



**TESTIMONY OF**

**BRANDON BECKER, DIRECTOR  
DIVISION OF MARKET REGULATION  
U.S. SECURITIES AND EXCHANGE COMMISSION**

**REGARDING THE MARKET 2000 REPORT  
AND  
THE UNLISTED TRADING PRIVILEGES ACT OF 1994 (H.R. 4535)**

**BEFORE THE  
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE  
COMMITTEE ON ENERGY AND COMMERCE**

**U.S. HOUSE OF REPRESENTATIVES**

**JUNE 22, 1994**

U. S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

## EXECUTIVE SUMMARY

### STATEMENT OF BRANDON BECKER, DIRECTOR DIVISION OF MARKET REGULATION U.S. SECURITIES AND EXCHANGE COMMISSION REGARDING THE MARKET 2000 REPORT AND THE UNLISTED TRADING PRIVILEGES ACT OF 1994 (H.R. 2515)

#### H.R. 4535: The Unlisted Trading Privileges Act of 1994

The Commission believes that H.R. 4535, amending Section 12(f) of the Exchange Act, would remove unnecessary regulatory delays that inhibit market competition with respect to unlisted trading privileges ("UTP"). The exchange application, public notice and Commission approval process existing under Section 12(f) have been in place since 1936. H.R. 4535 would eliminate these procedures, thereby enabling exchanges to extend UTP immediately to most securities that are listed on another exchange or traded on Nasdaq.

Currently, the Commission processes hundreds of exchange applications yearly for extension of UTP. Comments on these applications are extremely rare, which seems to indicate that the rigid procedures for considering individual applications to extend UTP are no longer appropriate. Thus, the Commission supports the Subcommittee's efforts to streamline the regulatory process in this area.

The Commission is aware that some concern may exist regarding immediate UTP in securities that are the subject of an initial public offering ("IPO"). H.R. 4535 provides a temporary 2-day delay of UTP in such cases. The bill also requires the Commission to undertake rulemaking to determine whether a delay for IPOs is appropriate. The Commission believes that this is a balanced and prudent approach and will consider public comments in this complex area.

#### Market 2000

Over the past 20 years, our securities markets have changed dramatically in response to technological advances, new product developments, and global economic expansion. These changes led market participants to raise questions regarding whether the existing regulatory framework had kept pace with market developments. In response to these concerns, the Division of Market Regulation undertook the Market 2000 Study. The Report concludes that today's equity markets are operating efficiently within the existing regulatory structure. Nonetheless, recommendations were formulated to make the markets work better for investors and to make competition work better for the markets.

The Commission is aware of the importance of timely implementation of the recommendations of the Report, and already has published for public comment three proposed rules arising from the Market 2000 recommendations. Specifically, the Commission has sought public comment on proposed rules that would enhance disclosure of payment for order flow practices and related issues, require broker-dealers sponsoring automated trading systems to maintain certain records and make certain periodic reports to the Commission, and expedite Commission review of SRO proposed rule changes in many instances. The Commission staff currently is reviewing the comments received concerning these proposed rules. Although the Commission is encouraged by the SRO efforts in response to the Report, the Commission looks forward to further initiatives by the SROs to implement fully the recommendations.

TESTIMONY OF  
BRANDON BECKER, DIRECTOR  
DIVISION OF MARKET REGULATION  
U.S. SECURITIES AND EXCHANGE COMMISSION  
REGARDING THE MARKET 2000 REPORT AND  
THE UNLISTED TRADING PRIVILEGES ACT OF 1994 (H.R. 4535)  
BEFORE THE SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE  
UNITED STATES HOUSE OF REPRESENTATIVES

June 22, 1994

Thank you Chairman Markey and members of the Subcommittee. I welcome the opportunity to discuss with you the report, Market 2000: An Examination of Current Equity Market Developments ("Market 2000 Report" or "Report"), prepared by the Commission's Division of Market Regulation.<sup>1</sup> The Report, issued this past January, is an important part of a continuing dialogue among the Commission, investors, broker-dealers, and the markets about how best to ensure the most fair, open, and efficient equity markets. In addition, I am pleased to have this opportunity to voice the Commission's support for H.R. 4535, the Unlisted Trading Privileges Act of 1994, which also results from this dialogue and the work of members of your Subcommittee. The Commission believes that H.R. 4535 would remove unnecessary regulatory delays that inhibit market competition with respect to unlisted trading privileges. Thus, the Commission supports the Subcommittee's efforts to streamline the regulatory process in this area.

Over 20 years ago, the Commission undertook an examination of the equity markets similar to the study that led to the Market 2000 Report. At that time, questions had arisen as to the fairness,

competitiveness, and efficiency of the U.S. markets. As a result of the Commission's examination, then Chairman William J. Casey sent to Congress the first of a series of reports which would culminate in the restructuring of the United States equity markets. A growing market crisis at that time affected both institutional and individual investors: increasing volume could not be accommodated; fixed commission rates had caused inefficient relationships between market participants and unnecessarily high transaction costs; restrictions on access to markets prevented competition from working to serve the investor. The Commission proposed a vision of how our markets could be enhanced to provide a foundation for the future as well as to fulfill a compelling public need. This vision was premised on the use of technology to link markets and market participants efficiently within a fair regulatory framework. The orders placed by large and small investors alike would be executed in the best market, with market information available to all. Within this system competition would drive the evolution of the markets. Where diversity of interests impeded progress, the Commission would be authorized to act directly.

This vision was enacted into law in the Securities Acts Amendments of 1975 ("1975 Act Amendments"), in which Congress directed the Commission to facilitate the development of a "national market system".<sup>2</sup> The principles Congress embraced to guide the development of this system have served our markets and our country well, enhancing a marketplace that by any measure is

the fairest and most efficient in the world. The strength of the U.S. equity markets is evidence of their effectiveness. Our national market system enjoys the benefits of the following developments over the past 20 years:

- Technological advances that have made it possible to display, expose, and execute orders in volumes that were unheard of even ten years ago.
- Instantaneous and inexpensive communication among markets and participants.
- Execution of orders at the best bid or offer quoted across a spectrum of markets.
- Resiliency that enables our markets successfully to weather crises that would paralyze the financial systems of other nations.

While these developments have generated positive results, the evolution of our equity markets and the implementation of the national market system have posed difficult and vexing questions. The dramatic changes of the markets in response to advances in technology, new product developments, and global economic expansion caused many commentators to question whether the regulatory structure had kept pace. Concerns about market fragmentation, inadequate disclosure of market information and unequal regulation were raised.

Market 2000

The Market 2000 Report is an attempt by the Division to review these concerns and suggest changes where appropriate. The Division took on the task of conducting a comprehensive assessment of the state of our equity markets to provide guidance for the continuing development of the national market system. Concurrent with the study, Congress held a series of hearings in 1993 that raised many of the issues covered by the Report.<sup>3</sup> In addition, the U.S. General Accounting Office ("GAO") released a report on market structure.<sup>4</sup> The information from those hearings and the GAO Report substantially contributed to our understanding of the difficult structural issues facing our markets today. With the support of your Subcommittee and other members of the Congress we were able to produce a comprehensive assessment of the state of our equity markets that we hope will provide guidance for the continuing development of the national market system.<sup>5</sup>

The response by the securities industry and by the news media to the Report attests to the enormous amount of hard work and careful analysis by all the many participants in this process of review and analysis.<sup>6</sup> We look forward to continuing to work with you as we move forward on the implementation of the recommendations in the Market 2000 Report.

The Report makes clear that our markets are not in crisis today. By all measures, our system is working well to raise capital and provide a wide range of investment opportunities for an even wider range of investors. The trading environment that

was envisioned by Congress in 1975 has been largely realized. The Report reaffirms that the objectives delineated by Congress which have conferred so many benefits on our markets remain valid as guiding principles for the Commission.

Nevertheless, the Division found that in several areas the markets could work better for investors and competition could work better for the markets. The Division formulated specific recommendations for action in these areas. While the recommendations are incremental, some address highly contentious issues. In many instances, there are no clear answers, but there are several equally viable or plausible alternatives. In those cases, the Division has offered recommendations which it believes are most appropriate, based on its experience and accumulated knowledge.

Protecting investors while maintaining a fair field for competition is the touchstone of the Report's recommendations. To achieve this end, Market 2000 identified three broad themes. First, arrangements between customers and broker-dealers should be as clear as possible.<sup>7</sup> Second, markets should have as much information about supply and demand as is consistent with customer interests.<sup>8</sup> Third, competition and innovation in the provision of trading services should be encouraged.<sup>9</sup> The Market 2000 Report recommends specific action in each of these areas.

The importance of the first goal, clear arrangements between broker-dealers and customers, is self-evident. Investors' decisions to participate in the equity markets are critical to the

success of the economy and our national well-being. The decision to participate is predicated on the perception, and reality, of fairness and integrity. Well-informed customers and fulfilled expectations regarding the obligations of brokers toward their customers are the essence of fairness and the basis of investor confidence. Market 2000 recommends that investors be put first and that broker-dealers be reminded of their obligation to provide best execution.

In addition, the Report calls for enhanced disclosure with respect to practices such as payment for order flow and soft dollar arrangements.<sup>10</sup> Because broker-dealers have a comparative advantage in monitoring the quality of executions, Market 2000 also calls upon broker-dealers that use automatic routing procedures to assess market quality on a periodic basis, and for markets and market makers in listed securities to offer price improvement.<sup>11</sup> In addition, Market 2000 recommends action to improve order handling practices for securities quoted on the National Association of Securities Dealers Automated Quotation ("Nasdaq") system and to improve the overall quality of the over-the-counter ("OTC") market.<sup>12</sup>

The second theme, the desirability of well-informed markets, is premised on the Commission's long-standing belief that transparency plays a fundamental role in the fairness and efficiency of the secondary markets. The principle of transparency is a fundamental aspect of investor protection and efficient markets. There are many benefits associated with enhanced market



transparency. First, transparency enhances investor protection. Second, by encouraging investor participation in the market, transparency promotes market liquidity. And third, transparency fosters the efficiency of securities markets by facilitating price discovery and open competition, thereby counteracting the effects of fragmentation. Each of these benefits both promotes and is a function of the others. For example, by providing protection for investors, transparency encourages greater participation in securities markets and, therefore, enhances the liquidity of those markets. This increase in liquidity, in turn, increases market efficiency. Similarly, by reducing the effects of fragmentation and increasing the pricing efficiency of securities markets, transparency also promotes the fairness of the markets. Thus, timely and comprehensive disclosure of information on quotations, trading volume, and trading practices is essential to the market. Selective or partial disclosure impairs market pricing mechanisms, weakens competition and prevents customers from monitoring the quality of their executions. In assessing whether information on customer orders should be publicly disclosed, or only available to market professionals, Market 2000 advocates giving more information to market participants, including investors.

The high level of transparency in the U.S. markets today can be attributed largely to Commission action that resulted in the creation of a consolidated quotation system, the consolidated tape, and last sale reporting for Nasdaq securities. The Commission has ensured that data concerning market transparency is available

equally to investors, analysts, and all other participants in the U.S. equity markets so that they may have a complete picture of trading activity. This has secured the role of the U.S. equity markets as the most efficient, liquid, and fair markets in the world. To ensure that the U.S. equity markets maintain their preeminent position in an increasingly global market place, the Report urges continued Commission efforts to enhance transparency in all markets. Greater transparency would unite the various market segments by enabling market participants to assess overall supply and demand. Moreover, greater transparency would promote fair competition between markets and preserve an efficient price discovery mechanism.

The Report's recommendations regarding increased transparency focus on the stock pricing system, the display of customer orders, and after-hours trading. To improve transparency, the Report recommends that markets move from the current pricing system for stocks to a decimal system.<sup>13</sup> Market 2000 recommends additional display and exposure of customer orders and more complete and accurate reporting of trades, including after-hours trades and trades in U.S. securities nominally executed abroad.<sup>14</sup> In addition, Market 2000 recommends that the SROs consider the feasibility of an order exposure rule.<sup>15</sup>

The third theme is that competition and innovation should be encouraged. Technological advances have changed dramatically the way that the securities business is conducted and promise to change it further. Market 2000 points out that many of the innovations

in the markets during the past 20 years have been generated by competition. The introduction of new technologies that benefit investors has been the result of competition between and among markets and market participants. Congress recognized the central role of competition when it instructed the Commission to facilitate, but not design, the national market system.

Market 2000 calls for increased oversight of automated trading systems and recommends recordkeeping and reporting requirements for these systems.<sup>16</sup> The Report recommends that the National Association of Securities Dealers ("NASD") assert greater oversight over the trading of listed stocks in the over-the-counter market to maintain market integrity.<sup>17</sup> Additional recommendations involve securities transaction fees,<sup>18</sup> Commission review of SRO proposed rule changes,<sup>19</sup> off-board trading restrictions,<sup>20</sup> shareholder approval of delisting decisions,<sup>21</sup> and the Intermarket Trading System.<sup>22</sup>

The Commission is aware of the importance of timely implementation of the recommendations of the Report. Under the leadership of Chairman Levitt, the Commission already has initiated action on all of the recommendations of Market 2000 that require Commission action. The three rulemaking proposals that have been initiated cover payment for order flow, automated trading systems, and the review process for SRO rule changes. These proposals also discussed "soft dollar" and decimal pricing issues. I would like to discuss briefly the Commission's efforts in these areas.

Generally speaking, payment for order flow is a practice

whereby market makers or exchange specialists compensate brokerage firms for directing customer orders to them for execution. This practice has generated much debate and controversy within the securities industry regarding the potential benefits and harm to public investors. Those market professionals who receive payment for order flow confront a potential conflict between the interests of the customers they serve and their own interests. This conflict raises, in turn, disclosure, best execution, agency and market structure issues.

Last October, the Commission published for public comment a proposed rule that would require enhanced disclosure of payment for order flow practices on customer confirmations, annual account statements, and new accounts.<sup>23</sup> The Commission also sought comment on various alternative approaches to payment for order flow, such as banning the practice outright, passing-through the payment to customers, and adopting a decimal pricing system. In addition, the Commission sought comments concerning the extent of payment for order flow in goods and services, and whether the proposals would lead to an increase in this type of payment for order flow.

Opponents of payment for order flow cite several factors that make cash payment for order flow inconsistent with market principles. They believe the practice compromises the broker's legal obligation to obtain best execution of the customer's order, distorts competition among markets, and violates the broker's fiduciary obligations under common law agency precepts. Supporters of payment for order flow argue that the practice provides economic

benefits that flow to the customers. They view the payments received by firms that route order flow as volume discounts that result in substantial savings to these firms. Moreover, supporters claim that payment for order flow enhances competition that has resulted in reduced execution costs in all markets. The comment period on the proposed rule on payment for order flow practices has expired. The Division staff is analyzing the 54 comments received.

The adoption of a decimal pricing system to replace the current system based on eighths (12.5 cent increments) not only is a part of the payment for order flow debate, but also has been the subject of a fair amount of debate in its own right. Adoption of a decimal-based system would permit narrower spreads and greater flexibility in the pricing of securities. This narrowing of the spread might mitigate some of the economic incentive behind payment for order flow arrangements. Some commenters favoring decimal pricing argue that market makers' willingness to pay for order flow indicates that current spreads are too wide. Opponents to decimalization argue that costs of conversion to a decimal system would far exceed the potential benefits to investors. Market 2000 recommended that the current system be revised, at a minimum, by going to sixteenths (6.25 cent increments).

The current pricing system dates back to the 1700s and, apparently, Spanish currency. The current federal securities laws, however, do not dictate what pricing system the markets should employ. It is important that the issues associated with revising the pricing of stock be fully explored by all those involved in the

decision making process. The potential costs of converting to decimal pricing must be balanced against the benefits of more precise pricing.<sup>24</sup> In addition, it is important to consider the effect that a conversion could have on the competitive posture of the U.S. equity markets relative to the global stock markets. There is likely to be a lively discussion on these issues.

A separate Commission rulemaking proposal arising from Market 2000 involves automated trading systems operated by broker-dealers. Existing technology has facilitated the development of private trading systems that automate the execution of orders based on quotations of the system sponsor or its affiliates. Other systems have developed that automate both the dissemination or collection of quotations, orders, or indications of interest and complement transaction execution. To date, the Commission largely has regulated these systems as automated broker-dealers.

Some traditional markets have argued that proprietary trading systems compete with them for order flow and therefore should be subject to comparable regulation. The Division concluded that its experience with these systems and their current level of activity do not warrant extensive regulation by the Commission. The Report indicated that the regulatory structure contained in a prior proposed rule, proposed rule 15c2-10, that would have subjected proprietary trading systems to less substantial requirements than those applicable to the SROs but more substantial than those for broker-dealers was not appropriate at this time. Market 2000 highlighted the need to obtain the information necessary for

evaluating the operation of these automated trading systems with regard to national market system goals, and for monitoring the competitive effects of these systems, among other objectives.

As a result, the Commission published for comment last February a proposed rule that would require broker-dealers sponsoring these systems to maintain participant, volume, and transaction records, and to report system activity periodically to the Commission.<sup>25</sup> The proposal would cover both proprietary trading systems operated by broker-dealers and some automated trading systems operated by third market makers.

The comment period for this proposal has ended. The Commission has received six comments on the proposed rule. Five of the six comment letters supported the concept of a recordkeeping and reporting rule, but recommended that it be amended to address specific concerns. For example, commenters argued that the recordkeeping requirements of the rule may be overly burdensome, and expressed concern about whether the reports required to be filed with the Commission would be confidential. The sixth comment letter, from the NASD, opposed adoption of the rule, arguing that the Commission should reinstate proposed rule 15c2-10, which it withdrew concurrently with the proposal of rule 17a-23. The NASD argued that, with respect to systems that merely automate traditional market maker functions by a registered broker dealer, the rule is overly burdensome. The NASD also argued that, with respect to automated trading systems that act as markets, the rule should address the competitive concerns of the SROs by imposing

requirements more similar to those applicable to SROs. The Division currently is reviewing the comment letters and is considering the commenters' suggestions.

Market 2000 also reviewed the role of the Commission in guiding the continued development of the U.S. equity markets. The Report recommends improvements in the Commission's oversight of the SROs. In particular, Chairman Levitt directed the Division to review its procedures for processing proposed rule changes by SROs. The goal of this review was twofold. First, to reduce the number of filings with unresolved issues that had accumulated over the years, and, second, to establish a mechanism to accelerate the Commission's review of future rule filings without compromising investor protection.

As a result of Chairman Levitt's efforts, old rule filings have been dramatically reduced and new procedures have been proposed. Specifically, the Commission has published for comment amendments to Rule 19b-4 and Form 19b-4, the rule and form that set forth the procedures for the filing by the SROs of proposed rule changes under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments would expand the scope of proposed rule changes that may become effective upon filing pursuant to Section 19(b)(3)(A) of the Exchange Act. In particular, routine procedural and administrative modifications to existing order-entry and trading systems and noncontroversial rule proposals would become eligible for expedited review. The proposed amendments are intended to expedite and streamline the process through which



proposed rule changes are filed and become effective. The Commission also proposed to amend the rules and forms applicable to the annual filing of amendments to registration statements of national securities exchanges, securities associations, and reports of the Municipal Securities Rulemaking Board, to streamline those requirements.

One recommendation of Market 2000 requires legislative action. The Report recommends that transaction fees apply equally to listed and Nasdaq securities. Section 31 of the Exchange Act imposes a transaction fee on all national securities exchanges, based on a fixed percentage of the aggregate dollar value of executed trades. The Report recommends that Section 31 be amended to extend transaction fees to Nasdaq securities. The House of Representatives passed a Commission authorization bill (H.R. 2239) that contained a provision for self-funding which included extending Section 31 fees to Nasdaq securities. A Commission authorization bill has not been considered by the Senate. The President's proposed budget for fiscal year 1995 provides for Section 31 fees on Nasdaq securities. This bill currently is under consideration in the appropriations committees of both the House and the Senate.

As you can see, the Commission has actively pursued prompt implementation of the Market 2000 recommendations directly related to Commission action. All of the remaining recommendations of the Market 2000 Report require action by the SROs. I would like to discuss briefly the SROs' efforts and comments concerning the

Report's recommendations, along with the Commission's work with the SROs to implement the remaining Market 2000 recommendations.

Upon release of the Report, Chairman Levitt sent letters to the SROs asking for their response to the Division's recommendations. Subsequently, your Subcommittee asked the SROs to respond to Market 2000 recommendations. The SROs responded favorably on the Division's overall approach and agreed that the U.S. markets are working well. The SROs, however, raised issues about a number of the difficult structural proposals and suggested that further study was required regarding some of those proposals.

The SROs have started to implement a number of the recommendations in Market 2000. For example, the NASD has made significant progress with respect to recommendations affecting the OTC market. The NASD has filed with the Commission proposed rule changes concerning the protection of customer limit orders<sup>26</sup> and display of SelectNet interest to non-NASD members.<sup>27</sup> The Commission believes that efforts by the NASD represent a significant step in implementing recommendations concerning transparency and limit order practices in the OTC market. The NASD also pledged to work with the Commission on the remaining recommendations, including recommendations concerning surveillance and order handling responsibilities for third market trading.

In addition, the SROs agreed with several of the recommendations in Market 2000 that require specific action or rulemaking by the SROs. These include increased transparency through the display of customer limit orders and the display of

after-hours and overseas trades, and improvement of market executions by assessing market quality on a periodic basis and by markets and market makers in listed stocks offering price improvement.

For several of the recommendations, however, the SROs believe that additional examination is necessary, or did not comment at all. These recommendations concern eliminating the one-eighth pricing system, the feasibility of an order exposure rule, off-board trading restrictions for after-hours trading, shareholder approval of delisting, and extending the ITS/CAES link to all listed stocks.

Cooperation with the SROs is essential to implementation of the Report's recommendations; the Commission intends to continue working with the SROs to resolve any outstanding issues. In this regard, the Commission staff has discussed with the SROs implementation of the Market 2000 recommendations. The Commission believes that more needs to be done by the SROs. It expects that the non-controversial proposals will be implemented expeditiously and hopes that other recommendations will be implemented in a timely manner.

#### Unlisted Trading Privileges

In the release initiating the Market 2000 Study, the Division noted that the regulatory process associated with unlisted trading privileges ("UTP") could be a potential area for reform. Shortly thereafter, members of your Subcommittee began working on draft

legislation that would amend Section 12(f) of the Exchange Act regarding UTP. H.R. 4535, the Unlisted Trading Privileges Act of 1994, is the result of your efforts in this area, working with market participants and others to streamline the regulation of UTP. The Commission supports H.R. 4535, and believes that it will remove unnecessary regulatory delays that inhibit market competition.

As you are aware, Section 12(f) of the Act specifies the circumstances under which a national securities exchange may extend UTP to a security. Currently, Section 12(f) of the Act requires an exchange to apply to the Commission before extending UTP to any security. Section 12(f) also requires the Commission to publish the application for notice and provide opportunity for hearing. If the Commission determines that certain criteria have been met, the Commission then issues and publishes an order approving the application. H.R. 4535 would remove these procedures.

The existing exchange application, public notice, and Commission approval process for UTP has been in place since 1936.<sup>28</sup> Prior to the enactment of the Exchange Act and Section 12 thereof, exchanges were free to trade both listed securities and securities not listed on any exchange. Thus, exchanges frequently extended UTP to securities pursuant to exchange member requests. Section 12 of the Act altered this practice by prohibiting an exchange from trading a security that was not listed and registered on the exchange, subject to the limited exception provided in subsection 12(f).

Subsection 12(f), as enacted in 1936, allowed an exchange,

subject to Commission approval, to extend UTP to securities that were listed and registered on another exchange, or to securities that were traded OTC for which there was available information substantially equivalent to that available for listed securities. Prior to 1936, concern had been raised as to whether the markets, rather than the issuer, should have authority to determine the location in which a security may be bought or sold. The restriction on UTP in OTC securities addressed concerns regarding possible public reliance on a misperception that OTC securities traded on an exchange were subject to the same registration and disclosure requirements placed on exchange-listed securities.

Certain geographical and telecommunications issues also existed during the early years of the Act, which led to concern that sufficiently widespread public distribution of, and sufficient public trading in, a security should exist in the vicinity of an exchange extending UTP to a security.<sup>29</sup> Thus, Section 12(f), as enacted in 1936, established the 10-day notice and opportunity for hearing provisions for any party with a bona fide interest, including the issuer of the security, regarding a UTP application filed with the Commission so that the Commission could address these issues and concerns on a case-by-case basis with each exchange application for the extension of UTP.

Congress made its most recent revisions to Section 12(f) in conjunction with the 1975 Amendments. At that time, Congress chose to maintain the exchange application, notice, and Commission approval process that had been in place since 1936 regarding an

exchange's extension of UTP. In 1975, Congress also added criteria for Commission approval of UTP applications, such as consistency with the maintenance of fair and orderly markets and the protection of investors. Congress also listed particular areas that the Commission must consider with respect to any application for the extension of UTP to OTC securities. Among these is the progress that had been made toward a national market system. In addition, the Commission is required to make a finding that the exchange making the application does not have any rules in place that would unreasonably restrict competition between or among OTC dealers and specialists.

The Commission processes hundreds of exchange applications for the extension of UTP each year. In 1993 alone, the Commission processed over 1,600 exchange requests for UTP. Comments regarding UTP applications are extremely rare. Indeed, virtually no comments have been submitted to the Commission on a UTP application in over ten years. This lack of comments seems to indicate that the rigid procedures for considering individual applications to extend UTP are no longer appropriate.

As discussed above, the notice and opportunity for hearing requirement has not been substantively changed since 1936, and requires the Commission to process each application, ensure that notice of the application has been published in the Federal Register for a minimum of 10 business days, evaluate the application, and issue an approval order. Thus, regional exchanges must wait until a security has been trading for several weeks

before competing with the exchange that lists the security. This waiting period, while originally designed to provide a forum for public input in the Commission's determination, now has the effect of providing the listing exchange with sole trading rights until competing exchanges' applications are published and processed. The impact of the delay may be particularly significant because the initial bar to competition among the markets may influence order-entry firms' decisions in long-term order-routing determinations.

H.R. 4535 would eliminate the application and approval process, thereby removing unnecessary regulatory delays and enhancing the opportunity for competition among markets. As a general matter, H.R. 4535 would authorize immediate UTP in exchange listed securities and those traded on Nasdaq. Therefore, removal of the regulatory delays that result from the notice and opportunity for hearing requirements should serve to further the objectives of the Act, particularly with respect to free, open, and competitive markets, and generally should serve to streamline the regulatory process regarding UTP.

H.R. 4535, however, provides a temporary exception to immediate exchange authority to extend UTP in instances where a security is listed on another exchange and is the subject of an initial public offering ("IPO"). In these instances, during the 180-day period following the enactment of this bill, an exchange must wait until the third trading day in the security before extending UTP to the security. H.R. 4535 requires the Commission to undertake rulemaking within 180 days of the enactment of the bill to determine whether any delay in trading an IPO pursuant to

UTP should be required.

The Commission supports this approach to the potentially complex issues surrounding multiple market trading of IPOs. Several months ago, Commission staff became aware of some market participants' concerns that multiple market trading of a security while it initially is being offered to the public may hinder efficient pricing and distribution of the security. The Commission, however, has not received concrete evidence or any thorough analysis of the potential harms associated with UTP in IPOs.

Commission staff, led by Chairman Levitt, have worked to forge an appropriate approach to this area. The Commission supports the approach taken in H.R. 4535. It attempts to balance the interests of those who wish to level the competitive playing field and streamline the UTP process against those who have expressed concern with the effects of the change on the stability of the markets and the capital formation process. The Commission believes that, given the market uncertainty that is associated with any significant change in how and by whom IPOs are traded, the compromise presented in H.R. 4535 is a prudent and balanced approach.<sup>30</sup>

During the 180-day period following the enactment of H.R. 4535, the Commission will seek public comment from the national market centers and participants regarding this topic. In particular, the Commission plans to seek comments concerning the benefits associated with streamlining the regulatory process and enhancing competitive opportunities among market centers with



respect to UTP and IPOs, and identification of the negative effects that immediate UTP may have on the distribution of these securities. Specifically, we will look to the markets to provide data on the nature and effect of trading activity in connection with IPO listings.

For 60 years, the Commission has worked with the Congress and the Senate to ensure that equity market regulation protects investors, aids capital raising, and keeps pace with the changing dynamics of the secondary markets. The Market 2000 Report and H.R. 4535 are new steps in this process. The recommendations of the Market 2000 Report address existing obstacles to investor protection and fair competition. H.R. 4535 removes unnecessary delays that inhibit competition among markets. The Commission looks forward to continuing to work with the Subcommittee in the future in our efforts to identify and implement solutions to problems and concerns that arise as the U.S. market enters into the 21st Century.

Thank you.

1. Division of Market Regulation, Securities and Exchange Commission, Market 2000: An Examination of Current Equity Market Developments (Jan. 1994) (Hereinafter Market 2000).
2. Pub. L. No. 94-29, 89 Stat. 97 (1975).
3. Oversight Hearing on the Future of the Stock Market focusing on the National Market System Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (April 14, 1993); Oversight Hearing on the Future of the Stock Market focusing on Inducements for Order Flow Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (May 13, 1993); Oversight Hearing on the Future of the Stock Market focusing on Proprietary Trading Systems Before Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (May 26, 1993); Oversight Hearing on the Future of the Stock Market focusing on Soft Dollar Practices Before Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (July 13, 1993).
4. GAO, SEC Actions Needed to Address Market Fragmentation Issues (1993); Oversight Hearing on the Future of the Stock Market focusing on the Results of a GAO Study on Market Fragmentation Before the Subcomm. on the Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 1st Sess. (June 29, 1993).
5. In response to the release of the Market 2000 Report, Representative Markey stated:

The recommendations set forth in SEC staff report will help assure that the key public policy objectives that Congress has set forth over the years in the federal securities laws, such as fair treatment of investors, transparent markets, vigorous competition between marketplaces, and open access to the national market system, will continue to be advanced as our nation's stock markets move into the 21st century. I'm pleased to see that the SEC staff has reached many of the same conclusions that the Subcommittee came to during the course of its hearings last year on the future of the stock market, such as the need for regulatory changes aimed at improving disclosure of inducements for order flow, soft dollar practices, and adoption of an order exposure rule.

News Release, Edward J. Markey, Chairman, U.S. House of Representatives, Subcommittee on Telecommunications and

Finance of the Committee on Energy and Commerce (Jan. 27, 1994).

6. See, e.g., Sharon Walsh, "SEC to Propose Broad Financial Market Changes," Washington Post, Jan. 27, 1994, at D10; Richard Waters, "More Power to Investors," Financial Times, Jan. 28, 1994, at 7; Sam Scott Miller, "Market 2000: Modest Proposals or Revolutionary Seeds?" Prentice Hall Law & Business Insights, Vol. 8, No. 3, (Mar. 1994) at 20.

See also letter from William H. Donaldson, Chairman and Chief Executive Officer, New York Stock Exchange, Inc. ("NYSE"), to The Honorable Edward J. Markey and The Honorable Jack Fields, House Telecommunications and Finance Subcommittee, (Mar. 31, 1994); Letter from James E. Duffy, Senior Vice President and General Counsel, Legal & Regulatory Policy Division, American Stock Exchange, Inc. ("Amex"), to The Honorable Edward J. Markey and The Honorable Jack Fields, House Telecommunications and Finance Subcommittee, (Apr. 12, 1994); Letter from Joseph R. Hardiman, President, NASD, to The Honorable Edward J. Markey and The Honorable Jack Fields, House Telecommunications and Finance Subcommittee, (May 3, 1994); and Letter from William G. Morton Jr., Boston Stock Exchange, Inc., Homer J. Livingston, Jr. Chicago Stock Exchange, Inc., Leopold Korins, Pacific Stock Exchange, Inc., and Nicholas A. Giordano, Philadelphia Stock Exchange, Inc., to The Honorable Edward J. Markey and The Honorable Jack Fields, House Telecommunications and Finance Subcommittee, (Apr. 6, 1994).

7. Market 2000, Study V.
8. Market 2000, Studies IV and VII.
9. Market 2000, Studies III, VI, and Appendix II.
10. Market 2000, Study V, at 9-15.
11. Market 2000, Study V, at 3-5.
12. Market 2000, Study V, at 5-9.
13. Market 2000, Study IV, at 8-10.
14. Market 2000, Study IV, at 5-8, and at 10-14.
15. Market 2000, Study IV, at 10-11.
16. Market 2000, Study III, at 26, 27.
17. Market 2000, Study III, at 25, 26.
18. Market 2000, Study VI, at 7, 8.

19. Market 2000, Study VI, at 8-10.
20. Market 2000, Study III, at 8-10.
21. Market 2000, Study VI, at 11, 12.
22. Market 2000, Appendix II.
23. Securities Exchange Act Release No. 33026 (Oct. 6, 1993), 58 FR 52934 (Oct. 13, 1993).
24. In their letters to Representatives Markey and Fields, the SROs stated that they are reviewing the implications of moving to a 1/16ths or a decimal pricing system. See supra note 6.
25. Securities Exchange Act Release No. 33605 (Feb. 9, 1994), 59 FR 08368 (Feb. 18, 1994).
26. Securities Exchange Act Release No. 33697 (Mar. 1, 1994), 59 FR 10842 (Mar. 8, 1994).
27. Securities Exchange Act Release No. 33938 (Apr. 20, 1994), 59 FR 22033 (Apr. 28, 1994).
28. For discussions of the history of UTP in U.S. markets and Section 12(f) of the Exchange Act, see, e.g., Stephen L. Parker & Brandon Becker, Unlisted Trading Privileges, 14 Rev. Sec. Reg. 853 (1981); and Walter Werner, Adventure in Social Control of Finance: The National Market System for Securities, 75 Colum. L. Rev. 1233 (1975).
29. See Amendments to Securities Exchange Act of 1934, S. Rep. No. 1739, 74th Cong., 2d Sess. 1936; SEC, Report on Trading in Unlisted Securities upon Exchanges (1936); and Hearings before the Senate Comm. on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and 97 (73d Cong.), Stock Exchange Practices (1934).
30. Letter from Arthur Levitt, Chairman, SEC, to the Honorable Ron Wyden, U.S. House of Representatives (Nov. 29, 1993).