in the economy. You try to get on the Metro down here, you do it with hard dollars. You try to fly up to New York, you do it with hard dollars. You try to make a telephone call, you use hard dollars. You pay your mortgage, you use hard dollars.

Why is it that in this situation, the folding green stuff that most of us are familiar with appears not to work? Why does this system require or like -- let me not use the word, require -- why does the system like soft dollars so much?

Does soft dollars not introduce an entire new generation of what I might call a monitoring problem into the entire operation of this sector? By monitoring problem, let me analogize the soft dollar situation to something that people not involved in the brokerage industry might understand from their daily way of life.

In a sense the soft dollar arrangements are much like frequent flier discounts, and the monitoring problem that you run into there are much like the situations that employers often run into in terms of how their employees make arrangements with regard to flying around and who gets to keep the frequent flier discount.

For example, suppose you have a pension fund, the fund hirer is a manager, it pays that manager a fee, and that fee is supposed to cover all travel expenses. The manager then makes an arrangement with an airline and that airline is not the cheapest carrier. But what that airline does, is it passes back a frequent flier discount.

Suppose it is not just a frequent flier, but it will also buy you luggage, it will pay for the limo to the airport, hotel stays, meals on the road. It is all travel related expenses, though.

To what extent do the pension funds know about the extent of frequent flier discounts being paid back to the managers, and why is it that these discounts are being paid back in this soft dollar analog? Why not just discount the air fare? Why not just write a hard dollar check?

So, in many ways, I guess it is an analogy compounded with a question. Why do not hard dollars work?

Suppose, hypothetically, just hypothetically, soft dollars were prohibited. Would not people continue to be paid for services that have value the same way that everybody else gets paid for services that have value?

MR. KETCHUM: Mr. Potts?

MR. POTTS: Commissioner, I am confused as to why you distinguish between internally generated research and externally generated research when you were giving this conversation about commission dollars.

COMMISSIONER GRUNDFEST: I do not mean to distinguish.

MR. POTTS: The term "soft dollar" is one that is difficult to get your teeth into. It does not have definition in common usage. If I were to hold up a dollar bill and start to bend it and try to persuade you that that was a hard dollar, you would have difficulty with that.

The term does not have definition in the law and in addition it does not have agreement around this table. We have already talked about plan sponsored directed business. Is that or is that not a soft dollar? There are very arrangements that are clear for independent research sources; there is disagreement there.

So the term needs a better definition. I do not think that internally generated research is different from externally generated research. A commission dollar is a commission dollar.

MR. KETCHUM: I guess that, it would seem to me, Commissioner Grundfest's question is, it would still be on the table.

However you differentiate it, what are the difficulties in paying hard dollars for those services, and why is the -- other than the historical evolution in connection with a fixed commission business -- why does the industry continue to lean heavily towards receiving those services through soft dollar understandings?

MR. KETCHUM: Mr. DaPuzzo?

MR. DAPUZZO: One of the factors changing that I have seen since 1986 is with some of the smaller institutions who had prior to 1986 justified the fact that they did not need certain pieces of equipment because they did their decision making for long term, and being kept up to the minute in certain information devices was not very important to them.

Since then, they have found that Autex's machine, NASDAQ machine, and various other quotation devices have helped them, I believe, execute their orders, and they have created departments which they did not have before in execution, which they had, as I said earlier, not been able to under their structure, considered that they could afford it.

I think the fact, now, that these things could be paid for with the same commission dollars, probably even with a lesser fee than they were paying back in 1986, because I think the records show that the commissions per share were down ?? in 1986, and now they have these services and they are doing either the same amount of business or perhaps, again, even less.

MR. KETCHUM: Mr. Binns, you for one, in your written statement, indicated some concerns about the present level of soft dollars and how money managers may be using the business you provide them.

Would you share the view of Mr. DaPuzzo that those are beneficial services and the best way to receive them is through the use of soft dollar research-directed business?

MR. BINNS: I think we would feel that probably all of the services we are talking about are beneficial to some degree. The question is, if one were paying hard dollars, would all of the services that are now being provided be provided?

Our sense is that answer to that is no. So that tells that in the system as a whole -- there are a lot of very talented, bright people doing things at very high levels of compensation that are not really totally necessary. We do not like to pay this.

As an end user and investor on behalf of the beneficiaries of our pension fund, it bothers us to think that a system goes on and continues that has a lot of waste in it and inefficiency, let's say. I cannot make a specific suggestion as to how to get this and cure it, because it is something that has evolved over time.

But basically we think we would prefer, and probably a lot of other pension fund sponsors also, would prefer that the system existed somehow so everything could be paid for in hard dollars and you knew exactly what you were paying for and how much you were paying for it.

MR. KETCHUM: If there is a discipline in this system, it would seem to be from the pension plan sponsors, and I guess to some degree from the ERISA regulation involved with it.

Perhaps Mr. Bahr, and perhaps Mr. Lerner, you could talk a little about what -- Mr. Bahr, you wanted to do a separate point, I suspect. But perhaps you could talk a little bit about what capability there is for pension plan sponsors to manage the quality of execution they are receiving and the services received by the money manager, and perhaps, Mr. Lerner, from the Labor Department vantage point, your perspective of the role of the pension plan sponsor is in the this monitoring obligation.

MR. BAHR: Let me just address Commissioner Grundfest's question.

Obviously, these services could be paid for in hard dollars. We within our organization, with about seven active money managers running some $4 billion, meet at least no less than twice a year to review our research budgets and soft dollar budgets. There is a risk, obviously, anybody could become a soft dollar junkie, even running his own internal money.

We have been running about 15 percent a year for the last two or three years, and it has not really changed very much, because we try to monitor closely what we are paying for services.

I do agree that a lot of hardware and software type of programs, as Austin George said, are being delivered for soft dollars, and it is an efficient way of delivering them.

If soft dollars were not available, the extra commissions -- because I do not think commissions would drop -- the extra commissions would be paid to the investment banking community.

I think it is important to us that the community stay successful and profitable, but we also have to think what is necessary for us to get the full service from the various brokers that we deal with. Therefore, we try to make sure that they are compensated properly, but that we also are able to use soft dollars to take care of other needs.

As far as my ordering trades, I think we have all read the learned studies that have been done, some you put in the briefing book, and it appears that no matter who sponsors the service or the study, they all seem to come out proving that they do the best job in providing transactions. I do not think transactions costs can easily be monitored, as we have all said.

The head of our equity trading department has about 40 years of experience in the investment business.

They log in all trades by time, before or during the day, the amount of volume that is traded, and the price, and I think while it is subjective, there is nothing that can be good experience of seeing whether you have done a good, adequate job, and we rely heavily on the traders to make sure they are getting adequate transactions and executions.

We have not seen execution diminish. If liquidity is diminished, it may be because the cents-per-share are down so low, not because of soft dollars. In fact, one of our traders suggested, with the competitive arena we are now facing, execution may actually have improved a little bit as people are watching execution more carefully.

Your previous question on how much of a research, we have also found over the last 12 months that in dealing with a full-service broker, that whether we are balancing an index fund, rebalancing systematic portfolios or whatever it is, they have agreed that our research salesmen and the research department are being compensated out of our equity transactions. So equities are equities, and we hope that it is taking care of part of our research needs which are vital to us as internal managers.

MR. LERNER: Let me address it from the ERISA perspective, but at the outset being from another governmental agency, I have to give a standard disclaimer that these are my views.

The Chairman addressed some opening questions, as did Commissioner Grundfest, which I think go to the heart of what our interests are, which is accountability and the issue of monitoring.

Our concern is not as much the soft dollars themselves, but what do the trustees of the plan -- it may be the sponsor, it may be in a corporate plan, or it may be in a union-employer plan, the trustees of that plan -- what do they know and what are they following as to how their dollars are being used. That is our concern.

We in our release had followed the SEC's release, spoke to that point, that the trustees of the plan have an obligation to monitor their investment managers, whether or not 28(e) is applicable. On the other hand, others have raised the question of directed trades.

Under ERISA, when you select an investment manager, it removes the trustees from certain liabilities, certain responsibilities. But it does not remove them from all of them, so that they still have that obligation to monitor the investment manager.

Let me just mention another point, when you select an investment manager, when a trustee selects an investment manager, it can no longer take direction from those who select it as to do this or to do that or buy this stock. So when a direction is given to the investment manager, it must be cautious in following those directions to ensure themselves that what they are doing is, in fact, obtaining the best execution.

Now, we all say around this table people do not know what it is, but I believe that it has a capacity for being looked at and not just being brushed aside and saying we cannot monitor it.

The rhetorical question that I would like to ask, which really comes from some of the inquiries that we have done, is what kind of records do you keep at your firms, as far as soft dollars.

When we have gone into situations often records are kept for a period of time and discarded. Sometimes the records are not existent; they are really verbal commitments that are made. I would be interested in what type of records are actually kept.

Let me just close by saying I was interested that California does apparently keep some sort of records on execution and on soft dollars, and I would be interested in how they do it as compared to others.

But, in conclusion, our role and our interests is really that the participants of a plan get the use of their assets, and part of their assets are the commissions that are paid.

MR. KETCHUM: Mr. Schwan, maybe you could expand on the statement that you made before, and indicate also whether you conduct a similar evaluation as Mr. Binns does as to the amount of research received by money managers handling your accounts and how that is used.

MR. SCHWAN: The record keeping really begins with the request by one of the units of the investment operation for some particular soft dollar service or some service that can be, in fact, paid for with soft dollars. That has to be internally justified and approved, arrangements made with a broker as to what the commission cost will be. We set that. If the broker does not want to do it for that, we go to someone else -- and the ratio, both. Once that is approved, then the service is acquired and records are kept as to that service, its use, and it is periodically reviewed.

The whole series of services are products acquired in this manner, are reported to the trustees on an annual basis, as is a projection of the next years anticipated use of similar prox, paid for with soft dollars.

As far as the execution goes, that is, without any comment as to the validity of the monitoring capability, we do get -- we have a consultant that monitors every trade, not only conducted for soft dollar purposes, but all purposes, both internally and external managers, and quarterly reports are furnished as to the effectiveness of those trades.

For the most part, we are getting is a report that says there is a negative cost impact on the trades that are being executed, the total trades, including those soft dollars and not-soft dollars.

So we are satisfied that we are tracking, recording, and evaluating the services on an ongoing basis. However, if there were to be discontinued, if that capability was not there, I think what it would mean to us merely is an inconvenience in that I would have to find somebody to get those services budgeted.

Being a government agency, it took me some two years before I could start up again, but I do not think I would lose anything in the process.

So I view it as a convenience more than anything else, because we would not buy the service if we did not need it, with soft dollars or hard dollars.

COMMISSIONER GRUNDFEST: Excuse me, Mr. Schwan, could you explain how the ratios are typically calculated?

MR. SCHWAN: The ratio is 2 to 1 that will pay and the commission is 5 cents.

MR. KETCHUM: Putting this all together, 1988 was a slow commission year, from almost any perspective one could imagine. Yet the amount of research-oriented business, at least according to the Greenwich study, did not drop by the same percentage as the amount of commission dollar used.

I think perhaps first directed from the money management side, did you find in a slow commission year greater pressures in order to meet the expectations of providing commission dollars in return for research, either for third-party or otherwise?

Did you find also the amount of business that was directed as a result of pension plan sponsor requests to impose any impacts or pressures on you as the year went by. If so, how did you respond to those?

MR. RIES: I think there were pressures last year, but I think it depends on the size of the firm. If the firm is large enough and does enough trades, you are not going to have the same type of problems with a smaller firm.

In other words, you need a certain amount to pay for the research that you need to perform your investment management services. I mean, there is some basic amount of research you must have. Once you get that, then when you have the issue of other people directing as well, it does put pressure, because there are just less commission dollars to go around.

I think last year there was some pressure, but it was not a serious pressure. In another year, in a tighter market, it could have some impact.

MR. GEORGE: I would suggest that my traders would comment that I had plied more pressure on them last year to try to get the business to the people we wanted to see it go to.

In effect, it was harder -- you thought immediately of what broker is competent to this order and who is it that we really would like to see to get the business -- very much of a heightened intensity because of the condition of our own business, not because of a heightened demands for research buying.

MS. STARK: I would definitely agree with Austin.

I think most people's turnover was much lower in 1988, as a result much less commissions were paid out and you were focusing each and every order in terms of what percentage of this can I use to pay off my soft dollar budget.

One of the other difficult parts, though, is that in terms of -- when we direct commissions for a plan sponsor, it is done on a percentage basis, and it was very, sometimes hard to explain to a plan sponsor why we are only paying maybe $5,000 in commissions instead of $20,000 to remind them, in fact, that their turnover was lower and 25 percent of a smaller number is just going to be a smaller number.

MR. KETCHUM: Did you have situations in 1988 where you lost accounts because you did not meet directed requests?

MS. STARK. No.

MR. GEORGE: I literally cannot remember them; I do not think so.

MR. KETCHUM: I would like to return, perhaps, to second -- to the question of executions on the debt side as opposed to the equity side. I find that development in the business to be of interest.

As I understand, Mr. Cusic and Mr. Potts, with respect to executions provided for debt securities, your traders will essentially attempt to call either a primary dealer or a number of primary dealers or others to get the best possible price you can identify, and then attach some commission or commission equivalent in addition to that price. Is that a fair description of your debt services operate?

MR. CUSIC: All of the debt trading that we do on our bond desk is done in competition, and what we mean by that is, we act as an extension of the trading desk of our client. We try to find, going to various dealers, the best price we can possibly find to make an offering. When we make an offering, it is done on a net basis. The net basis means that within that there is an inclusion for a research credit. The client is able to judge based upon the other offerings that he is receiving whether or not this is a competitive price. If it is, then it is likely that we will get the trade, because it does include a research credit.

But it is all done on a net basis, and usually in competition.

MR. KETCHUM: I assume to do it on a net basis and in order for it to be a profitable business, you are not offering it at the same price that you are buying it from the dealer in the security, whether that be a markup or otherwise.

MR. CUSIC: Well, there is a markup or markdown, depending, of course, on which side you are on, but the fact that it is offered on a net basis means that the client can compare our offering with that he is receiving from another dealer.

MR. KETCHUM: With respect to the three money managers involved here, do you generally deal on a net basis with respect to primary dealers, or how do you generally find -- what price are you offered for primary dealers when they bid and offer? Do you have perception that you are offered a different price than a wholesale price?

MR. GEORGE: In the fixed income arena, I am not a fixed income trader. We do not use principal transactions for soft dollar payments, nor do we, equity over-the-counter arena.

MR. KETCHUM: Is that true for each of you?

MS. STARK: I echo that, definitely.

MR. KETCHUM: Mr. Beard?

MR. BEARD: Just for the record, Rick, I would like to state that Morgan Stanley is a primary government dealer with high ranking market share, and it is our policy to not to make markets to any converters of primary bond merchandise.

CHAIRMAN RUDER: Could I rephrase the question? I think that it is bothersome.

If two people are offering executions and one person says, "I'm going to give you an execution capability plus some services." What do we expect, that there is some cost involved, that the execution is not going to be as good as the person that says, "I'll give you the execution without providing you something else"?

I do not know how you measure that. I take it that the sponsors have some way of tracking that and are able to say, "We seem to get the same kind of executions from the people who offer us soft dollars that we are getting from the people who do not."

That suggestion does not make sense to me. There seems to be something wrong if that is the result you are going -- could you tell me a little bit about the monitoring and what happens and how you judge whether you are getting the similar execution?

MS. SCHWAN: The monitoring of the execution, certainly in the fixed income area, is not nearly that that we have existing in the equity areas, really are what I was discussing earlier.

By the way, I want to correct a response I made to the Commissioner's question. The ratio is 1-1/2 to 1, not 2 to 1. I do not want everybody think we just changed our policy.

On the fixed income side, I think that is definitely a deficiency of the inability to really monitor that in the same way that we monitor equity. That is one of the reasons that we have not made extensive use of fixed income generated soft dollars. Although we have, I think last year was like $200,000 total, but it is not a great deal. It has not been in the past.

I would think that if we were going to use it on a broader basis like we do the equities, we could not do that without having some way of really knowing.

Because I have the same question you do --

CHAIRMAN RUDER: On the equity side, are you getting results which tell you that you are getting as good quality execution when you are receiving something extra that you are when you are not?

MR. SCHWAN: We do not monitor them separately. In total we monitor and we are satisfied that we are getting very good execution in the overall.

We know only that when we are getting something extra in the equity side, we know that we are doing it still for -- the execution has to be there, and we are doing it for a relatively, we believe, small amount of commission.

MR. SILFEN: Mr. Chairman, just with respect to your question on the monitoring side, I might point out that the institutional investor pension form in May of this year did a study of -- published a study of leading plan sponsors, and it was interesting to note that, well, 99 percent of them are very good at precisely monitoring their commission rate. Only about 45 percent of them are monitoring market impact.

With respect to market impact, I might add that a lot of this monitoring, or so-called monitoring, is done by the consulting community. I might point out that was not mentioned earlier today, to the best of my knowledge, a meaningful portion of the consulting community is paid by soft dollars.

One might question, (A) how objective they might be with respect to this, and (B) any monitoring system, whether it was totally objective or not, does not monitor opportunity cost, and those are the trades that do not get done, the transactions where professional trading desks for other reasons feel compelled to fulfill obligations to soft dollar firms as opposed to going to places where they feel they might get a better execution.

Since we are in the analogy business here, I might use my summer baseball analogy. It would be like having Ted Williams in telling you, you have to bunt one out of three times and one out of four times.

Hopefully, plan sponsors in their wisdom are selecting institutions that provide stock selection and execution on a premier basis.

On the execution side, I notice that they do not tell them whether to buy Dow Chemical or Dupont, if they do have a view with respect to where they should do their business some amount of the time.

MR. KETCHUM: I suspect there may be some plan sponsors who would argue that if Ted had only gone the opposite way a little bit more, that he would have hit .400 more than once.

If I could just return for one second to the question of dead executions to follow-up on it -- if either Mr. Cusic or Mr. Potts.

To the extent that you do apply a markup in those transactions of a few basis points, even recognizing the price you quote is net, why is your customer not able to go to the primary dealer or the dealer directly and get that price minus the basis points?

Are you providing a service of canvassing more dealers providing a service of anonymity?

What is the value of that service that you think makes you institutional customer comfortable paying editor-positioned price in a market that is a net market?

MR. CUSIC: The answer is yes to your question in the sense that clients do call dealers on their own, but the market is not always efficient and our trading desk, which is staffed by professional traders, makes every effort to try to find a better price in the marketplace. It does not always work that way, but a high percentage of the trades can be executed in competition because, in effect, we do find a better or a price equal to that which they are seeing from other dealers.

The mark for markdown with respect to that is disclosed to the client, and the client knows that when he makes a decision based upon prices he sees on broker screens, his own canvassing, and receives our offering, whether or not he is getting what he considers to be a fair and competitive price.

MR. KETCHUM: Before we move on to the questions of liquidity that we do not seem to have been able to avoid in the discussion so far, I think it perhaps is useful and helpful that they had underlined that the question of soft dollar practices is not a peculiarly United States issue, although we may have been the most innovative in designing standing services provided.

It is a question that has developed internationally, suggestions that Canadian's soft dollar business is double what it was before, and that soft dollar activities in the United Kingdom and in Europe generally have increased substantially.

In that case, we are very pleased that a representative from the Securities and Investments Board is with us today. SIB has been looking at this issue, including putting out what I thought was an extremely searching and thoughtful release on the question in the last year, and I wonder, Ms. Muston, if you could possibly talk a little bit about your review of the soft dollar questions in the United Kingdom.

MS. MUSTON: Thank you.

Our rules have only really been in effect for just over a year now, and on the soft commission question, we took the line initially that it was not really for us to interfere in the marketplace to the extent of making a judgment as to whether they were a good or a bad practice. They were there, and we would have some form of regulation.

The rule that we imposed though was vague, I think to say the least. We prohibited soft services unless they improved the performance of the firm in providing services for its customers.

We did not have any mandatory disclosure requirement, if the broker maintained his obligation to provide best execution.

Now, over the last year -- the rules had not been going very long before people started saying that it was not working very well. There was a lot of criticism that disclosure just was not there, that the definition of the services was much too vague, and all sorts of things were going on.

So it was quite clear that there were very strong views held in the marketplace. There were the traditional brokers who felt very strongly that soft dollar services were totally undesirable, and though obviously the people on the other side, the fund managers and the soft houses, who felt that they were not at all and that provided regulation was of the right nature, then they should be allowed to continue.

So we issued our consultatory doctrine, not trying to take any particular line one way or the other. We tried to set out the arguments that were around in the marketplace and see whether actually there was any consensus out there, all these issues.

Well, we obviously sparked some sort of chord, because there was a very large response to our document, but it did not really help in trying to find whether there was a consensus or not, because views were quite clearly split.

We asked a number of questions in the document. For example, did people think soft dollar services were intrinsically different from traditional research services?

Obviously, were the existing rules adequate?

Should we ban the service, ban soft dollar services? Should we have a clearer definition?

Should we have more strict disclosure requirements?

We expected the views to be from the traditional brokers, ban it; from the fund managers, no, let it continue. But in fact, it was not like that at all. The views have come back fairly split in all categories.

I think all I can say at this point, where we are obviously still analyzing the responses and deciding which way we should go forward, but I think what I can say is that there certainly was not any clear majority for banning soft dollar services, although there was an underlying element in the responses that, well, some people thought perhaps it would be nice to able to ban them; but they are there, and it just would not be practical.

If we were to ban soft dollars services, then they would simply go overseas, for example.

But there was, obviously, a clear majority saying that our rules were not adequate, and the line that seemed to be taken was that we should go for a clearer definition. Lots of people cited the definition which the SEC has, and that we should go for more rigid disclosure rules.

Also, that all arrangements should be written and obviously recorded much more and efficiently than they are now.

The one other question that we really addressed in the document was that of soft for net, soft services for net. Quite interestingly, the responses on that did come back fairly clearly. People thought soft for net, the practice of soft for net, was not in line with the fund managers of fiduciary shop responsibilities, and that we actually should go for banning that.

Well, as I say, we have not come to any conclusions on any of these matters yet, and it is extremely interesting to me to hear the arguments which are being put around this morning.

We are hoping that our thoughts will develop over the next couple of months, and we will be putting out the next stage of our consultation document in the autumn, so you will see how we go along.

CHAIRMAN RUDER: You do not think you are going to get certainty from our discussion?

MR. KETCHUM: One clear view expressed throughout the table.

Are there any views around the table with respect to developments internationally in soft dollars business?

MR DAPUZZO: I would like to address not only the national but the net part for a moment, and stay with the area you talked about before, the bond trading. I think that was into a section of its own.

But where we do over-the-counter, particularly our firm, we only do it in stops where we make a market, stops which are on the national market system. So therefore the price and the volume and everything is apparent to everyone dealing.

We also will prohibit doing anything at an away-from-the-marketplace. In other words, if a seller is going to accept a discount bid, that cannot be soft dollared; if they are going to accept a premium offering, that will not be soft dollared. It has to be executed within the framework of the market.

So we felt that we were dealing -- although on a net basis -- we were dealing within the framework of the market where credit would have been put on a ticket anyway, whether it was internal for our own research or whether it goes to a soft dollar pool for whatever use the intention is, it is something else.

So we felt very clearly, as our legal counsel and our outside counsel did, on the over-the-counter side.

MR. KETCHUM: Is your trader aware that it is soft dollar business at the time he makes a quote for the trade?

MR. DAPUZZO: The quote basically knows the inside market, so, as I said, in a national market system, our quote is relevant. We do a transaction, we never deal in our quotes anymore over-the-counter. We are normally dealing just on what the best quote shown is -- now if it is going to be traded away from there because the market maker feels for that size, this is a better price, then it automatically becomes eliminated from the soft dollar possibility.

So that was the one part I was saying on the net.

Then on the international side, the other thing is that we -- in some of the foreign markets, obviously, there is some spreads, so I would think that there is, again, a difference there.

Although it is equities, the quotes are not on the machine and they are not necessarily trackable as they would be if you were in a national market system.

COMMISSIONER GRUNDFEST: So what you are saying is that on the over-the-counter market, if you are going to do soft dollar business, you are going to be guaranteed the spread, you are not going to do better, you are not going to do worse?

MR. DAPUZZO: No, no, no, never guaranteed the spread. You are going to deal at the price that the client can receive anywhere, ostensibly.

In other words, it would be the seller; he is going to get that highest bid shown. If he has a limit price and said for them to put that price on it, we would not execute away from that price, lower than that price.

MR. MANNING: One of the questions that we have always had at Merrill, and one of the reasons why we at least today have not gotten into the OTC equity area with the soft dollars, is the whole question of how you determine best execution.

It is clear from the conversation around this table this morning that even if listed markets monitoring for best execution is not simple -- and in the over-the-counter market, assuming execution at the inside bidder offer, and assuming execution net with soft dollaring of the spread or some part of the spread, I guess it still raises the question as to whether inside market net as displayed, even in a system as efficient as NASDAQ, is always best available price and how you determine that?

I do not know how often transactions go off between the bidder offer for soft dollar credit given, but it is one of the things that we sort of struggle with as you are trying to figure out what is best execution in over-the-counter equity market.

MR. DAPUZZO: What would be the difference, though, in my opinion, why do you not soft dollar a normal trade?

See, we share responsibility; the institution is still the same. So that if there is a question about the execution or quality of the execution, it would hold true whether it is a soft dollar trade or a normal trade.

MR. KETCHUM: Perhaps we could turn now to some of the questions relating to liquidity and the restruction in the market that has been alluded to by a number of the participants throughout the morning.

There have been a number of articles written in recent months suggesting that a number of major firms are restructuring their block positioning business. That restructuring to the extent it has occurred, obviously is in response to many things, including of course, reduction in commission rates generally, and perhaps changes in the business and volume levels in 1988 and 1989.

I think it would be helpful to -- one of the first that at least made announcement of restructurings was Morgan Stanley.

I think it would be helpful, Mr. Beard, if you could discuss what your restructurings have been, what changes have been made by Morgan Stanley in recent months, and perhaps Mr. Silfen can talk about how he perceives changes in the block positioning business from Goldman Sachs' standpoint.

MR. BEARD: I will not take you through the full specifics of the handout, but just briefly, the reason we decided to take a look at our business was, as Mr. Silfen from Goldman Sachs stated, their firm was operating this business unprofitably, so was Morgan Stanley, and we felt that everybody was, because our analysis of the facts were that we were one of the lowest cost producers of institutional equity brokerage business.

It was our view that subsequent to the changes of 28(e) that the marketplace indeed had become restructured, and that full-service firms such as Morgan Stanley have become the marginal producer or the swing producer, and that the people who are able to price their products specifically to research services had become the dominant factor.

Obviously, this in a high fixed cost business is an extremely dangerous position to have oneself postured in.

The third reason, of course, is in addition to

28(e) changes, we felt that the brokerage industry exhibited substantial overcapacity that needed to be corrected in time, and that one of the things we could do adjust to that was to change the level of liquidity we provided to the entire marketplace, focused the level of liquidity on the important part of the marketplace, namely, our major customers.

As David Silfen said earlier, there is a certain instinct of self-preservation to take the longer term, and our view is to take a longer-term view and to make sure we survive the short, intermediate term which we thought would be quite adverse for a profitability point of view or continued adversity from a profitability point of view.

It is our clear view that the business will not change. You will not restore liquidity to the marketplace until the market expunges this excess liquidity, and profitability at least to some dimension or important termination of the loss factor is adjusted.

To answer your question, Rick, specifically, what did we do, we took a careful analysis of our business.

One of the things we looked at is some of our major competitors have done. We looked at getting into the soft dollar conversion business and rejected it as not appropriate for our perspective.

We looked at many other alternatives and we decided the best thing for us to do was to slightly increase our spending for research, which we did about 15 percent.

We transferred the important aspect of restructuring as we transferred about 40 percent of the institutional accounts that we were covering that we felt were not adequately paying, nor did they have the capacity to pay for our level of service, being able to research an execution, we transferred them to a different level of a different part of the firm where they received a different level of service we felt was more in line with their capacity to pay.

Finally, of course, we made sure that we maintained for a substantially constricted list of institutional clients a comparable level of liquidity provision.

I think if you want to just look quickly at the attendant charts here, you can see why we drew this case.

I referred earlier to the second chart that showed that firms like ourselves were getting at least a three times greater impact in terms of loss of volume. Our perception is that we have a substantial volume problem, we being a proxy for full-service firms. We know that in terms of realizations, our commission rates, the history there is on the second chart. There continues to be price pressure, but we feel it is more of a volume problem than a price problem.

The commission rates there are indexed. We are currently running at slightly over 66 percent of the 1981 rate, which is an order of magnitude, I think, for all firms, about 10 cents. This is a blended rate.

I think it is fair to say that most of us, without getting into any competitor problems, our doing our domestic business at around 6 cents a share, and that, if you look at the next page, we tried to put together, without disadvantaging ourselves competitively, a rough breakdown of what the costs are on current price and volume, judging 1989 to 1987.

The yellow line at the top would reflect ourselves as a proxy for full-service firms.

The total cost of the business, you can see we reduced that to the green line. In 1989, the horizontal lines are basically an amalgam of volume and commission price. You can see the commission level in 1987 was that black level, which you can go back to the index and reference what it was. That has further declined to the 1989 level, as has the volume, and you can see why we are operating at a slightly less unprofitable base, both in '87 and '89.

This business, without putting any product, any other product through it, primary merchandise Mr. Bahr referred earlier to, options and over-the-counter other products, this is a discrete look at the institutional equity brokerage business.

That was Morgan Stanley's response in the marketplace.

You can see, when I stop talking, that the final chart, what has happened to at least our level of provision of liquidity to the marketplace. The last chart shows that on an index to 1986 the gross risk positions that our trading desk has taken over the years. The horizontal red line, would show you an average position for the year, and you can see off that 100 percent index that in the last three years, our revision of liquidity and its watergates, the smaller customers has decreased by approximately 50 percent.

MR. SILFEN: Have there been similar changes at Goldman Sachs or are you considering similar changes?

MR. BEARD: Not yet, but we are considering it. As I mentioned earlier, we have for a long time had a philosophy of being a customer-oriented service firm, and that philosophy served us well through the '70s and early '80s. It has not served us well over the last couple of years, especially in the secondary trading of listed securities.

One of the problems, I think, that has evolved for us is that our current research budget for equity securities is approximately $65 million, worldwide. We questioned in that past whether we were being paid on the margin for research. It is clear to us now that we not only not being paid on the margin for research, but we are not even being paid for our distribution capability and our capital commitment capability.

I think if we did not have a long-term view to the business, we would have made some of the changes that Anson outlined that Morgan Stanley has done.

I would point out with respect to the execution side of the business and some of the comments that Mr. Cusic and Mr. Potts made earlier as to how the soft dollars firms handle themselves, about 20 years ago the institutional trading community felt that the floor of the New York Stock Exchange and the specialist community was not sufficiently capital intense, capitalized, or had the distribution capability to handle institutional size order.

I find that one of the outgrowths of the soft dollar business is that is where most of this business is going to, that is directly to the floor of the New York Stock Exchange via DOT.

Most of these firms compared to the full-service firms do not have a broad-brushed distribution capability other than tapping into an industry-wide electronic system such as Autex, which I would maintain does not compete with organizations that have 3-, 4-, 500 people that distribute securities globally and 20 to 25 people who commit capital.

Just to conclude the concerns that we have from an industry point of view is the fact that we see clearly less competition out there. Firms have either exited the customer service business, or have severely limited the clients that they are going to offer services to.

It might seem strange, but we would actually like to see more competition out there in the marketplace. We do not see enough competition; we do not think that is good for liquidity.

From a philosophical point of view, one might ask the question whether it is desirable going out, whether one wants to be in a more adversarial environment as capital and talent in the equity business gets redirected away from the customer-oriented side of the business towards the more proprietary principal side of the business, something that we have clearly seen happening, and to date do not see any diminution in that movement.

MR. KETCHUM: Mr. Silfen, you mentioned before that one the trends that you find disturbing from at least your firm's interest is that you do not see the so-called easy orders worked, which reasonably we can expect it to have less impact on market price, and you are only see the hard orders. Austin George addressed that to some degree as well. Why is this a concern, if indeed in the past it was important in order to maintain block positioning pricing for you to see both types of orders?

Is that not, in effect, a subsidization, and why is it not possible to price the block positioning service at the right level and simply charge a higher price for the service rather than require in some way a separate flow of orders that really do not require the block positioning service?

MR. SILFEN: I think to a degree that happened in the industry where people have changed the pricing mechanism where they are going to risk capital.

What has changed, though,in the past, that the major institutions had a sufficient amount of order business as well as capital commitment and business that either needed value-added services, and they had much more than they do now with the soft dollar phenomenon, the ability to redirect those orders to the firms that were offering value-added capital commitment and distribution.

Now, many of those so-called easy orders and maybe the 100 or 150 most liquid stocks are spoken for, so to speak, by the soft dollar obligations, and the benefit that accrued to those firms in the past where they had that