

MEMO# 12031

June 20, 2000

SEC ISSUES REPORT ON ELECTRONIC COMMUNICATION NETWORKS AND AFTER-HOURS TRADING

[12031] June 20, 2000 TO: SEC RULES COMMITTEE No. 90-00 EQUITY MARKETS ADVISORY COMMITTEE No. 36-00 RE: SEC ISSUES REPORT ON ELECTRONIC COMMUNICATION NETWORKS AND AFTER- HOURS TRADING The staff of the Securities and Exchange Commission's Division of Market Regulation has issued a report¹ (a copy of which is attached) examining the impact of ECNs and after-hours trading on the securities markets and recent regulatory initiatives taken to address the growth of ECNs and after-hours trading. The first part of the Report provides a general overview of ECNs and discusses regulatory initiatives, such as the Order Handling Rules and Regulation ATS, designed to address the role of ECNs in the national market system. The Report also examines some recent developments regarding ECNs, such as the establishment of linkages between ECNs and the exchanges and the impact of ECN fees on best execution. The most significant part of the Report is contained in the second section, which discusses the structure of and trading activity in the after-hours market, as well as regulatory initiatives relating to after-hours trading. In particular, the Report describes the structure of the after-hours market for both listed and Nasdaq securities. For example, the Report discusses efforts by the exchanges to implement after- hours trading for listed securities, such as the New York Stock Exchange's and American Stock Exchange's crossing sessions, in which matching buy and sell orders can be executed at 5:00 p.m. at the 4:00 p.m. closing prices, and the Chicago Stock Exchange's "E-Session," which handles limit orders from 4:30 p.m. to 6:30 p.m. The Report also discusses the primary Nasdaq trading and price reporting systems, such as SelectNet, that are used to trade after the close of the regular trading session. The Report found that the current level of trading after-hours is extremely low in comparison with that of the regular trading session. The Report also found that after-hours trading is concentrated in the time period immediately following the 4:00 p.m. regular session close and that much of the after- hours activity in Nasdaq during this time period is institutional in nature, with retail activity becoming more prominent thereafter. Data gathered for the Report also showed that there are liquidity constraints in the after-hours market. In particular, the Report stated that most of the after-hours trading volume appears to be concentrated in a small number of stocks, particularly those that have been the subject of major corporate news announcements issued after the 4:00 p.m. regular session close. 1 "Electronic Communication Networks and After-Hours Trading," Report by the Division of Market Regulation, U.S. Securities and Exchange Commission, June 2000 ("Report"). 2The Report also discusses the findings of the after-hours working groups established by the NYSE and the NASD to examine after-hours trading,² as well as several initiatives to increase transparency in the after-hours market, including efforts to extend the

consolidated last-sale and quotation information that is available for the regular trading session to the after-hours market. In addition, the Report discusses efforts to extend many of the rules applicable to the regular trading session to the after- hours session. For example, Nasdaq has made several modifications to its rules to make clear that Nasdaq market makers who open their markets after the close of the regular trading session are generally obligated to conduct their business during the extended session in conformity with all NASD rules. Finally, the Report discusses several issues that would need to be addressed if the primary markets decided to implement full after-hours trading sessions. In particular, the Report states that these markets will need to develop standardized order types to avoid investor confusion and to ensure that these orders receive best executions. In addition, the Report noted that the NYSE/NASD after-hours working groups found that investors and the securities industry have come to rely on 4:00 p.m. closing prices in equity securities and that the Division believes that proposals by the primary markets for after-hours trading sessions should make provisions to preserve distinct regular session closing prices for equity securities. Ari Burstein Assistant Counsel Attachment Attachment (in .pdf format) 2 See Memorandum to SEC Rules Committee No. 83-99 and Equity Markets Advisory Committee No. 34-99, dated October 21, 1999, summarizing the working groups' reports.

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