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Statement No. 201

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Statement of the Shadow Financial Regulatory Committee

on

New York Stock Exchange Governance and Market Structure Issues

December 8, 2003

Recently members of the New York Stock Exchange ("NYSE") overwhelmingly approved several amendments to its constitution designed to improve governance and increase transparency. The amendments call for (i) a substantial reduction in the number of NYSE directors from 27 to 8, (ii) a reconfiguration of the Board of Directors to include only directors who are independent of NYSE members, member organizations, and listed companies, (iii) assignment of various responsibilities to the Board of Directors, including the hiring, firing, and monitoring of management, executive compensation, regulatory compliance, and approving major changes in business policy, (iv) the creation of a new Board of Executives, representing various constituencies of the NYSE, to oversee operational procedures, and (v) increased disclosure of governance practices, management compensation, charitable contributions, and political donations. Approval of the amendments by the Securities and Exchange Commission ("SEC") is pending.

The Shadow Financial Regulatory Committee recommends expeditious approval of the amendments by the SEC. The new governance structure at the NYSE should result in a more engaged board of directors, nimbler decision-making, and more effective regulation of trading practices. By improving the efficiency with which the NYSE is operated, the governance changes should benefit investors. If the NYSE decides to adopt an even more sweeping governance change, by converting to a shareholder entity, as exchanges throughout the world have done, the SEC should permit it.

Unless the NYSE's new governance structure is shown unable to regulate trading practices on the Exchange effectively, the SEC should not require the NYSE to separate its regulatory unit from the rest of the Exchange. A good test of the effectiveness of the NYSE's new governance structure will be the thoroughness and expedition with which it investigates, reports, and punishes alleged misdeeds of some NYSE specialists that presently are under investigation. Also, until several issues concerning market structure regulation are resolved, it would be unwise for the SEC to require a major change in the structure of NYSE regulation at this time. The market structure that results from any reform can have a major effect on how regulation is organized.

One market structure issue involves the so-called "trade-through" rule, which requires that orders for NYSE-listed stocks be executed at the "best" displayed price over all marketplaces (even though this price may not be available for the contemplated trade size). The Intermarket Trading System ("ITS") was designed to implement this rule.

The Committee urges the SEC to repeal the trade-through rule. Many investors consider other attributes of trade execution, such as speed, anonymity, and the ability to execute a large order at a single price to be as important or more important than best price. Since ECNs generally provide faster execution and greater anonymity than the NYSE, the trade-through rule has the effect of impeding competition between the NYSE and ECNs.

The Committee is aware that the increased competition that would arise from repeal of the trade-through rule could cause fragmentation in the market for NYSE-listed securities. Some argue that such fragmentation would reduce liquidity in NYSE-listed stocks, thereby increasing trading costs. A more likely outcome is that one marketplace would emerge as dominant if there are significant benefits associated with consolidation of order flow. If, as the NYSE contends, it attracts most of the order flow in NYSE-listed stocks because of its superior liquidity and not because of the trade-through rule, then repeal of the rule would not result in a large diversion of order flow from the NYSE. Accordingly, the Committee recommends that the Commission repeal the trade-through rule. In addition, the Committee recommends that the ITS be abolished, since its sole purpose is to facilitate the implementation of the trade-through rule.