REMARKS OF

COMMISSIONER J. CARTER BEESE, JR.*
U.S. SECURITIES AND EXCHANGE COMMISSION

MARKET 2000 AND INTERNATIONAL CAPITAL MARKETS

PROMETHEE/MATIF CONFERENCE

PARIS, FRANCE
FEBRUARY 11, 1994

* The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners, or the staff.

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

Let me begin by stating something that I'm sure everyone in this room can attest to. Fundamental changes are sweeping the world's capital markets. Markets seem to be constantly flirting with new highs and capital is moving freely across large parts of the globe at the stroke of a computer key. In fact, advances in technology have led some experts to predict that our ability to compute, to communicate and to transact will increase by a factor of one hundred over the next ten years.

Along with this extraordinary technological capability comes new and increasingly sophisticated financial products that are making yesterday's simple terms of "stocks" and "bonds" seem like a relic of the past. Indeed, today's complex financial instruments are better defined in terms of cash flow and volatility characteristics. In today's world of corporate finance, it is possible to take a plain vanilla, fixed-rate bond, and by financial engineering, change its payment structure, change its currency, change its maturity, change its rating, give it equity characteristics, and slice and dice it into tranches.

And today we are witnessing an explosion of capitalism around the world, to the tune of $300 billion dollars of privatizations scheduled to come to market. This phenomenon -- coupled with market reforms from Shanghai to Budapest to Mexico City -- is intensifying the demand for capital all over the world.

And, as we navigate the sometimes unchartered waters of today's new products and today's global markets, we must explore aggressive new ways to keep pace — new approaches to regulation, and new ways for the securities industry to meet these challenges without the strong arm of excessive government regulation.

At the SEC, efforts are underway to prepare for these changing markets. An important part of this effort is our Market 2000 study — a study I am pleased to present to you today. As many of you know, Market 2000 is a comprehensive analysis of the competitive and market structure issues affecting the U.S. equity markets. It is my hope that Market 2000, along with the public comment on the study, will prompt a dialogue — not only on the current hot issues — but also on how technology, institutionalization, derivatives and globalization are impacting the market and how these forces will change the marketplace by the year 2000. And perhaps most importantly, at least from the perspective on an SEC Commissioner, is how the U.S. markets will be positioned versus other increasingly competitive world markets.

Market 2000 represents the first comprehensive study of our markets since the so-called "Institutional Investor Study" done in the mid-1970's. As some of the veterans in the room no doubt remember, the Institutional Investor study *led to the un-fixing of commission rates; the development of consolidated quotation and transaction reports among U.S. exchanges; the Intermarket Trading System; and the initiation of transaction reporting for NASDAQ securities.*

Since that time, the U.S. equity markets have undergone dramatic changes, not the least of which are the growth in trading volume, advances in trading technology, the increasing dominance of institutional investors, the introduction of standardized and OTC derivative products, and the explosion of cross border activity.

While these developments have resulted in significant cost savings, convenience, and variety to the investing public, they also raised important questions of market transparency, liquidity, efficiency, and domestic and international competition. As a result, the SEC, as well as market participants, have been confronted with issues such as payment for order flow, proprietary trading systems, the growth of third and fourth market trading, and fair competition between the exchanges and NASDAQ.

The basic finding of the Market 2000 Report is that today's equity markets are operating efficiently within the existing regulatory structure. Accordingly, the Report does not call for broad structural changes to equity market *regulation. The Report does, however, contain a number of proposals for action that I would like to briefly summarize. These proposals can be divided into four general areas: transparency, fair treatment of investors, fair market competition, and open market access.*

Transparency

1) Intramarket transparency could be improved by display of limit orders.

2) Intramarket transparency could be improved by eliminating the one-eighth pricing system.

3) Intramarket transparency could be improved by display of SelectNet interest.

4) The SROs should enhance transparency for after-hours trades and trades in U.S. equities nominally executed abroad.

5) The SROs should consider the feasibility of an order exposure rule.

Fair Treatment of Investors

1) The Commission should require greater disclosure of payment for order flow and broker-dealer order handling practices.

2) Disclosure of Soft Dollar practices should be improved.

3) Broker-Dealers using automatic routing procedures need to assess market quality on a periodic basis.

4) Markets and market makers in listed stocks should offer price improvements.

5) NASDAQ/NMS limit order handling practices need revision.

Fair Market Competition

1) Surveillance and order handling responsibilities for third market trading need to be strengthened.

2) The Commission should continue a flexible approach to automated trading systems but should propose recordkeeping and reporting requirements for these systems.

3) Transaction fees should apply equally to listed and NASDAQ securities.

4) The Commission should expedite the process of reviewing SRO system changes.

Open Market Access

1) Off-Board Trading restrictions should be removed for after-hours trading.

2) NYSE Rule 500 and AMEX Rule 18 should provide companies with a reasonable opportunity to move to another market.

3) The ITS-CAES link should be extended to all listed stocks.

Those are the general recommendations contained in the Report, but let me discuss in a little more detail two issues that we dealt with prior to the release of the Report -- payment for order flow and T+3 clearance and settlement.

Earlier this fall the SEC published for comment a proposed rule regarding Payment for Order Flow. Specifically, the release proposes to amend Rule 10b-10 to require a broker dealer to include on the confirmation of each transaction whether payment for order flow was received, and, if so, the amount of any payment or monetary equivalent received in connection with the transaction.

The release also proposes to add new Rule 11Ac1-3, to require disclosure on each new account statement and on a yearly basis thereafter on the annual account statement, the firm's policies regarding payment for order flow practices in exchange listed and NASDAQ national market system securities; and information regarding the firm's aggregate amount of monetary-based payment for order flow.

Payment for order flow is an issue that deeply divides segments of the securities industry and has been the subject of extensive debate and analysis. Opponents of payment for order flow liken the practice to a payoff, while proponents consider it a legitimate business practice in a highly competitive market.

The SEC's recent rule proposal attempts to strike a balance between these competing viewpoints -- and does so in a manner that I believe is wholly consistent with the core principles of the U.S. federal securities laws.

By advancing the notion of a disclosure based solution, the Commission steered clear of picking "winners" and "losers" between competing market participants. Instead, by requiring relevant disclosure, investors will have the information necessary to make informed decisions for themselves. And if investors determine that payment for order flow is an unfair practice, savvy market participants will use the absence of payment for order flow practices to their competitive advantage.

As an aside, let me call your attention to the fact that the payment for order flow release also contains language directing SEC staff to report back to the Commission on the need for enhanced disclosure by investment advisers in the area of soft dollar arrangements. In many respects, soft dollars and *payment for order flow are two sides of the same coin. While there certainly are technical differences between the two practices, both represent payment of cash and non-cash inducements for allocating business among market participants. The staff report was recently completed and it is my hope that the Commission can move swiftly in this area as well.*

Another area where the Commission has recently taken action is the adoption of a T+3 settlement timeframe for most broker-dealer securities transactions. Under new Rule 15c6-1, most transactions that now settle on T+5 will be required, effective June 1, 1995, to settle on T+3.

Once again, this was not an issue that proceeded without significant debate. All told, 1,941 comment letters were received, and many commenters opposed to the Rule raised legitimate concerns regarding the needs and preferences of retail investors.

After weighing these concerns, however, the Commission believed that it was important to proceed with T+3. As I mentioned earlier, the last 20 years have seen unprecedented changes in the world's securities markets. Not only has volume grown exponentially, but market participants now routinely operate in multiple markets -- foreign and domestic -- equity, debt and derivative. With *this has come an unprecedented, but inevitable, linkage among the world's securities markets.*

In light of these linkages, the clearance and settlement system must be prepared to absorb shocks from more remote sources than ever before. Since the 1987 Market Break there has been a near universally held view, first expressed in the Brady Report, that improvements needed to be made in domestic clearance and settlement systems.

Subsequently, the Bachmann Report quantified for the first time what we all knew intuitively about the clearance and settlement system: time = risk. Or, to put it another way, nothing good happens between trade date and settlement.

By adopting T+3 the Commission attempted to strike a reasonable balance between the needs of the retail customer and the structural changes necessary to adapt to the technological world we now live in. It is my hope that the technological developments that will be spawned from adopting T+3 will eventually enable us to further curb systemic risk with an even shorter settlement cycle.

The move to T+3 has brought into focus a question that I believe will need to be addressed in the future. As we shorten the settlement cycle, do we *in fact deemphasize the significance of the confirmation statement? And if that is a side-effect of our action, should we begin to look at front-loading more disclosure in account opening statements and annual statements? I don't have answers for these questions today, but I do think the Commission and the industry need to rethink the entire approach to providing certain types of disclosure, and the timing of that disclosure, to make it more meaningful to retail investors.*

Conclusion

Initial reaction to the Market 2000 report has been something of a subdued yawn. One of my favorite reviews came from the Financial Times when they wrote:

> *"When a securities watchdog declares that the regulatory system is operating pretty well and requires no substantial remedial treatment, it comes as something as a surprise. When the regulator in question is the U.S. Securities and Exchange Commission, a watchdog whose genetic make-up carries more than a hint of the bloodhound about it, the response is more one of shock."*

The balanced nature of the report has been generally well received by market participants -- one prominent industry professional seemed to sum things up the best when he said "Just because you go to the doctor doesn't mean he's going to operate."

And keep in mind that the release of the report marks the start of a process -- not the end. For the Market 2000 report to really have significance, it needs to spark a dialogue among investors, regulators, academics and market participants, domestic and abroad, about how to prepare for the challenges of the future.

The current challenge for regulators and markets around the world, however, is to validate the overwhelming vote of confidence that we have received from investors. Market 2000 is a major effort in this regard, and hopefully will help us to adapt to the new demands of tomorrow's markets.

Thank you.