Remarks of

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Increases in Institutional Activity

While most phases of the securities industry have grown during the past year, the growth in one particular segment deserves mention. The importance and the activity of institutions in the stock markets have been rapidly increasing. Our analyses show, for example, that the combined purchases and sales of those institutions for which we have data, including mutual funds, private pension funds and insurance companies increased approximately $17 billion in 1968. The rate at which institutions were buying and selling in the first half of 1969 indicate that their purchases and sales will increase by approximately that amount in 1969. This sharp growth in institutional volume has been reflected not only in the net acquisitions of institutions and growth in the value of their portfolios, but it has also reflected a very sharp increase in turnover rates during the last five years.

The staff, in analyzing turnover rates for institutions and the effect that rising turnover rates -- applied to larger portfolios -- have had on stock volume during the last few years, have come up with some interesting figures. As you may recall, stock volume on registered exchanges grew sharply in each of the years 1965-1968. Looking at turnover rates of the selected institutions for which we have data, we find that open-end investment companies began to increase their turnover rates in the last half of 1965 and since that time the mutual fund group has in effect reduced the apparent investment horizon from five years to less than two years. The life insurance group also began increasing its turnover rate at that time, reducing the implicit investment horizon from ten years to less than five years. The increase in pension fund turnover began about the same time but was slower to get started gaining momentum in the beginning of 1966. Over the past five years the investment horizon on pension funds, as a group, has declined from approximately fourteen years to roughly six years. Finally, property and casualty companies, although not exhibiting the sustained increase in turnover rates, have also significantly shortened their investment horizon during the last two years.

One effect of increased turnover by these institutions was to cause stock volume to grow each year by substantially larger amounts than would otherwise have occurred. For example, nearly forty percent of the increase in the total purchases and sales of these institutions in 1968 was due solely to the shortening of the investment horizon. This suggests certain things with respect to the activity of these institutions in the stock markets. It is hard to believe that investment companies, as a group, can continue to increase turnover of their portfolio. Similarly, there are limits to which other financial institutions can continue to increase turnover rates of their stock portfolio.

Thus, it would appear that at least one component of the growth in institutional stock market activity is not likely to continue indefinitely. However, that does not mean its place will not be taken by some other force, such as the entry of the many thousands of insurance company representatives into the broker-dealer ranks. With 150 insurance companies and some 45,000 insurance salesmen already registered to sell equities, the net inflow to equities and the net acquisitions by institutions may grow at an even more rapid rate in the future. It would seem that something is bound to happen when we watch the NASD grow from 97,000 registered representatives in 1967 to 132,000 in 1968 and to the really amazing figure of 168,000 in 1969.

The Back-Office Problem

The worst of the back-office problem is apparently behind us and while we weathered the storm, the more we learn about it since, the more serious we consider it to have been. It seems quite clear now that the Commission and the industry should have been in a better position to identify and resolve some of these problems before they reached a crisis proportion. For example, figures developed by the Commission show that during the period leading up to the time of greatest back-office stress, the brokerage industry generally, and the New York Stock Exchange firms particularly, were hiring and training registered representatives at a far disproportionate rate to the hiring and training of the personnel needed to handle the increased sales generated by those well-trained and, for a time at least, well-rewarded registered representatives. Somewhere in the regulatory pattern a red flag such as this should have indicated the congestion which was bound to follow. We have all learned a great deal from our experiences and we should realize that the dangers which attended the back-office cirsis are too great to ever be permitted to occur again.

Indications are that there has been a substantial improvement in the back-office operations of securities firms from the beginning of this year when fails-to-deliver of New York Stock Exchange members totaled $4-1/2 billion. We should pause for a moment when we consider the $4-1/2 billion figure since that figure represented 16.4 percent of the entire assets of member firms at that time. As of the third week in November, the weekly estimates of our staff indicate that these fails were in the area of $1.8 billion, representing roughly six and one-half percent of the assets of New York Stock Exchange firms. In January fails represented 28 percent of member firm capital and in the third week in November they still represented 52 percent of member firm capital.

When we have sharp upsurges in volume such as occurred for approximately two weeks in mid-October, fails-to-deliver securities may be expected to increase temporarily, particularly when the level of volume is already near the apparent capacity of the industry to settle and clear transactions. However, it is imperative that when such increases in volume do occur that we be on the alert to symptoms of the back-office problem and not allow the deterioration to again place the industry in the kind of situation we recently experienced. For this reason, it is disturbing to note that fails-to-deliver rose sharply following the rise in volume in mid-October, but as of the end of the third week of November they had not receded significantly. What happened was that only six days in mid-October in which the combined volume on the New York Stock Exchange and the American Stock Exchange exceeded twenty million shares caused fails-to-deliver to rise 27 percent from the figure in September. It has been four weeks since there was a single day when the combined volume on the two exchanges has exceeded twenty million shares and in fact the combined volume has often been far below that level. However, the level of fails as of the 21st of November had receded only slightly from the level reported at the end of October. This is alarmingly similar to the pattern in fails which occurred in mid-1967 when the back-office problem was first developing and for which the industry is still paying a staggering price.

Customer Complaints

The Commission is now receiving in the form of customer complaints what we hope is the residue of past conditions and not representative of current back-office conditions.

It was not long ago that public investor complaints sent to the Commission could be numbered in the hundreds. With the advent of the paperwork crunch, however, there was a dramatic increase in customer complaints. In 1967, for example, we received approximately 2,600 complaints, of which 67 percent were related to the back-office problem. Almost 4,000 investors wrote the Commission in 1968 and again most of the complaints were about the back-office of brokerage firms. An alarming 12,500 complaints were received for the fiscal year 1969 and again the principal complaint was with the back-office operations. For the first four months of the current fiscal year, July through October, the Commission has received more than 4,800 customer complaints which, if the pace continues, will result in over 14,000 complaints. More than 90 percent of the current complaints relate to the back-office. I should also mention that we have good reason to believe that brokerage firms are receiving as many as 25 or 30 complaints for every one received by the Commission. In short, the number of customer complaints is more than an interesting statistic; it is another barometer of the operational capabilities of the securities industry and we shall be monitoring the current complaints with a view to determining whether some further Commission action is required. At present, the public customer who writes the Commission complains about delayed delivery of securities for periods which may range as high as eighteen months or more. He also complains about delayed delivery of funds, uncorrected errors in his account which go uncorrected and which compound original errors. The public customer also expresses frustration that he is unable to get a simple response or acknowledgment to his inquiry.

It may bear repeating here that the Commission has stated that the dealer who sells the securities to a customer, or the broker who buys securities for a customer, will violate the anti-fraud provisions of the securities laws if he has reason to believe that he will not be able to deliver the securities with reasonable promptness. We have also warned broker-dealers that they may violate these provisions if they accept or execute orders for securities or attempt to induce purchases and sales, when they do not have the facilities and personnel to promptly execute and consummate the transactions.

I am confident that we can find acceptable solutions and much progress has already been made. However, since investor confidence is vital to the effective operation of the nation's securities markets, we urge everyone in the industry to continue their efforts and I can assure you that the Commission will continue to give you our fullest cooperation.

Registration Statement Filings

Another contribution to volume on both exchanges and the over-the-counter markets has been, and continues to be, the infusion of securities into the markets through the registration process. In fiscal 1967, 1,534 registration statements were filed with the Commission by registrants other than investment companies; in 1968, 2,473 were filed; in 1969, 4,170 were filed -- representing an increase of 69 percent over 1968 and an amazing increase of 178 percent over 1967. In the first five months of our present fiscal year, 1,595 registration statements have been filed as compared with 1,333 filings in the same period in fiscal 1969. For reasons which are not readily apparent, the registering of issues continues to increase despite the down-turns in both prices and volume in the markets.

The Commission has taken a number of steps in the past year designed to enable it to expedite the registration process, the most recent being the delegation of authority to the staff to clear registration statements, including first filings, which do not present unique or troublesome problems. The Commission last week received its appropriation for the fiscal year which began last July 1st. This will hopefully enable us to reduce both the registration statement backlog and the time period required for clearance, assuming the present rate of filings does not continue its dramatic increase. During the past fiscal year the Commission's volume was such that, coupled with last year's market activity, we recovered 118 percent of the funds appropriated for the use of the Commission.

While we intend to do our best to eliminate the backlog and reduce the clearance time, I cannot promise that the results will be immediately noticeable. We have already begun hiring additional personnel, but it takes several months to train new attorneys, analysts, and accountants to properly perform the work done in our processing branches.