

MEMO# 5564

February 8, 1994

SEC RELEASES MARKET 2000 REPORT

February 8, 1994 TO: BOARD OF GOVERNORS NO. 14-94 INVESTMENT ADVISERS
COMMITTEE NO. 12-94 SEC RULES COMMITTEE NO. 13-94 MARKET 2000 TASK FORCE RE:
SEC RELEASES MARKET 2000 REPORT

The Securities and Exchange Commission recently released the report of the Division of Market Regulation entitled "Market 2000: An Examination of Current Equity Market Developments." In its statement upon releasing the report, the SEC indicated that "the study is an attempt by the Division to assess the state of our equity markets and to provide guidance for the development of a national market system." A copy of the Executive Summary of the report is attached, and the proposals discussed therein are summarized below. In the course of the SEC's preparation of the report and recommendations, the Institute had urged it generally to consider that investors be able to effect transactions in the manner most efficient for them, that efficient markets require transparency, and that regulations applied to new trading systems should be tailored to the nature of the market being regulated. The report states that over 20 years ago, the Commission conducted a study of the equity markets that resulted in the introduction of legislation in 1975 to provide a framework for a national market system. It notes that dramatic changes in those markets since 1975 (due to, for example, technological advances, new product development and globalization) have raised concerns about market fragmentation, inadequate disclosure of market information and regulatory inconsistencies among competitors. The report explains that the Division undertook the Market 2000 study to respond to those concerns. According to the report, equity markets are operating efficiently within the existing regulatory structure and radical change is not necessary. The report identifies four areas, however, in which the Division believes improvements are possible: (1) fair treatment of investors; (2) timely and comprehensive disclosure of market information; (3) fair competition among markets and market participants; and (4) open market access. The report makes specific recommendations in each of these areas. For example, with respect to fair treatment of investors, the report suggests that, among other things, the SEC require greater disclosure of payment for order flow and broker-dealer order handling procedures, and improved disclosure by investment advisers to their clients concerning soft dollar practices. In the area of market transparency, the report makes recommendations concerning display of limit orders, reduction in the minimum pricing variation permissible for bids and offers from one-eighth to one-sixteenth of a dollar, enhanced public dissemination of SelectNet orders, development of a reporting system for after-hours trades and trades in U.S. equity securities that are nominally executed abroad and reconsideration of the imposition of an order exposure rule. At the Institute's urging, the NASD's Board of Governors recently voted to expand public access to SelectNet. To enhance fair market competition, the report recommends NASD oversight of third market activity and the application of specific trading principles to third market dealers designed to protect the integrity of the price discovery

process; recordkeeping and reporting requirements for automated trading systems; the extension of transaction fees currently only applicable to listed securities to NASDAQ securities as well; and expedited Commission review of certain SRO rule change proposals. With respect to open market access, the report suggests the removal of off-board trading restrictions on after-hours trading; changes to NYSE and Amex rules regarding delisting of securities from those exchanges; and extension of the link between the Intermarket Trading System and the NASD's Computer Assisted Execution System to all listed stocks. Paul Schott Stevens General Counsel Attachment

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