



**WMRC Article**

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New York Stock Exchange  
Battles to Rescue Reputation

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## United States: New York Stock Exchange Battles to Rescue Reputation

*An interim Chairman and CEO of the New York Stock Exchange (NYSE) has been appointed in place of Richard Grasso, who resigned from his position on 17 September following several weeks of criticism from members of the NYSE, federal regulators, and members of Congress over his multi-million dollar compensation package. The future of the NYSE's role as regulator has now been thrown into doubt as new questions emerge about many of its long-standing practices.*

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| <b>WMRC Perspective</b> |  |
| <b>Significance</b>     | Richard Grasso, the chairman and CEO of the New York Stock Exchange (NYSE) and an employee for 36 years, has resigned following several weeks of intense criticism over his lavish compensation package, which has raised questions from the government regarding the role of the NYSE Board and the broader functions of the NYSE. In the interim, he is replaced by John S Reed, former chairman and co-chief executive officer of Citigroup, who will be paid US\$1 for his services.                                 |
| <b>Implications</b>     | The questions that have been raised as a result of Grasso's pay have led to many more fundamental questions regarding how the NYSE is governed and how it functions, and these will lead to even more that will stir up calls for the most radical changes to the NYSE since it was founded in 1792, creating uncertainty in the market.   |
| <b>Outlook</b>          | WMRC believes that although the resignation of Grasso and the bright light being shone into the dark corners of the NYSE is causing consternation among Wall Street insiders, there will not be a fundamental overhaul of the exchange because it is too important to the overall health and growth of the US economy, even though it may be flawed. The changes that will be made will be primarily cosmetic, so as not to harm the competitive position of the world's largest and most lucrative securities exchange. |

### The Little Guy's Rise to the Big Board

Richard 'Dick' Grasso, a college drop-out, began his tenure at the New York Stock Exchange (NYSE) - also known as the 'Big Board' - as a lowly clerk in 1968 after a two-year stint in the US Army. Through hard work and tenacity, but primarily as a result of his friendly image and ability to get in the good graces of the wealthy and powerful of Wall Street, he eventually became one of their own. He was named Chairman of the Board and CEO of the NYSE in 1995, replacing William Donaldson who is now Chairman of the Securities and Exchange Commission - the federal government's regulator of the securities industry. In his time as head of the NYSE, Grasso oversaw the most significant period of growth in its history, the horror of the 11 September 2001 terror attacks, and the embarrassment of the epidemic of corporate scandals that highlighted the embedded problems on Wall Street. Immediately following the disclosure of Grasso's US\$140m compensation, the Securities and Exchange Commission began demanding answers. Over the next three weeks, Grasso came under attack from all sides, including from his former colleagues on the trading floor who began circulating a petition calling for him to resign. The controversy culminated last week when the NYSE Board voted 13 to 7 to demand his immediate resignation. Ultimately, Grasso himself fell victim to the greed that he so adamantly encouraged and protected because he forgot he was also supposed to regulate it - a role that it seems he was unable to adjust to after 30 years in the trenches fighting for every nickel. It took him 36 years to reach the pinnacle of his career, and just three weeks for it to come crashing down, starting with the first-ever public release of the NYSE Chairman and CEO's compensation figure.

### A Primer on the Big Board

The NYSE is a non-profit, member-owned entity founded in 1792 by a group of New York merchants. In its long and distinguished history, it has become one of the most influential and important institutions in the world. In recent memory, it was the embodiment of the capitalist state that stood proudly as a powerful symbol in the battle against

### A Three-Week Fall from a 36-Year Rise

**27 August**

Grasso's contract extended to 2007 and US\$140m in compensation figure released to public.

Communism. Most recently, following the terror attacks of 11 September 2001, it was a source of American power and resolve, as business as usual was restored much sooner than anyone had predicted after such a traumatic event only blocks away. At the same time that it has represented the success of the US, it has brought out the worst in many in the name of greed and self-fulfilment. The NYSE organisation itself has two primary roles: to provide a marketplace where securities can be bought and sold, and to regulate the firms conducting the trading. In its marketing function the NYSE competes with other exchanges in the US, such as the NASDAQ, and abroad, such as the London FTSE, for public companies to list their securities with them rather than with another exchange. In its regulatory function, companies wishing to buy or sell or somehow be involved in such transactions on behalf of a buyer or seller are regulated by the rules of the NYSE, which acts as a de facto regulator. For example, in order for a company to be listed on the NYSE, it must disclose certain information to the public as prescribed by the NYSE's rules. Companies can be de-listed from the exchange if they violate the rules or if they fall below certain financial (value) criteria. NYSE revenue comes from member fees and by taking a US\$0.078 per share traded.

### Governing the Big Board

The NYSE is governed by a Board of Directors, currently comprising 27 members: 12 directors from the securities industry and 12 public directors, the chairman and CEO, and the presidents, co-COOs and executive vice-chairmen. It is member-owned by the 'seat holders' - companies eligible to buy and sell securities on the trading floor. To become a member firm, a company must meet rigorous professional standards set by the Exchange. The number of seats has remained constant, at 1,366, since 1953. Institutional investors are corporations that invest on behalf of individuals and companies. These investors, particularly pension funds and mutual funds, hold an increasing portion of the value of US equities. At the end of Q1 2003, for example, private and public pension funds together held US\$2.4 trillion - 21.2% of total equities outstanding. Overall, US institutional investors, who owned only 7.2% of all equities in 1950, now hold a total of US\$5.7 trillion - 50.1% of outstanding equities. The securities industry has been rocked by dozens of high-profile scandals over the last two years, beginning with Enron. In 2001, the NYSE's Division of Enforcement brought a record number of enforcement cases, but the NYSE organisation has not been immune to the scandals that have plagued their members and clients. It has long been accused of being too insular, not transparent, self-selecting, unrepresentative of the membership, and without any representation from investors. Grasso's compensation and ejection has shed new light on this exclusive club, but it is by no means the only recent scandal to tarnish the Big Board.

### The Big Board's Minimalist Response to Outspoken Critics

Calls for greater transparency and accountability at the NYSE intensified as a number of corporate giants began to fall and as charges that conflicts-of-interest were rampant throughout Wall Street. Although the NYSE organisation itself was never implicated, New York State Attorney-General Eliot Spitzer lambasted the NYSE for, at the very least, being inept at rooting out malfeasance, or, at its worst, looking the other way regarding stock analysts' deceptions. Spitzer likened the NYSE regulators to Inspector Clouseau, the

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| <b>2 September</b>  | Securities and Exchange Commission demands details about compensation package.                                   |
| <b>9 September</b>  | NYSE documents show Grasso's pay went from US\$3m in 1996 to US\$22.5m in 2001 with entitlement to US\$48m more. |
| <b>11 September</b> | NYSE documents reveal that Grasso influenced how his compensation package would be structured.                   |
| <b>15 September</b> | Former NYSE Chairman James Needham calls for Grasso and others to resign.  |
| <b>15 September</b> | Public pension officials from California, New York, and North Carolina call for Grasso to step down.             |
| <b>16 September</b> | Wall Street's biggest firms call for Grasso's resignation and he steps down at NYSE Board's request.             |
| <b>21 September</b> | John Reed named interim Chairman and CEO of the NYSE.  |

### Key Facts about the NYSE

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| 1,366 members trading equities (maximum allowed).               |
| Membership costs US\$2m per year (based on auction).            |
| 1.44bn shares are traded per day (doubled from five years ago). |
| 80% of stocks listed on the NYSE are traded by the NYSE.        |
| 2,800 companies listed (470 non-US).                            |
| US\$15trn market capitalisation.                                |
| 85m investors own equities listed on the NYSE.                  |

### Recent Controversies at the Big Board

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| <b>December 2001</b> | Enron declares bankruptcy amid massive scandal (although the NYSE is not implicated, many argued it should have been watching Enron more closely). |
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bumbling policeman of the Pink Panther films, and said that self-regulation was 'a complete abject failure'. After the US Congress responded to the corporate wrongdoing by passing the Sarbanes-Oxley Act in 2002, the NYSE did take limited steps to be less insular by disallowing members of its compensation board to have ties to the securities industry, and forbidding NYSE executives to hold board seats of listed companies they oversee. Many of the changes proposed by a special committee appointed by the NYSE Board are designed to mirror the tighter listing standards the exchange adopted following the recent corporate scandals. However, the Big Board has only begun to address the concerns of some of its key constituents. The Council of Institutional Investors, representing 130 pension funds holding some US\$3trn in assets, has criticised the NYSE's governance, specifically that the NYSE board does not allow any slots for investors.

### Recommendations for Reform

Just as lately there is no shortage of critics of the NYSE and its governance, there are many with opinions about how it should be reformed. The big pension funds, such as the California Public Employees Retirement System (CALPERS), which holds US\$145bn in assets, are calling for investor representation on the board, greater transparency of compensation plans and financial statements, and a replacement for Grasso that has 'impeccable credentials'. Many Wall Street watchers are also calling for the role of chairman and CEO to be split, for more non-securities-industry directors on the board, and a way in which to minimise the influence the chairman and CEO have over who is nominated to the board. Among the more controversial suggestions is that the NYSE should completely separate its commercial function from its regulatory function, in order to minimise the potential for conflicts of interest. In the following weeks and months, these calls for reform will grow louder, but will be so diverse and complex that the noise will likely be drowned out by other headline-grabbers like the war in Iraq, unemployment, and the professional baseball World Series.

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| <b>April 2002</b>     | NYSE Board member Martha Steward forced to step down following probe into alleged insider trading.   |
| <b>May 2002</b>       | Securities and Exchange Commission begins formal inquiry into widespread conflict-of-interest charges involving Wall Street analysts.                                      |
| <b>March 2003</b>     | Grasso nominates Citigroup Chairman Sandy Weill to Board, but withdraws nomination following outcry since Citigroup analysts were sanctioned for conflicts-of-interest.    |
| <b>April 2003</b>     | Kenneth Langone, member of the NYSE compensation committee, is charged with illegally giving out shares of Initial Public Offering (IPO) companies as a favour to clients. |
| <b>September 2003</b> | Chairman and CEO Richard Grasso forced to resign over excessive compensation.  |

### NYSE Special Committee Governance Reform Recommendations

- 1** Only non-securities industry directors serve as members of the Compensation Committee.
- 2** Publish in the NYSE's annual report a Compensation Committee report that includes the compensation of the directors, the chairman and the four other most highly paid officers.
- 3** Prohibit service by NYSE senior officers on the boards of listed companies.
- 4** Separate the Audit and Finance Committee into two committees, and provide that only non-industry directors may serve as members.
- 5** Establish a standing five-member Governance Committee responsible for the ongoing review of the governance of the NYSE.
- 6** Require that the Committee for Review act with a majority of non-industry directors in overseeing the programmes of the NYSE Regulatory Group.
- 7** The board cannot consider as a non-industry director any director who is the CEO of a bank holding company that has a broker-dealer subsidiary that does business with the public.
- 8** Adopt and post on the NYSE website written Governance Principles to formalise and establish these and other best practices.
- 9** Codify the NYSE's current ethics requirements for NYSE directors, post the code on the NYSE website, and promptly disclose any waivers of ethics requirements for directors or executive officers of the NYSE.
- 10** Require that the board committee charters and membership of each committee be posted on the NYSE website.

Source: [www.nyse.com](http://www.nyse.com)

### Outlook and Implications

In the spirit of Wall Street, WMRC's Outlook and Implications is presented in a format that should be familiar, as may be the nomenclature:

**Buy:** Outcomes on which to bank the family jewels.

- **More scrutiny of regulators:** SEC Chairman William Donaldson used to have Grasso's job, so to avoid being accused of favouritism, look for him to be super-vigilant. Of course, he may just be upset that his salary never matched Grasso's.
- **Further shake-up of leadership:** Misery loves company, and Grasso will whisper to his former colleagues that he wants company in the unemployment line.
- **Calls for split of commercial and regulatory functions:** With Enron preparing to emerge from bankruptcy, WorldCom already renamed, and only a small number of the worst offenders of corporate malfeasance dragged from the Board room to a prison cell, major reform of the NYSE will have to wait.
- **Democratic candidates for US President will blame it on Bush (and each other):** Controversial news + people's money + election year = finger-pointing. It's the real national pastime.
- **Dick...Who?:** The market always marches on and although the steward of the NYSE is important, the forces of the free market will prevail and the unpleasantness of Mr. Grasso's pay will be a distant memory.
- **The NYSE returns the SEC's phone calls:** As a self-regulating body and with enormous political clout, the NYSE did not pay much attention to the requests from the SEC to reform. Although the NYSE may still avoid reform, they will now be much more responsive to the corporate governance reforms being put forth.

**Sell:** Dump it as fast as you can - predictions that shouldn't be touched, and why.

- **Goodwill from Washington:** The NYSE is viewed in Congress and the White House as the Golden Calf that should not be touched by government's heavy hand. Look for members of Congress to call its further worship a commandment violation.
- **Robust investor faith:** Already punch-drunk from the corporate ne'er-do-wells, there isn't much faith left to take away, but having the NYSE go bad makes Americans question Mom and apple pie, too.
- **Strong trader confidence:** Grasso's former colleagues in the trenches of the trading floor are bitter, and rightfully so. One would have thought that the rich and privileged on Wall Street would be above stabbing each other in the back. Apparently no one is safe.
- **Chairmanship will be coveted by the best and brightest:** Although the exchange needs a heavy dose of credibility, the NYSE may find that Grasso was cheap by comparison.
- **The NASDAQ will overtake the NYSE:** Despite the uncertainty at the NYSE in the short term and minimal market volatility, things will return to their normal, volatile state. The NYSE will maintain its position as the most dominant exchange in the world for the foreseeable future.
- **Politicians will offer specific proposals to regulate Wall Street:** Not in an election year. Wall Street is one of the biggest sources of campaign donations. Campaigners would be less badly off if they asked for a tax increase and a pay increase.

**WMRC Contact**

**David Rice** ([david.rice@wmrc.com](mailto:david.rice@wmrc.com))

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