HANK BOERNER

THE NYSE — BEFORE & AFTER AND THE POSITIVE IMPACT ON CORPORATE FINANCE

An important anniversary occurred this year that many corporate finance professionals probably overlooked or disregarded in their busy, everyday lives. It is now 40 years since the "Big Bang" occurred on Wall Street, an event that many in the brokerage and stock exchange communities regard as "Black Thursday." On that day, May 1, 1975, fixed fees for investor trading ended — and the modern era of corporate finance began.

Today, the small number of senior folks still working in the capital markets may look wistfully at the calendar on May 1 and yearn for the good old days. In May 1975, the history of the venerable New York Stock Exchange (NYSE) was divided neatly into the before and after of having and then not having handsome fixed fees and charges for stock trading. Wall Streeters then and even now call this the Big Bang. It was seen as a reshaping of the universe, with the after-shock reverberating forward even into 2015.

The NYSE has long been the premier stock exchange of the United States. For many finance professionals, the Exchange still reigns as the global citadel of stock trading. Corporate issuers often post references on advertising and promotional material to being a "New York Stock Exchange Company." "We have arrived as a publicly traded company with the NYSE listing," was the message conveyed to stockholders and stakeholders.

The NYSE is still a very important institution in the business and economic life of the U.S., but over the years it has changed in many ways. The Exchange was created along with the new federal government in the winding narrow streets of the old Dutch-founded downtown of New York City. The new nation's capital was on Wall Street (!), and in 1792 enterprising money men of the era put together a market to help with bond issues for the new country. Over the decades, the Exchange became arguably the most powerful stock exchange in the nation, with operations based on the "shout out" auction method.

Although government and some joint stock company bonds were the trading base early on, corporations increasingly came to the Exchange to raise capital through bond and stock issues. First a handful, then dozens, then hundreds, and then thousands of corporations traded their issues on the "Big Board."

Members dominated

"Members," or market specialists based on the trading floor, facilitated trades in public shares at their fixed "posts" for corporate issuers across the U.S. and eventually for issuers in many other nations. The Exchange was membership-based (some likened the approach to a country club ownership) and was later re-organized as a New York State not-for-profit. In the last years of the 20th century, the NYSE became a for-profit — itself an NYSE-listed, publicly traded enterprise like the several thousand companies listed for trades on the Exchange. And then the NYSE was acquired by the Intercontinental Exchange in 2012. The specialist system has radically changed over the years since 1975.[1]

Going back to the long era before and the 40 years after the end of fixed fees for trading: Before May 1, 1975, the 1,366 specialists on the floor were the official

HANK BOERNER *is chairman of the New York-based Governance & Accountability Institute, a private sector research, strategies, and consulting organization serving the corporate and capital markets communities. G&A is the exclusive data partner for the Global Reporting Initiative (GRI) in the United States and in two EU countries (the United Kingdom and the Republic of Ireland). He is a former head of communications for the New York Stock Exchange.*

market makers for corporate issues. Operating at their posts, they executed buy and sell orders and ensured an orderly market by holding shares overnight and at different trading periods using their own funds. In time, the enormous volumes of and swings in the marketplace would make this system unworkable. Still, there are specialists at work today: 443 of them, according to the NYSE, trading shares of the 2,800 companies listed on the Exchange floor in New York City.[2]

The NYSE fought to preserve its monopoly

After the October 1929 stock market crash, Congress and the Roosevelt administration looked at reforms for the financial markets. The 1933 and 1934 federal securities laws put into place many new rules for the brokerage community and for corporate issuers. After 1930, the individual investor was largely absent from the stock markets until the late 1950s.[3]

Then, in the 1960s, as trading volume increased and more companies listed, the NYSE system could not keep up. As a result of critical issues affecting the NYSE, Congress held hearings to develop reforms in the late 1960s and early 1970s — the first important trading laws to be enacted since the 1930s. Representative John E. Moss (D-California) was chair of the House of Representatives' Subcommittee on Commerce and Finance; under his direction a comprehensive package of securities industry reforms was developed, known as the Moss Bill. Its Title II draft language addressed regulation of exchanges and associations and called for "repealing fixed commission rates and eliminating the current concepts of membership and 'seats' on an exchange."[4]

FIXED-RATE COMMISSIONS WOULD SOON CEASE TO BE AND A NEW NATIONAL MARKET SYSTEM FOR TRADING WOULD EMERGE.

Chairman James J. Needham, a former Securities and Exchange Commission commissioner and then the first full-time chair of the NYSE, objected and commented to Congress that "...major differences can be resolved in a sincere and determined effort to achieve the subcommittee's goals without the danger of destroying that which you are attempting to improve."[5] The legislation moved ahead and passed Congress as the Securities Acts Amendments of 1975. Fixed-rate commissions would soon cease to be and a new national market system for trading would emerge, further diminishing the dominant role of the Exchange — and the NYSE community would never be the same.[6]

The Big Bang — May 1, 1975

Fixed-rate commissions and certain related charges for stock trading were officially abolished on May 1, 1975. To put that in perspective, the fixed rate charged to the investor was basically the same for trading 100, 1,000, or even 10,000 shares. A buyer of 100 corporate shares priced at $25.00 in 1975 would pay $49.00 and a bid-ask fee of $12.00, for a total of more than 2 percent of the purchase price of $2,500, explained Jason Zweig, "The Intelligent Investor," in his 40th anniversary commentary in *The Wall Street Journal*.[7]

If fixed rates were in place today, the current dollars for a $25.00 share would be $86.49, the total investment for 100 shares would be $8,650.00, and the NYSE fees charged would be approximately $200.00. The transaction costs for 100,000 shares could have been $200,000+. Extend that out over tens of thousands or hundreds of thousands of shares traded in transactions throughout the trading day and you can see why Wall Street viewed May 1, 1975, as an impending catastrophe.

New era of vanishing exchange monopoly

The specialist system generated fees that helped establish Wall Street brokerages as major forces in corporate finance. The brokerages' big pool of soft dollars vanished along with the high commissions. Sell-side brokers directed dollar flows to all sorts of proprietary research pre-1975; those sums plummeted afterward, leading to dramatic and sometimes unwelcome changes in analyst research. Some public companies lost most or all of their coverage. Research became a

profit center for brokerages and ultimately resulted in the scandals of the early 2000s, with large Wall Street firms making the research function a revenue generator that skewed research results in favor of investment banking corporate clients.

Public companies were charged for favorable research results to the advantage of some and the disadvantage of other issuers. In April 2003, the "Sheriff of Wall Street," New York Attorney General Eliot Spitzer, would extract $1.435 billion in fines in a global settlement from the 10 large sell-side firms.[8]

Corporate finance benefitted

Overall, there were many changes for corporations with shares listed or making trades on the NYSE after the Big Bang of 1975.

Discount brokerages were created and attracted many more small investors into the marketplace. Their investments in public companies created a large pool of capital for issuers. Over time, as information technology advances made long strides and electronic trading exchanges were established, the price of trades was brought to tiny fractions of pre-May 1975 levels.

Over the post-1975 years, the traditional NYSE auction market system of crying out share bids and offers from the trading post on the floor gave way to instant quotation and electronic matchup of orders. Prices are available almost instantly now on mobile communication devices.

Order flow dramatically increased: The typical day in April 1975 saw trade volumes per millions in the high teens and low twenties. On April 30, 2015, the daily volume for the NYSE group of companies was almost 1.5 billion in transactions! But another dramatic change was reflected: A reduced number of listed shares was traded on the Exchange itself. The NYSE now had to compete with other exchanges and trading platforms for shares listed on the NYSE.[9]

The evolution of the National Market System (NMS) beginning in the late 1970s profoundly changed NYSE operations. Whereas previously shares of NYSE-listed securities could only be traded on the Exchange, the NMS (sponsored by NASD and the NASDAQ Exchange) enabled trades away from the Exchange floor.[10]

Personal notes: The author at the NYSE

On a personal note as I look back at this period, I remember that I had arrived at the New York Stock Exchange in the early 1970s as a strategist and crisis communicator. The institution was moving through a series of critical events, including a complete overhaul of the governance system. (The board of directors had a street board, representing the member interest, and a public board, representing the public interest. A full-time chairman was recruited and a number of new officers were brought in, including me.)

In the late 1960s, because of the surge in trading volume, the old paper-based methods of buying and selling shares collapsed. "Runners," mostly men who raced around the old downtown with folders of shares of listed companies, moved from one brokerage to another. Eventually, the sheer volume caused the Exchange to shut down some weekdays to catch up with transactions. (I was told by insiders that it could take up to six months to straighten out some transactions.) New electronic systems were being built or designed to facilitate the enormous increase in trading activity. New rules were put in place for NYSE specialists with the passage of the 1975 securities reform legislation.

IN THE LATE 1960S, BECAUSE OF THE SURGE IN TRADING VOLUME, THE OLD PAPER-BASED METHODS OF BUYING AND SELLING SHARES COLLAPSED.

Prudent man rules relaxed and institutions arose

The federal government's relaxation of traditional prudent man investing guidelines for institutions created an explosion of transactions, with public employee and labor retirement systems in particular moving from safe investing (like U.S. Treasuries) to common stock. The era of the institutional investor (II) began in earnest. The little guy was long regarded as the backbone of the trading

day, and some of the Exchange staff were worried that institutional investors would move the individual investor aside. The NYSE even warned that the stock market itself was in danger if institutions became the dominant trading force.

Post-May 1975, discount brokering became all the rage. Charles Schwab, grandson of Charles M. Schwab, a partner to Andrew Carnegie who founded the U.S. Steel Company, created the Charles Schwab Corporation. The company started offering discount brokerage operations in 1975; in 1982, the firm offered what is considered to be the first 24-hour order entry and quote system for customers. Today, *Forbes* magazine ranks Mr. Schwab 220 among the world's billionaires, with a net worth of $6.7 billion. The new discount brokerage industry he pioneered was welcomed by many retail investors after the Big Bang.[11]

LOOK AT YOUR COMPANY'S ROSTER OF MAJOR HOLDERS; THESE FIRMS WOULD PROBABLY NOT HAVE BEEN ABLE TO INVEST IN YOUR COMPANY 50 YEARS AGO.

It was the important retirement reform legislation of 1974 — The Employee Retirement Security Act of 1974 (ERISA) — that paved the way for institutional fiduciaries to move beyond safe (mostly fixed-income) investments to diversity assets. The II became a major influence on all stock exchange operations and transactions and the major force in financing public corporations as growth of II investing would explode over the next decade. Look at your company's roster of major holders; these firms would probably not have been able to invest in your company 50 years ago. ERISA also contained provisions for what would become the popular 401(k) for corporate employees — creating additional capital flow into the markets.[12]

In 2015, it is hard to remember that there was a time before retail investors ruled the stock market. But change came quickly after ERISA; according to one summary, corporate and public sector pension and investment funds, endowments, and other fiduciaries had total assets under management of $100 billion. That figure rose to $500 billion in 1970; to $2 trillion in 1980; to $6 trillion in 1990; and $10 trillion as the 21st century dawned. Institutional ownership of all publicly traded U.S. equity securities surged from 10 percent in the 1970s to well beyond 50 percent over the next two decades.[13]

Think about the investment vehicles that the IIs have available today: corporate issues of all sizes and types, hedge funds, private equity, master limited partnerships, hundreds of exchange-traded funds, hundreds of mutual funds with institutional shares, hundreds of equity indexes, corporate junk bonds, and much more.

The naysayers protecting the old way

Looking back to 1973 and the NYSE's attempt to kill off many sections of the Moss Bill, the Exchange's public directors would testify about the harmful effects that reform legislation would have for the investor. Speaking to the subcommittee with such warnings were the independent lead director James M. Roche, retired board chairman and CEO of General Motors; Dr. Juanita M. Kreps of Duke University, who would become secretary of commerce; and Ralph S. Saul, chairman of the executive committee of First Boston Corporation (acquired by Credit Suisse in 1990). Chairman James Needham (appointed in 1972) left the NYSE not long after the Big Bang, in April 1976. I left shortly before him to start a corporate consulting practice.[14]

Lessons learned, or something like that

On a personal note, I look back at the tumultuous period of my days as a board-elected officer and head of NYSE communications. The 1,366 specialists of the day seat holders had a very nice business going; they were the beneficiaries of a powerful monopoly. (The first female member was Muriel Siebert, who only bought her seat in 1967.)[15] Fixed-rate commissions generated huge sums of money for the members of the monopoly; if a company's shares were listed on the Exchange, the trade had to come to the floor and be traded at the post of the specialist. Those glory days for brokers would begin to end on May 1, 1975, as the Big Bang really

did divide the eras of the New York Stock Exchange into "before and after."

The world did not end for Wall Street interests, of course; the brokerage community and investment banks would benefit enormously in the decades that followed the Big Bang, and the corporate community would have vast pools of fiduciaries' money to access for expansion, working capital, IPOs, liquidity for executive and employee stock sales, and much more.

The July 1973 argument of the Exchange that doing away with fixed-rate commissions would "...eliminate the traditional economic incentives that have led to securities brokers-dealers to submit voluntarily to stringent self-regulation as a condition of membership on a registered stock exchange" did not exactly result in a stampede away from NYSE membership. Membership dwindled over time as electronic trading became the new normal. The dramatic reduction of the membership took place after the Exchange itself became a public company in 2006, creating the NYSE Group, and the individual seats cashed in their membership.

As for the "old" NYSE, one might say "nothing is forever" — especially in finance. The Exchange is now owned by an "upstart" electronic trading system, the Intercontinental Exchange. *Sic transit gloria!*[16] ■

NOTES

[1] ICE buys NYSE-Euronext: The end of the street, *The Economist* (Nov 16, 2013). Available at: http://www.economist.com/news/finance-and-economics/21589913-improbable-takeover-highlights-uncertain-future-share-trading-end?zid=295&ah=0bca374e65f2354d553956ea65f756e0.

[2] For data on and historical narratives about the NYSE, see: "Facts & figures: Interactive viewer," The New York Stock Exchange (2015). Available at: http://www.nyxdata.com/nysedata/asp/factbook/viewer_interactive.asp?hidCategory=4; see also: New York Stock Exchange, *New World Encyclopedia* (Jan 2015). Available at: http://www.newworldencyclopedia.org/entry/New_York_Stock_Exchange; for information on Chairman James Needham, see his obituary: Bernstein, A., James Needham; Headed N.Y. Stock Exchange, *The Washington Post* (April 10, 2007). Available at: http://www.washingtonpost.com/wp-dyn/content/article/2007/04/09/AR2007040901159.html.

[3] The 1930s federal securities regulations were the 1933 Securities Act and the 1934 Securities Exchange Act. The majority of the legislation remains in place and was updated over the years through other laws, such as the Sarbanes–Oxley Act of July 2002. See: Securities Act of 1933, *Wikipedia* (2015). Available at: http://en.wikipedia.org/wiki/Securities_Act_of_1933; Securities Exchange Act of 1934, *Wikipedia* (2015). Available at: http://en.wikipedia.org/wiki/Securities_Exchange_Act_of_1934; and Sarbanes–Oxley Act, *Wikipedia* (2015). Available at: http://en.wikipedia.org/wiki/Sarbanes%E2%80%93Oxley_Act.

[4] "H.R.5050: Securities Exchange Act Amendment," introduced to Congress on March 1, 1973 by John E. Moss but was not enacted. Additional information available at: http://www.johnemossfoundation.org/h_rowen.htm.

[5] Boerner, H., "Exchange criticizes section of Moss Bill" (summary of congressional testimony), New York Stock Exchange (July 19, 1973).

[6] National market system (NMS), *Investopedia* (2015). Available at: http://www.investopedia.com/terms/n/nms.asp.

[7] Zweig, J., Lessons of May Day 1975 ring true today: The Intelligent Investor, *The Wall Street Journal* (May 1, 2015). Available at: http://www.wsj.com/articles/lessons-of-may-day-1975-ring-true-today-the-intelligent-investor-1430450405.

[8] Global settlement, *Wikipedia* (2015). Available at: http://en.wikipedia.org/wiki/Global_Settlement.

[9] "Transactions, statistics, and data library," The New York Stock Exchange (2015). Available at: https://www.nyse.com/data/transactions-statistics-data-library.

[10] *Op. cit.* note 6.

[11] Charles R. Schwab, *Wikipedia* (2015). Available at: http://en.wikipedia.org/wiki/Charles_R._Schwab; The world's billionaires: #220 Charles Schwab, *Forbes* (2015). Available at: http://www.forbes.com/profile/charles-schwab/; "Charles M. Schwab mansion," NYC Architecture (2015). Available at: http://nyc-architecture.com/GON/GON032.htm.

[12] "Frequently Asked Questions (FAQs): ERISA," United States Department of Labor (2015). Available at: http://webapps.dol.gov/dolfaq/go-dol-faq.asp?faqid=225.

[13] "Rise of the institutional investor," TJS Partners Inc. (2015). Available at: http://www.tjspartners.com/wise_words_on_investing/rise_of_the_institutional_investor; more comprehensive information is in the report issued by World Economic Forum, done in collaboration with Oliver Wyman: "Direct investing by institutional investors: Implications for investors and policy-makers," World Economic Forum (Nov 2014). Available at: http://www3.weforum.org/docs/WEFUSA_DirectInvestingInstitutionalInvestors.pdf.

[14] *Op. cit.* note 5.

[15] Muriel Siebert became the first female member of the NYSE in 1967. "Mickey" founded her own investment company, Muriel Siebert & Co., and later became the superintendent of banking for New York. See: "Muriel Siebert," Wikipedia (2015). Available at: http://en.wikipedia.org/wiki/Muriel_Siebert.

[16] *Op. cit.* note 1.