



Remarks Of

**Richard Y. Roberts
Commissioner*
U.S. Securities and Exchange Commission**

"Transparency"

**Before the
The First Annual New England Regional
Securities Conference
June 14, 1991**

***/ The views expressed herein are those of Commissioner Roberts and do not 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**

I. Introduction

One of the mandates of the Securities and Exchange Commission ("Commission") is to encourage communication among all the participants in the securities industry. While we often think of disclosure in terms of registration statements and periodic reports, many different types of information make our securities markets buzz with activity.

Communicating the volume of transactions in a security, or the closing price on the New York Stock Exchange ("NYSE"), may be just as important to investors as a press release about a company's third quarter earnings. Moreover, in efficient markets, share prices should reflect the market's view of financial news.

Many markets are not efficient, however. Information may not be available to the market, or if it is available, price discovery, such as we have on the floor of the securities exchanges, or with competing market makers in NASDAQ, does not take place because trades are negotiated privately and not reported to the market.

II. Transparency

Without price "transparency" in a market, dealers or specialists are unable to compete aggressively for transactions, and investors cannot

easily monitor executions to protect against sales practice abuses.

Moreover, fundamental financial information about an issuer is not readily reflected in current market quotes.

A. Equity Markets

Transparency has become the hallmark of efficient markets in this country. Historically, the central auction markets on the floors of U.S. securities exchanges brought buyers and sellers together in an environment where bids and offers were communicated face to face, and recent transactions were reported to investors off the exchange floor over a ticker tape. With the development of screen based trading systems and competing markets in exchange listed securities, it was necessary to develop a system for communicating current quotations to avoid fragmenting markets and to assure that investors received the best price available.

Dealers in the over-the-counter market for securities quoted on NASDAQ know that they will be able to compete for volume by raising their bids or lowering their asks. Similarly, competing specialists on the floor of our national and regional securities exchanges are protected by

rules that require reporting of trades over the consolidated tape, and an Intermarket Trading System prevents their competitors from trading with the public in listed securities at a price level less favorable than the best bid/ask. Moreover, even in the so-called "third market," in which dealers trade exchange listed securities over-the-counter, trade price reports provide the market with information about demand for a particular security.

Recently, the Commission has been examining the need for improved transparency in the equity markets as a result of the development of new trading systems and new trade practices.

1. New Trading Systems

As many of you are aware, the Commission has struggled over the past decade to effectively regulate an increasing number of new proprietary trading systems that are designed to fill the unsatisfied needs of limited segments of our securities markets or to provide far less costly execution. As one commenter recently said, "It doesn't take a genius to develop an electronic securities market today."¹ However, many of these

¹ David Rosensaft, quoted in, Ivy Schmerken Electronic Trading, The Bulls and Bears Come Out at Night, Wall Street Computer Review at 14 (September 1990).

systems cannot be easily classified under a regulatory scheme that contemplates only dealer markets and exchange markets. Moreover, these systems present complex policy considerations that challenge the efficiency of central markets. The Commission increasingly has been forced to balance the need for innovation against the concern that the creation of these new markets may result in excessive market fragmentation and impair price transparency.

To the extent possible, the Commission has attempted to ensure that these new trading systems report trades executed during regular market hours on a real-time basis. Unlike exchange and NASDAQ systems, however, they do not publicly report quotations (*i.e.*, priced orders). In addition, trading conducted on such systems after regular market hours also is not publicly reported. Obviously this is an area in which the Commission should, in my judgment, very quickly focus more attention.

2. Off-Shore and After Hours Trading

In addition to issues raised by new trading systems, attacks on the integrity of our markets also arise when firms send trades off-shore to be executed by their London affiliates in order to circumvent exchange

regulations or to avoid reporting transactions to the U.S. market. While dealers have well-founded reasons for protecting proprietary information that would benefit their competitors, the need for trade information, which has been the strength of our markets, cannot be ignored. Recently, the Commission approved a rule filing by the NYSE that was designed to recapture transactions in listed securities that were being sent overseas for execution after the close of trading on the exchange.²

The NYSE proposed to implement two after hours crossing sessions. During one session, investors would be permitted to execute transactions in individual securities at the closing price. In the other session, institutional investors could execute matched orders for baskets of stocks at an agreed upon price. The sessions would run concurrently and would last for 75 minutes after the close of regular trading. While the NYSE's sessions, which began yesterday, will benefit investors, one of the aspects of the proposal, an exemption from trade reporting for investors effecting

² Securities Exchange Act Release No. 29237 (May 30, 1991). The system also will compete with domestic crossing systems.

transactions in large baskets of securities, sets a disturbing precedent. Commissioner Fleischman, in particular, has pointed out the danger of such a precedent.³

Although the Commission permitted the NYSE initially to operate its crossing session for market baskets without requiring current reporting transactions, this exemption from our current reporting requirements should be reexamined in the near future. In addition, the Commission should reconsider whether the circumstances that justified the need for an exemption of this nature are valid, particularly in light of other exchanges' off-hours trading proposals pending before the Commission.

The Commission has indicated in the past that transactions in U.S. securities that are negotiated in the United States and sent abroad for execution are subject to U.S. securities laws. In a recent release, for example, the Commission stated that:

"trades negotiated in the U.S. on a U.S. exchange are domestic, not foreign trades. The fact that the trade may be time-stamped in London . . . does not in our view affect the obligation . . . to maintain a complete record of such trades and report them as U.S.

³ Id.

trades to U.S. regulatory and self-regulatory authorities and, where applicable, to U.S. reporting systems."⁴

The fact that foreign affiliates of U.S. dealers are used to provide the illusion that these are foreign transactions should not shield the trades from U.S. reporting requirements.

The provisions of Section 11A and 17(a) of the Exchange Act, in my judgment, empower the Commission to compel such trade reporting. Rather than endorsing a practice that introduces the "virus of opacity" into the U.S. securities markets, the Commission should exercise this current authority to require reporting of transactions between U.S. institutions that are generated in the U.S. markets and only nominally "executed abroad." A securities trading policy that masks from the market important trade information challenges the integrity of our capital markets and should not be permitted to germinate. This latter statement applies equally to new trading systems.

B. Debt Markets

Although I am concerned about transparency in our equity markets, more troubling yet is the current state of our debt markets. These

⁴ See Securities Exchange Act Release No. 28899 (February 20, 1991).

markets have become increasingly important in the past 30 years. The amount of federal and municipal financing has grown tremendously, and debt to equity corporate ratios have climbed continually since the 1950's. Notwithstanding the tremendous size of our nation's debt markets, many of the inherent safeguards, and many of the structural market protections, that are present in the equity markets do not exist for debt investors under our federal securities laws. And, until recently, the Commission's focus, in terms of investor protection, largely has been on the most visible segment of the securities markets - the equities market.

In 1975, for example, Congress added Section 11A, which I mentioned previously, to the Exchange Act and required the Commission to establish a National Market System for securities. As a result of this Congressional mandate, and ignoring for the moment the exceptions granted by the Commission in this area with its treatment of new trading systems and the NYSE's off-hours trading program, the Commission and securities industry jointly have worked on the development of an efficient National Market System for equity securities that has resulted in the transparency that we now enjoy. As I mentioned earlier, we now have an

Intermarket Trading System and real time quote and trade reports that allow investors the chance to identify and access the most competitive markets for a particular security.

The fixed income markets, however, have largely been an "after-thought" in our regulatory scheme. The 1975 legislation that required the Commission to take a hard look at the way equity securities were traded, did not focus on governments and municipal debt, and there was little mention of the market for over-the-counter and exchange listed corporate debt. These markets currently lack the disclosure and price discovery mechanisms that characterize modern efficient markets. Current trade price reporting would reduce price disparities by enhancing competition among dealers in debt securities, and by allowing customers to make more informed investment decisions.

Although the solution to some of the problems in the fixed income markets may need to come from federal and state legislators, it appears that progress already is underway at the Commission and in the industry. Private vendors now provide important market information about segments of the bond market that was not available ten years ago. In

addition, in the 1990s, I increasingly sense an awareness at the Commission of the need to focus more attention to improving our debt markets. There already has been movement to increase the price transparency in the non-investment grade corporate debt and government securities markets.

1. Corporate Debt

In addition to proprietary trading systems for corporate bonds, the NYSE currently has a system, known as the Automated Bond System, that allows for the automatic execution of transactions in corporate bonds. While this system accounted for a significant portion of the trading in RJR Nabisco bonds in the past year, most trades on the system are in odd lots, with the lion's share of the volume in corporate debt transacted over-the-counter between dealers. Consequently, the NYSE's ABS system does not serve as a source of price discovery for a large portion of transactions.

The NASD also recently has indicated that it may be willing to build and operate a system for trade and quote reporting in the high yield corporate debt market. The NASD's system, called the Fixed Income

Prototype System ("FIPs"), would provide the analytical data that also is available from many private vendors and could conceivably operate like NASDAQ and other NASD systems, providing current dealer quotes, offering same-day comparison of trades, and automatically routing transactions reported through the system to the appropriate clearing agencies and depositories.

To make either of these systems truly effective, however, the Commission would need to play an important role in requiring dealers to participate and to submit transaction reports that will be made available to the public through private information vendors. While dealers should be free to operate outside these systems, they should not be able to hide completed transactions from the public. The Commission needs to begin considering whether dealer transactions in corporate debt should be reported to the market in the same fashion that equity transactions are reported on the consolidated tape.

2. Government Securities

Current information in the government securities markets, which are the most liquid in the world, with almost four trillion dollars outstanding,

including Treasury securities and the securities issued or guaranteed by government sponsored entities, such as GNMA, FNMA, and FHLMC, also has remained available only to a limited club. No matter how large the transaction or market participant, access to the interdealer screens that contain current quotes was not available to non-club members. Instead, large institutions are forced to contact dealers directly to ascertain current quotes, and smaller investors, without relationships with primary dealers, are required to use intermediaries and hope that they receive a favorable execution. Without trade price dissemination, investors in the government securities markets have been denied the opportunity to compare their executions against the market.

Current barriers to information in the government securities market are crumbling, however. The Public Securities Association recently has announced the availability of a government securities pricing system that hopefully will break the monopoly on price information that historically has been maintained by primary dealers. The Government Pricing Information System, Inc. ("GOVPX"), which is scheduled to begin operations this Sunday, is the result of a joint venture of primary dealers

and five of the six interdealer brokers in the government markets. Once the system is operational, investors will have available for the first time, on a current basis, a composite picture of dealer activity showing executed trade prices, volume, best bids, and yield on a significant percentage of government securities transactions.

The system is not perfect, however. While it will provide information concerning transactions in Treasury securities, it will not provide information concerning other government securities. Nevertheless, the PSA's system has the potential to significantly improve our government securities market.

IV. Conclusion

There have been great strides made to improve the analytical and price information that is available to investors. Technology has given us a tremendous tool to communicate with investors and to improve the transparency of our markets. We need to make sure that such technological advances are used to improve price transparency in our debt markets. We also need to make sure that such technology does not reduce the transparency that currently exists in our equity markets.