

**MEMO# 13015**

January 10, 2001

# **CHAIRMAN LEVITT'S REMARKS REGARDING SECURITIES MARKET STRUCTURE ISSUES**

[13015] January 10, 2001 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 2-01 SEC RULES COMMITTEE No. 2-01 RE: CHAIRMAN LEVITT'S REMARKS REGARDING SECURITIES MARKET STRUCTURE ISSUES SEC Chairman Arthur Levitt recently delivered a speech focusing on several issues currently facing the securities markets.\* In particular, Chairman Levitt focused on such topics as the infrastructure of the securities markets, pricing data, linkages in the listed market, order interaction, and the Nasdaq opening. Chairman Levitt's speech is summarized below and a copy is attached. Market Infrastructure. Chairman Levitt stressed the importance of a sound market infrastructure, the central components of which are the system through which quotes and prices are disseminated to the overall market, and the connections through which these prices are accessed. He stated that there are structural features of the securities markets that are in need of modernization and that new entrants to the market "rightly demand a level playing field with more established players." He added, however, that individual competitive interests cannot always be relied upon to produce a basic framework for competition that serves the public and used the current debate over the dissemination of pricing data as an example of this problem. Pricing Data. With respect to the issue of pricing data, Chairman Levitt stated that "the discussion of how, not whether, to reform the current system of ownership and payment for quote data is both crucial and timely" and that the decision-making processes of markets that collect and distribute this data should be made more transparent to market participants. In addition, market participants should have meaningful input in decisions affecting the dissemination of this data. He further stated that "I see no divine right of any one organization to perform the function of collecting and disseminating market data to the public" and that this function should be more open to competition. He added, however, that unfettered competition may not lead to market transparency if market forces, for example, allow a dominant market to name a price for its data and withhold the data if it does not get its price. He suggested that market participants therefore "should not take for granted the benefit of the current systems, and must approach modernization with both creativity and caution." \* The National Market System: A Vision that Endures, Remarks by Chairman Arthur Levitt, U.S. Securities and Exchange Commission, Stanford University, January 8, 2001. 2Linkages in the Listed Market. Chairman Levitt stated that a system of competing markets also must support linkages that allow prices in one market to be accessed from anywhere in the overall system. He stated that it was not the SEC's role to dictate the specific type of linkages in the listed market and that "ensuring that a market is open to orders from other markets is one thing -- dictating the way they execute the orders is another." Chairman Levitt added that electronic markets should be permitted to more

freely compete in the listed market and that progress has been made in this area but that forcing these markets to use the ITS as a linkage has slowed their systems down. Chairman Levitt did state, however, that the ITS ensures price priority in the listed market and that it is difficult to see how enabling electronic markets to compete fully in the listed market will not erode this benefit to investors. According to Chairman Levitt, this issue raises difficult questions regarding the proper access and linkages that ECNs and exchanges should provide to one another and that “without a doubt, the issue of access in the listed market will confront my successor sooner rather than later.” Order Interaction. Chairman Levitt discussed the SEC’s recent focus on whether quote matching and internalization are reducing price competition in the securities markets and to what extent order interaction is beneficial to investors. Chairman Levitt summarized the findings of a recent study by the SEC’s Office of Economic Analysis on the spreads experienced by Nasdaq stocks and NYSE stocks which found that effective spreads, except for the very largest Nasdaq stocks, were wider for Nasdaq stocks. He stated that the findings of the study suggest that order interaction improves the prices received by customers and confirms that the ability to trade inside the best displayed quotes on Nasdaq is substantially limited. He noted, however, that average execution times for Nasdaq stocks were faster than for NYSE stocks. Chairman Levitt said that “if the study does nothing more than increase pressure on both markets to respond to the longstanding demands of investors, it will have served the public well.” Nasdaq Opening. Chairman Levitt stated that opening market prices are one of the systemic issues that impact the prices that investors pay and that while there is a single opening price in the listed market, a single “first price” does not exist on the Nasdaq market. He added that there is nothing wrong with dealers earning a spread when executing customer orders but that circumstances at the market open is in many respects a risk-free function of matching buy and sell orders and that “those market participants who route opening orders to dealers who do take a spread should think long and hard about their best execution obligations.” Chairman Levitt noted the progress made by Nasdaq in developing a “distributed call” mechanism at the opening and stated that this may encourage broader participation by institutions that currently avoid opening trading. He also added that it is his sense that a distributed call “moves us in the right direction” and that the “challenge of the opening should be addressed by Nasdaq prior to becoming an exchange.” Finally, Chairman Levitt stated that he has asked SEC examiners to examine current dealer pricing practices at the opening and its impact on investors. Ari Burstein Associate Counsel Attachment 3Attachment (in .pdf format)