and three-year-cycle budgeting-- to improve cost-effectiveness.

In addition to involving all management levels in our basic planning processes, we have launched a major new marketing effort to develop the strongest possible competitive posture for the Exchange and to explore a range of additional products that might be traded in our marketplace.

Philosophically, we recognize that in today's rapidly changing securities industry environment, the New York Stock Exchange cannot realistically regard itself as belonging only to those who hold memberships. The Exchange belongs, in fact, to all its constituents and, more broadly, to America. This has led us to reexamine the Exchange's traditional constituent relationships --particularly with listed companies-- and to develop some additional important changes in management style.

Listed companies have an intimate business relationship with the Exchange. They pay an important slice of our revenues. They provide the products --the listed stocks-- that are traded in our marketplace. In return, they require from us continuous affirmative markets in their stocks. By providing a high-quality secondary market for listed securities --a cost-effective market that merits the confidence of investors-- the Exchange plays a key role in enabling listed companies to tap fresh sources of capital when they need it.

In short, it has become increasingly clear to us that listed companies have as great a stake in the viability of the New York Stock Exchange as do our own members. It follows, logically, that listed companies should have a direct line into the decision-making processes at the Exchange that intimately affect their own businesses.

INPUT FROM LISTED COMPANIES

One major channel of input, of course, is our Board of Directors which, today, consists of --in addition to the chairman and chief executive officer-- 10 directors who are principals of member securities firms, and an equal number from outside the securities industry. Our public directors include seven present or former chief executive or senior officers of major U.S. corporations.

We have taken steps to meet the need for additional channels of communication with listed companies.

About a year ago, as part of an over-all program to strengthen communications with all our major constituents, we initiated a series of visits by senior Exchange officials to the nation's major business and financial centers. Each visit has included, in addition to face-to-face meetings with locally based institutional investors and regional member firms, a working session with chief executive officers of listed companies. These meetings have enabled us to learn, at first hand, the concerns of many of our corporate constituents across the country -- and to acquaint them with Exchange-related developments closely affecting their own businesses.

We have also added to our roster of hard-working Advisory Committees to the Board a new Listed Company Advisory Committee that we believe will be able to make a major contribution to Exchange decision-making. That committee, which includes the chief executive or chief operating officers of 12 broadly representative listed companies, is chaired by C. Peter McColough, chairman of Xerox Corporation.

We have developed another technique to encourage listed company officials to participate directly in the formulation of major Exchange policies. This involves circulating drafts of policy proposals to all listed company CEOs for review and comment -- early in the policy-formulation process, so that their best ideas can be incorporated into our policy decisions.

We used this approach very successfully late last year, as some of you may recall, in developing a new Exchange policy requiring listed companies to have audit committees that are independent of management. Officials of more than half our listed companies responded with constructive suggestions -- and many of their ideas were, in fact, included in the final policy that was approved by the SEC.

The quality of the input we received was well worth the effort to obtain it; and we will be soliciting listed company views on other major policy questions on a regular basis in the future.

I should add that we have been told that the new audit committee requirement --with which most listed companies seem comfortable-- has been hailed by some members of Congress as an example of the kind of initiative Corporate America can and should be taking in its own best interests.

PROGRESS TOWARD A NATIONAL MARKET SYSTEM

If there is any single issue that clearly underscores the mutuality of interest inherent in the relationships between listed corporations and the Exchange, that issue is the continuing evolution of a National Market System in which all listed stocks will be traded.

The structure of that system --and the way it operates and is governed-- will have a powerful impact, either positive or negative, on public confidence and the willingness of investors to invest in listed stocks.

Over the past two years, the securities industry has made progress toward developing a National Market System. Many important elements are already in place. These include the consolidated tape, which reports trades in listed stocks in all markets, and the various order-handling systems now operated by the New York and other stock exchanges. Progress has also been made toward establishing a nationwide network of interfacing clearing corporations and toward development of a composite quotation system.

What remains to be accomplished is an effective method of linking the various markets electronically to permit trading between and among them. A complicating factor is the announced decision of the SEC to remove the existing so-called "off-board trading" rules next January 1.

Without going into technical detail, removal of those rules would enable any securities firm to trade any publicly traded stock in its own offices, acting either as a dealer or as an agent. In other words, any New York Stock Exchange member firm could begin making over-the-counter markets in any listed stock or group of stocks.

The SEC itself has recognized that, in the absence of any other concurrent action, removal of the off-board trading rules could create some serious problems -- particularly with respect to fair dealing with investors and fragmentation of the existing markets. Other problems that we have identified include the possibility of serious damage to the existing stock pricing mechanism, over-concentration of the securities industry in a handful of large, well-capitalized firms, and the disappearance of smaller underwriting firms that now serve the specific needs of smaller corporations.

At public hearings last week, we urged the SEC not to remove these key rules until all the elements of a National Market System --including the essential inter-market linkage-- are in place. And we presented a proposed structure for a National Market System that we believe would establish the optimum balance between competition and protection of public investors, consistent with objectives specified by Congress.

We believe such a balance is absolutely essential to strengthening public confidence in the securities markets and to encouraging greater public investment in corporate equities.

Public confidence in the companies that issue equity securities is, of course, every bit as essential as public confidence in the marketplace where those securities are traded. The mutuality of interests that we share with listed corporations today is further underscored by the growing list of corporate governance issues that are impacting on public confidence and attracting increased attention from Federal legislators and regulators.

GOVERNMENT IN THE BOARD ROOM

These issues have a common denominator in that many of the solutions being proposed would impose new layers of government supervision and control on decision-making by corporate management.

At least one key issue has already been resolved. As many corporate officials have belatedly discovered, the Securities Acts Amendments of 1975 --the same legislation that called for the development of a National Market System-- gave the SEC ultimate authority to determine where and how a corporation's securities may be traded.

A brief look at some of the other recent developments suggests the dimensions of the challenge to the corporate community.

. For example, Congressman John Moss' Subcommittee on Oversight and Investigations has issued a detailed report calling for, among other things, legislation requiring corporate boards to have a majority of independent directors.

. In announcing a major new Proxy Study, the SEC recently declared that it might consider submitting or supporting legislation to establish Federal standards for corporate directors' conduct. I understand that a subcommittee of your Section has submitted an unofficial --but highly detailed-- response to that and many other issues of governance raised by the SEC, warning against "the de facto creation of a Federal corporation law before Congress can consider all of the implications of that action."

. In another area, a staff study issued by Senator Lee Metcalf's Subcommittee on Reports, Accounting and Management has recommended establishing Federal accounting and auditing standards.

. Senator Howard Metzenbaum has stated that "increased activities and power of corporations demand that Congress make them more accountable to the shareholders and public they serve." Recent hearings held by Senator Metzenbaum's Subcommittee on Citizen and Shareholder Rights and Remedies focused primarily on the pros and cons of Federal chartering of corporations.

. And a proposal by former SEC Chairman William L. Cary that would require corporate management and directors to meet minimum national standards of fiduciary obligations to shareholders --as an alternative to Federal chartering-- seems to be attracting widespread interest and support.

It is important to note that these proposals --unlike some others we've all heard-- do not come from irresponsible crackpots. The proponents are thoughtful people who are strongly positioned to help shape and influence the passage of legislation. The issues they are raising will not go away if we simply ignore them. Indeed, the movement to bring government right into the corporate board room seems certain to escalate in direct proportion to continuing public revelations and discussion of alleged corporate misconduct.

GETTING THE ACT TOGETHER

A. W. Clausen, president of the Bank of America recently summed up the challenge facing the American business community with characteristic bluntness. His words are worth repeating:

> “First, the credibility of the corporation in today’s society continues in question -- and that’s a festering sore that must not go untreated.
>
> “Second, any shadow of doubt about the fairness or the competence or the integrity of the business sector affects the general level of confidence in our economic future -- and that already is too low for comfort or complacency.
>
> “Third, the onus of correction is on us. If those of us in the corporate community don’t get our own act together, no one else will. They’ll just take it over. And they’ll have good reason.”

Those are not gentle words. But they command attention. The task of developing and carrying out initiatives to counter the prospect of pervasive government supervision and control over corporate governance and management may well be the greatest challenge that has ever faced Corporate America and the private enterprise system.

How well American business succeeds in meeting that challenge will bear directly on the quality of public confidence for many years to come.

THE NEED FOR INITIATIVES

As I have tried to indicate, we have a much deeper awareness than ever before of the New York Stock Exchange’s dual identity as a publicly oriented national institution and as an integral part of the larger American business community. We share with all segments of the private sector a profound public obligation to help assure the maintenance of strong, healthy capital markets in this country.

The capital-raising efforts of American business must continue to be strongly supported by broadly representative, efficient public markets, operating in the public interest and meriting the confidence and participation of large numbers of risk-oriented public investors.

We have identified a strong need for new initiatives -- for closer working relationships with all our constituents, and particularly with listed companies. The very valuable input we have sought and obtained thus far to assist in our decision-making has come primarily from chief executive officers. The question I ask you ladies and gentlemen is whether that is sufficient.

Many of our mutual concerns focus on areas in which the legal profession has vast reserves of knowledge, expertise and practical experience. Perhaps there is a role that the senior legal advisors to corporate management might define and undertake, not only in the interests of the individual companies you counsel-- but in the interests of the larger national business community, and in the public interest.

Should we at the New York Stock Exchange be establishing closer ties with you? And if so, what would be the best way to do that? We are completely open to your ideas. We are ready to work with you --if you believe a working relationship can be productive-- either informally, or within some kind of formal structure.

As you can see, I am reluctant to prejudge your response. What I am really asking, I guess, is do you want to channel your ideas on issues of mutual concern into our decision-making process?

That is not a rhetorical question -- or a convenient way of signing off this afternoon. We will welcome your views and ideas. And I can promise you that we will be responsive.

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