

MEMORANDUM

November 20, 1984

TO: Chairman Shad

FROM: Richard G. Ketchum, Director *RJK*
Division of Market Regulation

SUBJECT: Senator Proxmire's October 23, 1984 letter
proposing the establishment of an Advisory
Committee on International Trading Systems

In his letter dated October 23, 1984, Senator Proxmire suggested that the Commission study the internationalization of the United States securities markets and the rapid development of global trading systems. To facilitate that effort, Senator Proxmire recommended that the Commission establish an Advisory Committee on Trading Systems.

As you know, the Commission already is exploring several issues that have a direct bearing on the topics which Senator Proxmire suggested an Advisory Committee consider. For example, the Commission currently is soliciting comment on whether the purchase or sale of securities in the U.S. (directly or indirectly) should serve as a "waiver by conduct" of any applicable foreign security laws. The Division recently approved by delegated authority the Boston Stock Exchange's proposed electronic linkage with the Montreal Stock Exchange, and is studying its proposal to extend that linkage to the London Stock Exchange. The Division also is monitoring Instinet's extension of automated execution systems in the domestic market to international investors. In addition, there are a number of disclosure issues with respect to the internationalization of the markets being pursued by the Division of Corporation Finance.

We agree with Senator Proxmire that these and other issues merit the careful and thorough attention of the Commission. Indeed, as you know, certain of these matters, such as the "waiver by conduct" question, have been given priority consideration by the Commission. We also agree with Senator Proxmire that, at some point in the growing internationalization of the market, it may be appropriate to move from consideration of international trading questions on an ad hoc basis to the more comprehensive approach that an advisory committee or similar undertaking might permit.

At present, however, we believe that it would be premature to form an Advisory Committee on Trading Systems. Instead, we suggest that the Commission pursue one of the three alternative courses of action discussed below. Of the three alternatives, the one we favor is for senior staff members and Commissioners to conduct informal discussions with key participants in the securities industry on issues raised by the developing global securities market, and for the Commission to publish a concept release requesting comment on a number of these issues.

Discussion

The Advisory Committee on Trading Systems suggested by Senator Proxmire might focus attention on the internationalization of the U.S. capital markets and help foster a dialogue on the subject. An advisory committee, however, could not be expected to accomplish much more than that. Under the Federal Advisory Committee Act ("FACA"), an advisory committee is empowered to study only a specific set of questions defined prior to its inception, and to recommend changes in the appropriate federal laws and the rules and regulations thereunder. Regardless of whether it has accomplished that objective, an advisory committee must end not more than two years after its inception.

We believe that an advisory committee to study the developing global marketplace should be formed only when all the relevant issues have been defined sufficiently to be ripe for solution. Several of the matters cited by Senator Proxmire are still in their infancy; indeed, some are only in the proposed stage. To form an advisory committee that would formulate administrative or legislative recommendations for regulatory global trading systems, world-wide clearance and settlement systems, or similar programs could serve to stifle initiative and frustrate the development of economically efficient market systems without materially advancing the investor protection, disclosure, surveillance and other goals cited in Senator Proxmire's letter. At present, for most of the issues cited in the letter, we do not think that we would be able to define clearly either the scope of the possible problems or potential solutions to these problems in anything more than a rudimentary fashion. If an advisory committee were established, the committee could study only those issues, and could not redirect or redefine its inquiry. Even if an advisory committee were to develop some worthwhile ideas, moreover, the committee would be unable to give those ideas the longterm study they would necessarily merit.

Although we think that it would be premature to form an Advisory Committee on Trading Systems at this early stage, we believe that the Commission should encourage the securities markets and industry to focus on the potential implications of these developments. We see three alternative courses of action.

The first approach would be for the Commission to sponsor a formal workshop or roundtable on the developing global securities market. One advantage of this format is that the Commission could control the agenda and determine who participates, and thereby could provide an open forum not available in the advisory committee format. The open forum that the workshop or roundtable format would offer, however, does have its limitations. An internationalization workshop or roundtable would be less likely to make specific recommendations for securities law or market structure reform than an advisory committee, and any informal recommendations would have less weight than those of an advisory committee. The same participants also could not conveniently meet more than one time. If a series of sessions were held, the workshop or roundtable might look more like an advisory committee, and its discussions would be limited by the FACA to a narrow range of issues defined prior to its inception. Consequently, a workshop or roundtable could not provide a continuing forum for the investigation or development of salient issues.

The second approach is for the Commission to encourage the Securities Industry Association ("SIA") to sponsor either a conference or standing committee to study issues raised by the development of a global marketplace. The Commission would cooperate with the SIA in this endeavor, and actively participate in the conference or committee along with SIA members, dealer and custodian bank representatives, securities markets representatives, and academics. Unlike an advisory committee or a roundtable, an SIA committee could meet unencumbered by the strictures of the FACA. An SIA committee thus could provide an ongoing forum for the discussion and clarification of issues raised by the internationalization of the securities markets. This approach, however, is not without its flaws. The Commission might have difficulty convincing the SIA to form such a body. The Commission also would have less control over the agenda of the SIA entity or its membership.

The third approach, which is the one the Division favors, is for senior staff members and Commissioners to meet with industry leaders and strategic planners to discuss the internationalization of the securities markets. 1/ The informal meeting format offers the Commission the most flexible opportunity to gain a clear understanding of what issues the development of a global marketplace raises. Under this format, the Commission could carry on a series of meetings over an extended time period without being subject to the FACA. Using the flexibility inherent in informal meetings, the Commission could begin with general questions and gradually refine the issues. This approach could be enhanced (and adverse reaction from Senator Proxmire perhaps avoided) by issuance of a concept release generally requesting comment on the issues raised by Senator Proxmire.

After you have had the opportunity to review this memorandum, I would welcome the opportunity to discuss these alternatives with you.

Attachment

cc: Linda Quinn
John Fedders
Dan Goelzer
John Huber

1/ It also would be possible to pursue the latter two approaches concurrently; the Division would have no objections to approaching the SIA with the committee proposal at the same time as it pursued less formal contacts with the SIA and other industry representatives. However, it might be advisable to delay approaching the SIA until after these informal conversations have further identified the issues raised by the developing global market.