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CHAIRMAN LEVITT'S REMARKS REGARDING CHANGES IN THE SECURITIES MARKETS

* Dynamic Markets, Timeless Principles, Remarks by Chairman Arthur Levitt, U.S. Securities and Exchange Commission, Columbia Law School, New York, N.Y., September 23, 1999 (available at http://www.sec.gov/news/speeches). [11280] September 30, 1999 TO: BOARD OF GOVERNORS No. 61-99 EQUITY MARKETS ADVISORY COMMITTEE No. 30-99 SEC RULES COMMITTEE No. 72-99 RE: CHAIRMAN LEVITT'S REMARKS REGARDING CHANGES IN THE SECURITIES MARKETS ____ SEC Chairman Arthur Levitt recently delivered a major speech focusing on the significant changes occurring in today's securities markets.* He made clear that "no matter how much our markets change, markets of fairness, markets of integrity, and markets of quality should not be the most investors hope for but the very least they should expect." Acknowledging that technological developments and other changes affecting the securities markets raise issues that are too numerous and complex to be addressed in a single speech, he stated that no less than the following issues demand our attention: the proposed demutualization of the national exchanges; the impact greater competition is having on order flow, liquidity and execution costs; the imperative to interlink market centers; and more broadly, the challenge to provide investors with the efficiency of central markets without sacrificing innovation. Chairman Levitt's speech is summarized below and a copy is attached. Chairman Levitt provided a brief overview of how the markets have changed over the past 25 years. He cited the impact that the creation of a national market system and the adoption of the Order Handling and Alternative Trading Systems Rules have had on fostering competition and price transparency, reducing price spreads and execution costs, and promoting innovation. He also noted that in the OTC market, a single public quote stream developed which, among other things, gave Electronic Communication Network (ECN) quotes greater public exposure. Chairman Levitt observed that the emergence of ECNs along with other important developments pose significant regulatory challenges. ECNs. With respect to ECNs, Chairman Levitt stated that to ensure their own integrity, ECNs, for example, must be prepared to confront the consequences of a market downturn and must be equipped to handle temporary as well as extended periods of 2extremely high order flow. He discussed the fees charged by ECNs to access their quotes, observing that there is no competitive pressure on those fees and that they "stand alone in an otherwise fee-less arena." He has asked his staff for a recommendation to redress this imbalance. Demutualization. Chairman Levitt stated that the SEC has no intention whatsoever of standing in the way of Nasdaq's and the NYSE's movement towards for-profit status. He noted that such developments do raise the question of how best to maintain "our

time- honored system" of self-regulation. To defuse the potential conflicts of interest that may arise if the SRO is enmeshed within a for-profit corporation, Chairman Levitt stated that, at the very least, there must be strict corporate separation of the self-regulatory role from the marketplace it regulates. He noted that different models have been suggested, including one SRO that regulates all markets. Regardless of which model is followed, he made clear that any restructuring must ensure that "the self-regulatory obligation be vigorously fulfilled, adequately funded, and dedicated to serving the public interest." He further appealed to "public directors to jealously guard the self-regulatory standards of the markets they oversee, particularly listing standards." Options Markets. Turning to developments in the options markets, Chairman Levitt observed that while the effective spreads of some of the actively-traded options that the SEC recently examined fell between 22 and 44 percent since they went from single exchange trading to multiple listings, the options markets must continue to move forward. He called on the options markets to promptly put in place linkages to encourage the best possible execution of customer orders. He also urged market centers to act swiftly to address any short-comings in their capacity to handle options quote traffic. Finally, he stated that more competition must be cultivated. Competition. Observing that there is greater open-market competition than ever before, Chairman Levitt stated that now is the time to reconsider other restrictions that distort competition and introduce artificial costs. In particular, he recommended repeal of NYSE Rule 390, which prohibits NYSE members from dealing in listed securities off an exchange. Centrality. In discussing the increasing "fragmentation" of the markets, Chairman Levitt acknowledged the intrinsic value of centrality (e.g., the more customer orders that interact with one another, the better the prices will be), while cautioning that "[a]s centrality tends towards monopoly" it could stifle innovation and competition. He asserted that now is the time to revisit the conflict between competition and centrality. Specifically, he called upon market leaders to begin a dialogue on whether technology offers ways to achieve the benefits of centrality without stifling competition. He outlined the guiding principles in such an endeavor: price discovery and best execution should be enhanced; liquidity should be fostered; interaction between institutional and retail trading should be maintained; market innovation should be encouraged; and competition among market centers, above all else, should remain vigorous and dynamic. He queried whether, for example, consideration should be given to the creation of a "virtual limit order book," 3which, by exposing all markets' limit orders to the public, would allow investors to better ascertain market liquidity. He noted that this approach either alone or coupled with other approaches raises controversial questions without easy answers. Chairman Levitt stressed, however, that now is the time for "thoughtful, constructive, and far-reaching thinking," further noting that, "Neither our markets nor our investors can afford today's opportunity for change to be dominated by parochialism." * * * Amy B.R. Lancellotta Senior Counsel Attachment

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