Regulation of Electronic Communications Networks: An Examination of Tradepoint Financial Network’s SEC Approval to Become the First Non-American Exchange to Operate in the United States

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Regulation of Electronic Communications Networks: An Examination of Tradepoint Financial Network's SEC Approval to Become the First Non-American Exchange to Operate in the United States

Elizabeth M. McCarroll*

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"The new electronic interdependence recreates the world in the image of a global village."1

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Introduction

One need not think long to realize the extent of technological innovations since 1934, the year Congress enacted the Securities Exchange Act. The advent of accessible, efficient, and inexpensive global communication systems has brought economic opportunities to even the most remote individuals. Once impenetrable markets now seem ready to be exposed. Electronic systems are the catalysts behind this new interconnectivity. In the past, it was necessary to have a physical trading floor to effectuate stock exchanges. This necessity has been obliterated in recent years with the success of the National Association of Securities Dealers Automated Quotations (NASDAQ)\(^2\) in the United States and the countless electronic brokerage systems that have proliferated over the past two decades. One analyst described it as a “siege,” postulating that “the trading systems have produced the greatest upheaval in the financial marketplace since the present structure arose from the ashes of the Depression.”\(^3\) These new trading systems are a cause of great concern among the traditional exchanges. Even NASDAQ, which was intended to exemplify the modern exchange, has been caught in a bind. Both NASDAQ and the NYSE have been losing trades to alternative trading systems (ATS) or electronic communications networks, as they are also known (ECN).\(^4\) It is no easy feat for these institutions to convert to the ECN framework. To “build an ECN . . . you need capital, and a self-regulated organization” such as NYSE and NASDAQ “doesn’t have an easy way to raise it and a corporation with stock does.”\(^5\)

Everyone involved in the markets realized that the potential for market linkage and cross-border trading through ECNs is seemingly without bounds. Nonetheless, U.S. market regulators continually have restrained this burgeoning of global inter-relatedness due to fear of U.S. investors' vulnerability in comparatively unrestricted foreign markets. The Securities


\(^3\) Id.

\(^4\) Id.
and Exchange Commission (SEC) is concerned that exposure to foreign stock exchanges will leave unsophisticated U.S. investors unprotected.

Though attempting to accommodate innovation, an inability to reach a consensus regarding the means of regulating ATSs$^6$ has plagued the SEC. Generally, the SEC has defined a trading system as "any system providing for the dissemination outside the sponsor and its affiliates of indications of interest, quotations, or orders$^7$ to purchase or sell securities, and providing procedures for executing or settling transactions in such securities."$^8$ ATSs simply accomplish these activities through an electronic format in which computers link buyers and sellers with matching quotes to effectuate sales.$^9$ These computer systems are capable of reaching a larger number of investors than traditional markets by conveying market information to a broader group of players.$^{10}$ This broad reach has contributed to the growth of such systems.

There are several ATS variations, each affording a slightly different benefit or format than the other. Some ATSs constitute an entire exchange while others operate under a single-price auction format.$^{11}$ Other ATSs are cooperative branches of an existing traditional floor exchange, either providing another mechanism for trades or extending trading hours past the
These systems diverge not only from traditional regulatory classifications but also from each other. As a result, the historical statutory scheme provides an unnatural fit when applied to ATSs. In the absence of an agreement on how to classify ATSs for regulatory purposes, the majority of ATSs have registered with the SEC as broker-dealers (BDs). Some suggested alternative means of regulation include registering ATSs as “registered exchanges or facilities thereof, and exempt exchanges.” An ATS can register as an exchange by filing under Section 6 of the Securities Exchange Act of 1934, whereas Section 5 of the Act provides a means by which entities can seek exemption from registration. Another element added to the debate over the method of regulating ATSs was a suggestion to reintroduce rule 15c2-10. This rule provides an additional regulatory classification wedged logically between the broker-dealer category and the exchange category, with requirements stemming from both traditional structures.

Instead, in December 1998, the SEC released its final rule on the regulation of exchanges and ATSs, in which the Commission adopted new rules

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12. Examples include: “Retail Automated Execution System (RAES) of the Chicago Board Options Exchange, Scorex of the Pacific Stock Exchange, and the after-hours crossing networks of the New York Stock Exchange (NYSE).” Domowitz, supra note 8, at 96.

13. See id. at 94; Silverman, supra note 6, at 6. See also Regulation of Exchanges and Alternative Trading Systems, SEC Release No. 34-40760, 63 Fed. Reg. 70844, 70845 (Dec. 22, 1998) [hereinafter SEC Release No. 34-40760]. “[A]ny person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank” is a broker. A dealer is any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business.

14. Domowitz, supra note 8, at 98.

15. See id. at 99.

16. See id.

17. See id.
and amended existing ones to "allow alternative trading systems to choose whether to register as national securities exchanges, or to register as broker-dealers and comply with additional requirements under Regulation ATS,\(^\text{18}\) depending on their activities and trading volume."\(^\text{19}\) "Reg ATS," as it is commonly known, took effect in 1999. Basically, it "allows alternative trading systems to actually become stock exchanges, giving them many of the benefits and responsibilities of the traditional exchanges."\(^\text{20}\) However, despite this agreement as to domestic ATSs, the SEC failed at that time to reach a consensus regarding U.S. investors' access to foreign markets via ATSs and postponed addressing the issue.\(^\text{21}\)

Though cross-border trading had been a topic of debate throughout the regulatory colloquy, one entity added to the immediacy of the issue in 1998 and 1999. Tradepoint Financial Networks plc (Tradepoint),\(^\text{22}\) an electronic exchange in the United Kingdom, applied for permission to operate "in" the United States and in March of 1999 attained it.\(^\text{23}\) It "asked the

18. Regulation ATS is the name which refers to the new market-oriented regulatory scheme adopted pursuant to SEC Release No. 34-40760. This Regulation determines the amount of regulation that is applied to a system according to a set of specifications. See infra note 19.

19. SEC Release No. 34-40760, supra note 13, at 70844. Regulation ATS breaks down its requirements into three levels. If a system has (A) "less than five percent of the trading volume in all securities it trades" it "is required only to: (1) file with the Commission a notice of operation and quarterly reports; (2) maintain records, including an audit trail of transactions; and (3) refrain from using the words 'exchange,' 'stock market,' or similar terms in its name." If however, the system has (B) "five percent or more of the volume in national market system securities" it must "be linked with a registered market in order to disseminate the best priced orders in those national market system securities displayed in their systems (including institutional orders) into the public quote stream." Finally, if a system has (C) "twenty percent or more of the trading volume in any single security, whether equity or debt" it "would be required to: (1) grant or deny access based on objective standards established by the trading system and applied in a non-discriminatory manner; and (2) establish procedures to ensure adequate systems capacity, integrity, and contingency planning." Id. at 70848.

20. Id, supra note 3, at A10. While 10 years ago the United States had only nine securities exchanges, some feel that due to Reg ATS, the United States "could theoretically have more than 20." This "[almost everyone agrees ... would be too many." Id. A corresponding increase in demand would not necessarily be present. See id. Similar concerns have been voiced about allowing a low-volume exemption to ATSs — that it may result in an unnecessary proliferation of exchanges. See infra note 167.


23. The Commission believes that an exchange operated offshore but targeting U.S. persons, which is owned or controlled, directly or indirectly, through a financial interest or otherwise, by a U.S. national securities exchange or national securities association, would be considered a U.S. market operated by an SRO. As such, it would be subject to Commission oversight. The Commission notes that Tradepoint, as a condition to this Order, has agreed that it is subject to the Commission's jurisdiction.

SEC to allow U.S. broker-dealers and institutional investors to have access to its trading system, but requested that it not have to register as a U.S. exchange because it [is] a 'low-volume' exchange."24 Historically, such direct trade access was barred by virtue of Section 30 of the Securities Exchange Act of 1934, which makes it unlawful for "any broker or dealer, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States. . . ."25 But, because the SEC determined that "it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require Tradepoint to register as a national securities exchange," the Commission granted the application for exemption.26

Trading on the Tradepoint system will be effectuated through a screen-based27 technology, creating a seamless market undisturbed by the Atlantic. Tradepoint's application for an exemption as a limited volume exchange sparked discussion not only as to whether it is prudent to allow such direct access to a foreign market, but also as to whether classification as an exchange is the best way for such a system to register in the United States.28 This exchange title continues to raise concerns regarding the proper nomenclature for such an entity. Similarly, the applicability of traditional exchange registration requirements, the adequacy of protection for investors, and the flexibility for future technological innovation have all been called into question.29

This Note will argue that while the Application for the low volume Section 5 exemption was wisely awarded by the SEC to open the door to Tradepoint, this registration option is not adequate for the future. It constrains growth by rewarding Tradepoint's low volume nature and fails to adapt to the improvements provided by the electronic system. Instead, the SEC must regulate the access provider through a new set of requirements.

24. Kentouris, supra note 22, at 21. The registration requirement is waived if "such exchange . . . is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration." Securities Exchange Act of 1934, § 5, 15 U.S.C. § 78e (1997) (emphasis added).
27. A screen-based system is one which operates solely on computers — there is no physical trading operation outside of the network. If it is permitted to operate in the United States, the Tradepoint system will be run on Bloomberg machines "or through a direct connection to the Exchange through an existing global private data network operator." SEC Release No. 34-41199, supra note 23, at 14955.
rather than attempting to fit systems such as Tradepoint into traditional classifications for regulatory purposes. The Note will examine the regulatory options the SEC can implement to supervise not only Tradepoint, but ATSs and ECNs in general.

Part I of the Note presents the background leading to Tradepoint's application for a Section 5 exemption. It discusses the definition of an exchange as well as the barriers that dissuaded foreign markets from attempting to register in the United States in the past. It also addresses the procedural regulations that historically have barred registration of foreign markets, the objectives and Congressional intent behind these regulations, and the possible need to alter existing guidelines to adapt to technological advances. Part II discusses the options which existed for the registration of Tradepoint. It examines the pros and cons, as well as the applicability of each regulatory means, in light of the procedural evolutions of the technological era. It also analyzes alternative proposals championed by individuals and firms in the field who have an interest in the SEC's decisions. Part III sets forth the proposition that while the Application's approval under the Section 5 exemption was the best course at this time, it should only be temporary in nature. This section details the unique characteristics of the system. It discusses what makes Tradepoint a desirable addition to the U.S. market and what contributed to the Application's success. The section argues that the SEC must create a new means of registration for Tradepoint, which can then be utilized by subsequent foreign and domestic systems. Part IV examines the future impact the SEC's decision will have on the registration of all ATSs, as well as the possibility of a proliferation of privately owned electronic exchanges, both foreign and domestic.

I. Tradepoint Applies for Registration as a Limited Volume Exchange

On November 20, 1997, Tradepoint filed an application with the SEC, seeking an exemption under Section 5 of the 1934 Act in order to avoid the requirements of registration as a national securities exchange. In doing so, Tradepoint sought to gain SEC approval to register as a limited volume exchange, becoming the first non-U.S. securities exchange to commence activity "within" the United States. As a recognized Investment Exchange under Section 37(3) of the U.K. Financial Services Act 1986 and a Regulated Market under the European Investment Services Act, Tradepoint launched its operations in the United Kingdom in 1995. Since then, it


has provided investors with an alternative to the London Stock Exchange (LSE).\textsuperscript{33}

Tradepoint functions as a screen-based, electronic order market. Unlike other exchanges, Tradepoint does not list securities. Instead, it facilitates trading of LSE securities.\textsuperscript{34} However, Tradepoint's management believes that the enterprise can develop into a far more expansive electronic market, hopefully dealing in U.S. and foreign securities in the future.\textsuperscript{35} In the United States, Tradepoint seeks to offer a public market for registered securities and a separate, Qualified Institutional Buyer\textsuperscript{36} market which would offer unregistered securities.\textsuperscript{37} At present, the functions Tradepoint provides are largely inclusive. According to the narrative the SEC articulated in its Release No. 34-40161, Tradepoint:

provides to its Members\textsuperscript{38} an electronic, order-driven\textsuperscript{39} market that handles order entry and management, information display, matching, execution, and
immediate trade publication and settlement message routing. Members are able to access the current market position in any security traded on the Exchange; monitor selected market information provided by the Exchange in real time; enter or revise orders; send orders to the relevant instant auction and/or periodic auction books for execution . . . set up, access, and request trading and market reports; and input settlement routing instructions.

Additionally,

Members of the Exchange are also able to enter ‘cross trades.’ Cross trades between two customers of the same firm at a price between the bid and offer. To effect a cross trade, a Member will simultaneously enter a bid and an offer for a security, which will match after exposure to the electronic order book.

Under Tradepoint’s recent Section 5 approval, U.S. Members will be able to join the exchange in a manner similar to that of its current members. However, because of the unique U.S. securities laws, “the Exchange will offer two different levels of service — one for all U.S. Members (‘Public Markets’) and one limited to U.S. Members who are ‘qualified institutional buyers’ (‘QIBs’) as defined in Rule 144A of the Securities Act of 1933 . . . .” Also, as part of the arrangement, the system “has agreed to amend its market rules and member agreement to include provisions that expressly preserve a U.S. Member’s anti-fraud protections under the federal securities laws.”

there are “more than 80 members . . . .” SEC Approves Tradepoint to Enter U.S., supra note 34.

Traditionally, “order-driven” markets are ones in which a specialist, “an exchange member who is permitted to act both as broker on behalf of customers and as a dealer in his own account, responds to orders and seeks to match buyers and sellers.” Such a system differs from a “quotation-driven” system within a “dealer” market. In a dealer market,

virtually every trade goes through a professional dealer, or market maker, who continually publishes bids and offers in the securities in which she is registered.

While trades are executed not in a central location but by telephone or telex between the offices of brokers and dealers, prices are established through competition among market makers. The over-the-counter market has been called a ‘quotation-driven’ system, in that investors respond to prices quoted by market makers.

Poser, supra note 2, at 39-40.  

The SEC recently added “for certain securities listed on the LSE” to its description after the word “routing.” SEC Release No. 34-41199, supra note 23, at 14954.

SEC Release No. 34-40161, supra note 29, at 37197. In addition, “[t]he minimum display size for any order is 1,000 shares. The Exchange does not provide a facility for ‘reserve’ orders . . . and is completely anonymous.” SEC Release No. 34-41199, supra note 23, at 14954.


Id. This includes provisions which cover disputes.  

A court or tribunal with jurisdiction over any dispute arising out of or in connection with a transaction made on the Exchange shall apply the U.S. federal securities law statutes to any cause of action based upon fraudulent acts or omissions that either (a) occurred in the United States or (b) resulted in damages suffered in the United States.

SEC Release No. 34-41199, supra note 23, at 14958. It is also interesting that “[a]lthough the Exchange’s market rules and member agreement require members to
Coming in the wake of the SEC's Concept Release on Exchange Regulation\(^5\), which focused primarily on the coordination of ATSs, Tradepoint's application fueled the debate over the regulation of electronic systems. With the Release in 1997, the SEC sought commentary on the manner in which it should regulate ATSs. Recognizing the unique and new characteristics of these systems, the SEC wished to react to these innovations in an appropriate manner.\(^6\) The SEC imparted various regulatory proposals such as classification of ATSs as BDs\(^7\) and the regulation of the access provider itself. Yet, Tradepoint's filing as a low volume exchange seemingly circumvented the controversy by taking advantage of an option not available to other foreign exchanges.\(^8\)

A. What is an Exchange in Regulatory Terms?
Tradepoint's application elicited its own SEC release and subsequent comment period. At the root of this discussion was the simple, but not easily answered, question of what is an exchange. Traditionally, the definition in the 1934 Act served as the standard.\(^9\) It states that an exchange is:

> [a]ny organization, association, or group of persons . . . which constitutes, maintains, or provides a market place of facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to arbitrate their disputes in England, the Commission believes and expects that English arbitrators and courts will follow the above requirements and interpret and apply the U.S. federal securities laws as defined above." \(^{10}\)  

46. An appropriate manner will provide the traditional protections investors have come to expect, while also allowing innovation and growth. Some question the sincerity of this aim. SEC Release No. 34-40760, supra note 13, at 70846. The Commission encapsulated its aim in its final ruling on ATS regulation: "[T]he Securities and Exchange Commission is adopting a regulatory framework for alternative trading systems, to strengthen the public markets for securities, while encouraging innovative new markets." \(^{11}\) Id. at 70845. It later continued:  
The Commission believes that its regulation of markets should both accommodate traditional market structures and provide sufficient flexibility to ensure that new markets promote fairness, efficiency, and transparency. In adopting a new regulatory framework for alternative trading systems today, the Commission has incorporated suggestions and responded to requests for clarification made by commenters. The Commission believes that this regulatory approach effectively addresses commenters' concerns while carefully tailoring a regulatory framework that is flexible enough to accommodate the evolving technology of, and benefits provided by, alternative trading systems. \(^{12}\) Id. at 70846. In summary, the SEC that the "regulatory framework" they wish to establish, "should encourage market innovation while ensuring basic investor protections." \(^{13}\) Id.  
47. See supra note 13 for definitions of the terms broker and dealer.  
securities and the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such an exchange.\textsuperscript{50}

Today, the SEC's definition of an exchange changed to a more fundamental one to include "only those entities that enhance liquidity in traditional ways through market makers, specialists, or single price auction structure."\textsuperscript{51} This definition proved troublesome for Tradepoint since it operates without either market makers or specialists.\textsuperscript{52} Allowing Tradepoint to register under a fictitious label would expose the inherent conflict in the current definition without resolving the ultimate issue of how to regulate electronic systems. Anticipating this conflict, the 1997 SEC Release proposed to register an ATS as an exchange, where an exchange is "an organization that both (a) consolidates orders of multiple parties, and (b) provides a facility through which, or sets material conditions under which, participants entering such orders may agree to the terms of a trade."\textsuperscript{53}

In December 1998, the SEC published its latest regulation, Rule 3b-16, which once again altered the meaning of "exchange" under Section 3(a)(1) of the Exchange Act. Now, an exchange "(1) brings together the orders of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade."\textsuperscript{54} It appeared that Tradepoint fell within the confines of the new definition.

B. Historic and Continuing Barriers to Registration as an Exchange

In the past, many obstacles dissuaded foreign exchanges from pursuing registration in the United States. Computers have eliminated some of the obstacles, but many remain.\textsuperscript{55} Regulatory barriers create the chief problem for most foreign exchanges. As Stephen Wilson of Tradepoint observed, the London or Paris stock exchange could not use the limited volume exemption "because by definition you can't be a low volume exchange and be the dominant player in the market."\textsuperscript{56} However, newcom-

\begin{itemize}
\item \textsuperscript{51} Macey & O'Hara, \textit{supra} note 49. In addition to providing liquidity, "exchanges offer monitoring of exchange trading, standard form, off-the-rack rules to reduce transaction costs for investors, and a signaling function that serves to inform investors that the issuing companies' stock is of high quality." \textit{Id.}
\item \textsuperscript{53} Blanc, \textit{supra} note 32, at 28.
\item \textsuperscript{54} SEC Release No. 34-40760, \textit{supra} note 13, at 70847. The SEC explains that "Rule 3b-16 explicitly excludes those systems that the Commission believes perform only traditional broker-dealer activities." \textit{Id.} Therefore, if a system only routes orders, operates the bids and offers of merely one market maker or offers a forum for an individual to place orders against a single dealer, it is not included in Rule 3b-16's definition of an exchange. See \textit{id.}
\item \textsuperscript{55} See Ip, \textit{supra} note 48, at A6.
\item \textsuperscript{56} \textit{Id.}
\end{itemize}
ers such as Tradepoint may use the exception for registration. In addition, economic considerations posed a formidable impediment to foreign exchanges in the past. Before recent electronic innovations, a foreign exchange would have had to provide and operate a physical trading floor in the United States—a feat that could not be accomplished cost-effectively from abroad. The extensive regulation of exchanges by the SEC created another hurdle. In order to register as an exchange without a Section 5 exemption, a prospective exchange must navigate through an arduous series of obstacles. This process continues to be unfeasible for most foreign exchanges.

C. Regulatory Objectives

Why must we have such regulation if it encumbers registration and reduces direct access to foreign securities by U.S. investors? Jonathan R. Macey and Maureen O’Hara offer three reasons why regulation is necessary. First, the authors point to “the problem of incomplete contracts.” As they explain, the cost of contracting is expensive. Securities laws lessen this cost and allow market participants to engage in transactions “for free” since the laws provide standard contractual terms. Second, regulation facilitates

57. While a foreign exchange has never employed this tactic, the U.S. Arizona Stock Exchange has. The Arizona Stock Exchange (AZX) is a fully automated single-price auction market that facilitates secondary trading of certain registered equity securities by broker-dealers and institutional participants. It is the only stock exchange currently operating under a limited volume exemption from exchange registration. AZX participants enter limit orders through terminals in their offices. Bids and offers are displayed in the order books, which participants can view on their screens. Prior to a preestablished cut-off time, participants may replace or cancel orders. Within seconds after the auction cutoff time, the system reviews all orders with respect to each security and determines the price at which the volume of buying interest is closest to the volume of selling interest. That price will be the ‘auction price.’ Participants that have entered bids at or above and offers at or below the auction price will be entitled to execution at the auction price on the basis of time priority. Orders matched in the auction are executed by a registered broker-dealer pursuant to a contract with AZX. AZX operates two after-hours auctions and recently obtained Commission approval to operate a single auction during regular trading hours. AZX also allows participants to enter pre-matched orders into its system; these orders are then routed directly for auction.

Landauer & King, supra note 11, at 474-75. In granting the AZX its low-volume exemption, “the Commission used the volume levels of the fully regulated national securities exchanges at that time as the benchmark for low volume for AZX.” SEC Release No. 34-41199, supra note 23, at 14956.

58. See Letter from Bloomberg, supra note 28, at 2. Bloomberg has a direct stake in this regulatory debate since “[o]utside the United States, Bloomberg provides to institutional customers and others the ability over the BLOOMBERG service to trade on Tradepoint Investment Exchange.” Id. If Tradepoint received approval by the SEC, U.S. investors could only access Tradepoint via Bloomberg terminals, though the possibility remains that in the future others may be able to provide such access. See SEC Release No. 34-40161, supra note 29, at 37147.

59. Macey & O’Hara, supra note 49.

60. Id. “For free” means that no negotiation costs are incurred as a standard contract already exists.

61. See id.
enforcement mainly through surveillance of the market. This is necessary in order to minimize fraud and manipulation. Third, the authors assert that regulation protects third parties from the “externalities” that result from the two contracting parties. Despite the general justification for regulation, it remains unclear whether ATSs provide additional reasons for increased regulation.

Congress' intent behind Section 11(a) of the 1934 Act was the “centralization of all buying and selling interest so that each investor has the opportunity for the best possible execution of his or her order, regardless of where the investor places the order.” Congress established the SEC mainly to regulate market transactions and to prevent manipulation and excessive speculation which could cause national emergencies. It has charged the Commission to pursue efficiency, fair competition, trans-

62. See id.
63. See id. Minimizing fraud and manipulation of the market is among the SEC's outlined goals as mandated by Congress, which specifically requires fairness and transparency. The Securities Exchange Act of 1934 addresses manipulation in two different sections. Section 9 is the Prohibition Against Manipulation of Security Prices, while § 10, the best known of the manipulation and fraud provisions, is termed Regulation of the Use of Manipulative and Deceptive Devices. Section 10 states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange — (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

64. See Macey & O'Hara, supra note 49.
65. See id. Technology has afforded the SEC a better ability to monitor trading. However, in the SEC's final ruling regarding regulation of ATSs, the Commission discussed its concerns as to why ATSs do present unique justifications for additional regulation. Focusing mainly on the private versus public formation of ATSs, the SEC is concerned over the formation of a private market that developed only because the activity on alternative trading systems is not fully disclosed, or accessible to public investors. Moreover, these trading systems have no obligation to provide investors a fair opportunity to participate in their systems or to treat their participants fairly. These systems may also not be adequately surveilled for market manipulation and fraud. . . . In addition, alternative trading systems have no obligation to ensure that their systems are sufficient to handle rapid increases in trading volume as occurs in times of market volatility, and at times they have failed to do so.

SEC Release No. 34-40760, supra note 13, at 70845.
parency, access to the best prices, and an opportunity for investors to execute orders without a dealer.\textsuperscript{69} Tradepoint meets with these goals.

By creating an alternative to buying and selling through the LSE, investors will reap the benefits of this newly established competitive market.\textsuperscript{70} Already, “[a]nalysis shows that 86% of buyers and 82% of sellers beat the LSE spread.”\textsuperscript{71} The LSE will be forced to improve its services to fend off its adversaries, and costs should drop since the LSE will no longer be a monopoly. With the additional flexibility gained by the Commission since 1996, Tradepoint’s entry did not appear to pose a conflict of interest.\textsuperscript{72} If the aim of regulation is to achieve the best opportunities for investors and reach the SEC’s five stated pursuits, then Tradepoint specifically and ATSs generally seem to require no additional regulation.

The 1997 SEC Release regarding ATSs elicited similar concerns as those evoked by the Tradepoint Release. Still, the service Tradepoint provides appears to be consonant with the Commission’s objectives listed above. One commentator applauded “[t]he linking of all markets for qualifying securities through communication and data processing facilities” as it would “foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors’ orders, and contribute to best execution of such orders.”\textsuperscript{73} Tradepoint

\textsuperscript{69} See Macey \& O’Hara, supra note 49.

\textsuperscript{70} I believe there are also wider advantages to be gained from the existence of competition between exchanges and trading mechanisms in encouraging a better service for customers, particularly in the context of the dominating market share in the trading of U.K. equities held by the LSE. These are advantages which the SEC has recognized in its policy making in the domestic U.S. market. Letter from Anthony Neuberger, Institute of Finance and Accounting, to Jonathan G. Katz, Secretary of the Securities and Exchange Commission (July 9, 1998) <http://www.sec.gov/rules/other/f10-101/neuberg2.text> [hereinafter Letter from Neuberger]. See also Jeremy J. Siegel, Manager’s Journal: The SEC Prepares for a New World of Stock Trading, WALL ST. J., Sept 27, 1999, at A34:

If the SEC mandated this centralization of order-flow, competition would significantly enhance investor choice and the quality of the trading environment. ‘If barriers to competition did not exist, then neither would the need, in many respects, for regulatory involvement,’ said Mr. Levitt — a remarkable statement from a man who heads a regulatory agency.

\textsuperscript{71} Chris Gregory, Comments: Tradepoint: Unique Service in the USA (Apr. 1999) <http://www.tradepoint.co.uk/newslet_apr99_3.html>. For example, “[o]ne Member saw total price improvement over the prevailing LSE best bid/ask of over £46,000.”\textsuperscript{72} Id. In 1996, Congress provided the Commission with greater flexibility to regulate new trading systems by giving the Commission broad authority to exempt any person from any of the provisions of the Securities Exchange Act of 1934 . . . and impose appropriate conditions on their operation. This new exemptive authority, combined with the ability to facilitate a national market system, provides the Commission with the tools it needs to adopt a regulatory framework that addresses its concerns about alternative trading systems without jeopardizing the commercial viability of these markets.

SEC Release No. 34-40760, supra note 13, at 70846.

provides a step in this direction. Though the LSE has been able to operate without competition for decades, innovation will force it to improve its services. This is desirable because “competing market centers should be able to compete for participants and order flow on the basis of cost, service and innovation.”

The concerns regarding Tradepoint have been twofold. There is concern regarding Tradepoint’s similarity to ATSs and apprehension about exposing U.S. investors to foreign markets. The latter concern continues to be the strongest. In SEC Release 34-38672, the SEC expressed concern that the discrepancies between U.S. and foreign regulations may “have the potential to mislead U.S. investors that have come to rely on U.S. securities laws.” At the time of this Release, registration of ATSs as exchanges was an unpopular option. Instead, the main proposal was to police the access provider. This general form of supervision could itself take various forms. If the ATS were to engage in brokerage activity, it could register as a BD but could comply with the disclosure requirements of a Securities Information Processor (SIP). If it did not participate in traditional broker-dealer activities, it could merely register as a SIP. The SEC believed that both of these classifications provided the desired and necessary protections investors investing in foreign securities required.

Most of the alternatives suggested for regulating foreign market activity, and, more specifically, the activity of Tradepoint, were unsuitable. Because all of the traditional BD requirements were not necessarily applicable to an electronic system, an amended procedure would have to be adopted. From an administrative point of view, such a procedure is taxing as each entity would tailor exactly how they classify their activities for the purpose of circumventing certain requirements. However, prior to the Tradepoint approval, a “functional” approach had evolved into the SEC’s favored method of regulating domestic ATSs. Using entities’ activities and trading volume as the benchmarks for registration, domestic ATSs could be classified as either broker-dealers or exchanges. Regulation ATS is at

75. Insecurity due to the concern regarding this similarity is evidenced by SEC Release No. 34-38672, supra note 45.
76. See id. at 12.
77. Sam Scott Miller et al., Tethering Technology: The SEC’s Market Structure Concept, INSIGHTS 10 (Sept. 1997).
78. See SEC Release No. 34-38672, supra note 45, at 30987.
79. See id.; see also Miller, supra note 77, at 10. A SIP is a Securities Information Processors under § 11A of the Securities Exchange Act.
80. However, some feel registration as a SIP would just apply a new set of regulatory burdens on ATSs that may discourage innovation and would not necessarily eliminate the problems cross-border trading may create. See Miller, supra note 77, at 10.
81. See SEC Release No. 34-38672, supra note 45, at 30488 (discussing “adequate protections to U.S. investors trading on foreign markets . . . .”.
82. See SEC Release No. 34-40760, supra note 13, at 70844.
83. This is the name given to the SEC’s functional approach. See notes 18-20 and accompanying text.
the heart of this change and its vulnerability to manipulation seems apparent.

II. Regulatory Options and Regulation ATS

The five suggested regulatory classifications of ATSs are: (1) broker-dealer, (2) exchange, (3) exempt-exchange, (4) access provider, or (5) unregulated entity.\textsuperscript{84} The SEC classified Tradepoint as an exempt-exchange but this should solely be seen as a temporary measure. While Tradepoint currently fulfills the low-volume criteria, this has the potential to change over time and the SEC should not oppose such a development. The “functional” approach the SEC extended to domestic ATSs, using activities only as determinants as to whether any entity should be regulated as a BD or an exchange, is not a sufficient solution to the regulatory dilemma Tradepoint presents. Nor is the SEC’s low volume exemption a sufficient solution. The former contrives to force new electronic entities such as Tradepoint into dated pigeonholes, while the latter punishes growth by using volume as a criteria for whether an ATS must undergo the lengthy and cumbersome procedure of registering as an exchange. Furthermore, by postponing a ruling on U.S. investors’ access to foreign securities via ATSs, and by approving the Tradepoint Application without a broader statement regarding foreign ATSs, the SEC revealed its hesitancy as to the broad application of its functional regulatory approach. A new access provider registration procedure must be established in order to allow for innovation and cross-border growth. To understand why a new classification is necessary, a description of the various alternatives follows.

A. Registration as an Exchange

In order to obtain exchange status, an entity must register under Section 6 of the Securities Exchange Act of 1934.\textsuperscript{85} This procedure is relatively complicated as compared to registration as a BD.\textsuperscript{86} While Section 5 of the Act provides an exemption for entities subject to Section 6’s registration

\textsuperscript{84} Oddly, according to Benn Steil, Director of the International Economics Programme, “[a]ll natural economic distinctions between stock exchanges and broker-dealers have broken down . . . . Exchanges and brokers are now doing exactly the same thing.” Additionally, “Steil expects America’s big stock markets to follow the lead of the Stockholm and Sydney exchanges, where the silent screen has replaced the open outcry.” Alpert, supra note 13, at 19.

\textsuperscript{85} See Domowitz, supra note 8, at 98.

\textsuperscript{86} See id.

The first step in the registration of an exchange is the filing by the exchange with the Securities and Exchange Commission of a registration statement. This registration statement must be in the form prescribed by the Commission and must contain: (1) An agreement by the exchange to comply with the Act and enforce compliance by its members, which is discussed in greater detail below. (2) Data as to the exchange’s organization, rules of procedure and membership, and other information which the Commission may require. (3) Copies of its constitution, articles of incorporation, by-laws, rules, etc., and (4) An agreement to furnish the Commission with all amendments to the documents referred to in paragraph (3).
requirements due to their low volume status, these vehicles are still considered "exchange." The applicability of this exemption to Tradepoint and similar ATSs is a primary cause of concern. Benn Steil, Director of the International Economics Programme, argues that a decision by the SEC to permit Tradepoint to register as an exempt exchange, despite its continued bar on foreign exchanges registering under Section 6, would be "fundamentally flawed" since "there is no basis for the underlying assumption that U.S. investors are better protected when trading on a less liquid trading system than they would be trading on a more liquid one."87 Less liquidity does not ensure a safer environment for investors.88

Furthermore, one can argue that the low-volume exemption does not create a solid precedent for future foreign electronic system candidates because it only applies to small exchanges89 and is vague even within its own narrow application.90 This is because Section 5 fails to articulate a set criterion to determine what constitutes "limited volume."91 The SEC has attempted to address this failure by proposing certain guidelines by which Tradepoint's volume would be measured.92 Resulting from the difference in share price and volume between the U.S. and U.K. markets, the Commission recognizes that Tradepoint's average daily volume in London may not reflect the numbers it would reach in the United States. Therefore, the SEC has proposed to use "dollar value as a benchmark for volume, rather than average daily number of shares traded" since that will "more appropriately

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Meyer, supra note 25, at 44.


88. Many feel the world's most liquid market, the U.S. government bond market, is also the world's safest. See Rich Miller & Beth Belton, Dow Soars on Rate Cut Fed Psychology: Prevent Havoc of Lost Confidence, USA TODAY, Oct. 16, 1998, at 1B.

89. Other foreign markets would be unable to copy this means of entering the U.S. system. See Ip, supra note 48, at A6.

90. According to the Securities Exchange Act of 1934, § 5, the exemption applies to exchanges of limited-volume, but it remains unclear as to which exchanges can qualify as such.

91. The guideline which was used to determine whether the Cincinnati Stock Exchange constituted a low volume exchange was "the volume of the smallest of the fully regulated national exchanges." Domowitz, supra note 8, at 99. This exchange averaged 717 trades per day with a daily share volume of 1,238,241 in 1990. See id. at 99 n.20.

92. See SEC Release No. 34-40161, supra note 29, at 37148-49. When discussing the "Exemption Standards" for Tradepoint, the SEC noted that the Exchange is a low-volume market in the U.K. since its volume was "significantly less than one percent of the LSE's average daily volume." The standard used to measure securities transactions and "overall market activity" is "the monetary value of trading." Seeing as "[i]n the U.K., share prices are roughly one-seventh of what they are in the U.S. for a comparable security," the SEC therefore detailed the adjusted measures that it would have to utilize to measure activity if operating in the United States. Id. at 37149.
reflect the difference in dollar value between U.S. and U.K. markets, and the difference in the way trading is measured in the U.K.\textsuperscript{93}

Possible manipulation of regulatory procedure by trade entities is another issue surrounding the exchange status debate. By allowing the Section 5 exemption and not simultaneously stating that it is to be considered a temporary solution, Steil feels the SEC is effectually "promoting regulatory arbitrage."\textsuperscript{94} Tradepoint's application itself is a signal of such regulatory circumvention. If a foreign ATS cannot achieve Section 6 status, does not want to be a BD, or cannot be considered one since BD services are not the crux of its operations, perhaps Section 5 is the path to follow. If the Commission does not set a strict standard, it is only rational for trading systems to pursue the least burdensome means of regulation. Moreover, if classification determines whether an entity can operate in the U.S. market, applicants will seek a label that allows entry into that market. As this Note will examine later, this concern over manipulation can likewise be raised if the SEC were to pursue the functional approach it already has applied to domestic ATSs.

While Tradepoint achieved a Section 5 exemption, it is also necessary to examine how a larger volume ATS might pursue the standard exchange registration course under Section 6. Though Section 6 applies to "national exchanges,"\textsuperscript{95} one must postulate how a foreign exchange could follow this regulatory path in the future. If Tradepoint achieves the exchange exemption and operates "in" the United States, it would be extremely difficult to argue that larger, well-managed electronic systems cannot do likewise despite the historic bar to such activity.

The bureaucratic procedures outlined in Section 6 are rather extensive. Among the administrative critiques are complaints that "(i) it takes too long to register as an exchange; (ii) the statutory protections for ATS exchanges may well prove insufficient; and (iii) the process of implementing rule changes is unduly cumbersome."\textsuperscript{96} After filing an application to become an exchange, applicants often wait two years before attaining the SEC's decision.\textsuperscript{97} In the fast-paced securities world, the opportunity cost of two years of inactivity could be devastating. Such administrative delay is antithetical to the aim of diminished system congestion which lies at the heart of the ATS movement. The additional concerns the SEC has regarding foreign securities trading could even extend the waiting period beyond two years.

\textsuperscript{93} Id.

\textsuperscript{94} Letter from Steil, \textit{supra} note 87, at 2. "Regulatory arbitrage" is the phrase Steil uses to describe what he believes would be the eventual outcome of a decision to allow Tradepoint to enter the United States under a low-volume exemption. Steil suggests that "[i]f rather than create a formalized structure for promoting regulatory arbitrage between National Securities Exchange (NSE) and ATS classifications, I believe that the Commission needs to consider seriously a much different approach." \textit{Id}.


\textsuperscript{96} Letter from Bloomberg, \textit{supra} note 28.

\textsuperscript{97} See \textit{id}.
Several critiques of exchange classification for an ATS generally exist. Macey and O’Hara enumerated the problems. First, the trading of NASDAQ securities would no longer be an option for the entity if classified as an exchange. It could only engage in such conduct if admitted to the NASDAQ/National Market System unlisted trading privileges plan, and even then it would be barred from trading other unlisted securities. This would be problematic as liquidity would be reduced. Second, requiring an ATS “to assure regulatory oversight of [its] participants” if classified as an exchange would “add needless costs and uncertainty to the business of providing alternative trading systems without increasing the quality of surveillance currently provided by exchanges and other self-regulatory organizations.” Third, because ATSs would also be required to “join market-wide plans to coordinate [their] activities, quotations and trade reporting with other firms,” much of the electronic benefits would be lost. Such coordination not only would diminish the value of its services but would also curtail its order capacity. This is neither desirable to management nor consonant with innovation. Fourth, the authors show that under current exchange requirements, the corporate governance framework of an ATS would have to be completely overhauled (i.e., changed from a proprietary firm to a “member owned” firm “with public representation on the board”) in order to achieve exchange status. Such a redesign seems not only needless and costly, but would “undermine the ability of ATS to develop and innovate.” In its current state, exchange classification is a most maligned regulatory avenue for ATSs.

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98. See Macey & O’Hara, supra note 49. In addition to the problems Macey and O’Hara suggest exchange classification would have, they briefly set out additional arguments against such registration. They argue that under an exchange classification, ATSs would be (1) unable to protect their customers property rights in information; (2) unable to solve the conflict of interest problems that exist within firms that act simultaneously as brokers and dealers; and (3) unable to innovate to further improve market conditions by reducing the transactions costs associated with secondary market trading. See id.

99. See id.

100. See id.

101. See id.

102. Id.

103. Id. See also supra note 19 for the requirements of Regulation ATS, describing the coordination requirement for ATSs that trade “five percent or more of the volume in national market system securities.”

104. Its capacity would be lessened as its ability to handle orders would decrease. See Macey & O’Hara, supra note 49.

105. Id.

106. Id.

107. The list of critiques of exchange classification for Tradepoint, and ATSs in general, is extensive. One additional critique that Bloomberg L.P. offered in its August 28, 1998 letter is that as an exchange, an ATS would lose many statutory protections it now enjoys, including effective appeals to the Commission and the federal courts based on statutory protections provided to exchange members and members of the NASD under the Exchange Act. In place of those protections, the ATS would have only the uncertain and amorphous protections from, e.g., predation by other market centers, that might be afforded it as an Intermarket Trading System (ITS).
Some commentators feel that if Section 6 exchange status is the route the SEC chooses to apply to ATSs, registration requirements for such electronic exchanges must be amended in order to remain consistent with the SEC's ultimate goals of efficiency and openness to innovation. In addition to revising the existing framework in order to alleviate the shortcomings and bureaucratic impediments mentioned above, Bloomberg L.P. has presented various additional amendments which, in its opinion, should be made to the exchange format. Roger D. Blanc has advocated four main "adjustments and exemptions from current exchange regulation" which "should be implemented":

(i) a for-profit ATS should not have enforcement powers or duties with respect to the business conduct of its participants, which are essentially its customers;

(ii) institutional participants should be exempted from the requirement, applicable generally to exchange members, that they register as broker-dealers or organize brokerage affiliates to act as the participants on the ATS "exchange";

(iii) limitations on members' (i.e., participants') trading under section 11(a) of the Exchange Act should be relieved; and

(iv) with respect to treatment of foreign securities, issuers should not be required to register under section 12 of the Exchange Act so long as the audience for an ATS is limited to institutional investors and broker-dealers, because these entities are allowed to purchase foreign securities in an initial sale under Rule 144A of the Exchange Act. (emphasis added).

These suggestions appear to be reasonable, especially in light of the institutional investor element. Fewer protections are necessary since institutions generally are more sophisticated than individual investors, able to weigh risks and judge possible effects on its income, and often are already regulated by governmental agencies other than the Commission due to their unique nature. Regardless of the institution's actual success in its market involvement, these corporate entities certainly do not need the expensive protective services of the SEC. Suggestion iv is most pertinent to Tradepoint's application. The SEC has demonstrated concerns

See Letter from Bloomberg, supra note 28.
108. See supra notes 46 and 63 regarding the SEC's goals.
109. See Blanc, supra note 32, at 26, 29.
110. Id. at 30, 31. Section 12 of the Exchange Act, Registration Requirements for Securities. Rule 144A (4)(i) permits such foreign trading:

In the case of securities of an issuer that is neither subject to Section 13 or 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) (Section 240.12g3-2(b) of this chapter) under the Exchange Act, nor a foreign government as defined in Rule 405 (Section 230.405 of this chapter) eligible to register securities under Schedule B of the Act, the holder and a prospective purchaser designated by the holder have the right to obtain from the issuer, upon request of the holder. . . .

111. Institutional investors include insurance companies, pension funds, banks. See Blanc, supra note 32, at 31.
112. See id.
beyond that of domestic ATSs when considering a foreign ATS’s status. Once again, Blanc highlights the institutional investor aspect of foreign market access providers, repeating his endorsement of a hands-off regulatory policy when dealing with these market savvy investors.

B. Registration as a Broker-Dealer

At present, the majority of ATSs are registered as broker-dealers.\footnote{113}{See Silverman, supra note 6, at 1. See also note 13.} While they “must register with the SEC\footnote{114}{Registration as a BD is required under Section 15(a)(1) of the Securities and Exchange Act of 1934. Section 15(b) describes the procedure for filing, while Section 15b1-1 details the application process as follows: “(a) An application for registration of a broker or dealer filed pursuant to Section 15(b) shall be filed on Form BD in accordance with the instructions.” Securities Exchange Act of 1934, § 15b, 15 U.S.C. § 78o-4.} and become a member of [a] self-regulating organization (SRO),”\footnote{115}{Domowitz, supra note 8, at 98.} the registration requirements for BDs are less burdensome than those for exchanges.\footnote{116}{See id.} This is because BDs are free from real-time market surveillance and exempt from the SEC’s Automation Review Policy.\footnote{117}{See id.} Since registration procedures for BDs are comparatively lenient, many seek BD status, at least while awaiting registration as an exchange.\footnote{118}{See Letter from Bloomberg, supra note 28.} However, as many applicants have come to realize, the process of becoming a registered BD can “be an extremely expensive process of filing and refiling applications and rules.”\footnote{119}{Id. The following BD registration requirements help illustrate why the process is exhaustive. In addition to registering with the SEC, many BDs also file with the NASD. The NASD requires a signed and notarized registration form (Form BD), Applicant Certification Form, Form U-4s and fingerprint cards for each employee who is required to be registered as an agent or principal due to their activities, New Member Assessment Reports, Firm Contact Questionnaire, a check or money order for the appropriate exam and fingerprint fees as well as a series of informational and documentation requirements as outlined in Rule 1013(a)(2) of the NASD’s Membership Proceedings. In brief, the applicant must provide detailed business plans, description of financial controls and description of supervisors and principals. The list of information required is extensive since it requests very specific information. In addition to SEC, NASD, and state requirements, “[c]ertain broker/dealers will be subject to federal statutory provisions requiring them to become members of SIPC. . . . All non-bank broker/dealers registered with the SEC that conduct their principal business within the United States, its territories, or possessions must become members of the Securities Investor Protection Corporation (SIPC).” National Association of Securities Dealers, Inc., How to Become a Member of the National Association of Securities Dealers, Inc. (visited Nov. 8, 1999) <http://www.nasrd.com/4700toc.html> [hereinafter How to Become a Member].} While many of the state requirements are similar to those of the NASD and SEC, “many state regulating agencies require that applicants provide additional documentation
and information directly to their offices to fulfill their application requirements."\(^\text{121}\) For a BD with agents in multiple states, especially an electronic BD that could easily be active in all fifty states as well as the District of Columbia and U.S. territories, the state registration procedure can become a seemingly endless bureaucratic process. Because of this, many advocate modification of the BD regulatory procedure in the hope of achieving a less onerous process. Among the suggested modifications is the elimination of various filing requirements which some deem inapplicable to ATSs.\(^\text{122}\) These requirements include, among other items, the submission of FOCUS\(^\text{123}\) reports and the maintenance of a specific net capital requirement.\(^\text{124}\)

C. SEC's Domestic-Functional Approach: Choice between Exchange and Broker-Dealer Status

Ignoring alternate proposals that will be examined in the following sections, some see only a choice between BD and exchange regulatory status for domestic entities akin to Tradepoint.\(^\text{125}\) To determine which classification should be applied to ATSs dealing in domestic securities, the SEC advocates and has now codified a functional approach. Under this system, "activities" and "trading volume" are to act as the determining characteristics in the choice between BD and exchange status.\(^\text{126}\) While at present the SEC has only set this procedure for domestic ATSs, a similar ruling could easily have applied to Tradepoint-like systems. Many advocated a similar approach to the SEC, in which regulation is "based on functional attributes of a trading market"\(^\text{127}\) rather than an entity simply assuming a title. Under this looser approach, an entity's functions do not determine whether or not an ATS is a BD or an exchange for regulatory purposes, but rather the functions themselves determine what monitoring is necessary. This method will be termed the 'purely functional' approach.

Proponents of the purely functional approach, as opposed to the functional solution, cite as one of its benefits that "rather than on the basis of some arbitrary technical categorization, firms [would] be able to select the

\(^{\text{121}}\) Id.

\(^{\text{122}}\) See id. for details regarding the suggested means of alleviating the BD registration process. See also note 119 for discussion of the extensive BD registration requirements.


\(^{\text{124}}\) See Letter from Bloomberg, supra note 28.

\(^{\text{125}}\) See SEC Release No. 34-40760, supra note 13, at 70844. In the SEC's summary regarding "Regulation of Exchanges and Alternative Trading Systems," the Commission stated that it was "adopting new rules and rule amendments to allow alternative trading systems to choose whether to register as national securities exchanges, or to register as broker-dealers and comply with additional requirements under Regulation ATS . . ." Id.

\(^{\text{126}}\) See id.

\(^{\text{127}}\) Domowitz, supra note 8, at 95.
precise services they wish to offer." The purely functional approach would appear to quash the practice of classification manipulation. This is because if an ATS performed a certain service, that service would be regulated regardless of the entity's title. In addition, ATSs would not be limited to only performing the services its classification permits. Further, supporters point out that under this purely functional approach, the SEC's "regulatory objectives" would be achieved since two firms which "offer the same bundle of services" would be regulated the same way. Third, it is contended that the purely functional approach "best promotes innovation because it provides competitors with the maximum amount of flexibility consistent with regulatory objectives."

D. No SEC Regulation

Another proposal the SEC advanced in its discussion of alternatives for the regulation of foreign market activities in the United States is to "rely solely on home country regulation of the foreign market." While the Commission noted that the 'no regulation' method is at one extreme of the scale of regulatory options, the proposal does merit analysis. The general fear concerning foreign securities involves the adequacy of transparency. In order to protect market participants, the Commission seeks to ensure that "sufficient information is disclosed to U.S. investors regarding the risks of trading on foreign markets." In addition to protective concerns, most economists agree that a high degree of transparency results in an "efficient market." The greater the disclosure of current information regarding securities, the more efficient the market is. As a rule, foreign companies

128. Macey & O'Hara, supra note 49.
129. See note 94 regarding the concern that regulatory arbitrage would result from allowing Tradepoint to utilize the low-volume exemption as a means of registering in the United States. This is similar to the concerns examined earlier regarding "regulatory arbitrage."
130. See Macey & O'Hara, supra note 49. Presently, there is a lack of even-handedness in the SEC's treatment of ATSs. "It makes no sense for two firms that offer the same service to clients to be subject to different regulatory burdens merely because one of these firms has been classified as an 'exchange' while the other has been classified as a broker-dealer firm." Id.
131. Id.
132. Id.
134. See SEC Release No. 34-38672, supra note 45, at 30487. The Commission identifies registration as an exchange and no regulation as the two extremes of the regulatory spectrum.
135. See id.
136. Id. at 14. Generally, in terms of the SEC's regulation of domestic securities, "as long as the prospectus contains the required information and fully discloses the risks of the offering, the SEC will permit the offering to go forward. The SEC does not judge the merits of the offering as an investment but only seeks to ensure the full and fair disclosure of all relevant facts about the issuer and the offering." James, supra note 32, at 227.
137. See Poser, supra note 2, at 7.
138. See id.
do not disclose as much information as U.S. firms. Consequently, there is concern that unsophisticated investors would be unable to judge the investment risk involved when dealing in securities of foreign companies. Tradepoint is comparatively transparent to the LSE. This transparency has factored into its attractiveness and perhaps has played a role in its success with the SEC.

Despite the generally less stringent disclosure requirements of foreign securities regulation, and more specifically, of the United Kingdom's regulatory scheme, U.K. exchanges and the securities traded on them are regulated. The LSE runs the Official List and the Unlisted Securities Market (USM), the former being the larger of its markets. Tradepoint exchanges securities listed on the Official List. In order for a company to trade on the Official List it “must submit listing particulars” while the USM requires that a prospectus be filed. These documents encompass the disclosure element which the SEC feels is most vital to investor protection. Similar material must be included in both the listing and prospectus formats and generally includes:

(a) the company name;
(b) its registered office;
(c) the date of incorporation;
(d) the company number;
(e) the names and addresses of persons giving a declaration as to accuracy of the disclosure document;
(f) a declaration as to the accuracy of the disclosure document;
(g) the names of the company's auditors, their addresses and qualifications;
(h) the name and address of the company's bankers;
(i) the sponsoring member firm;
(j) the name of the company's solicitors;
(k) details of the shares for which admission is sought;
(l) the company's objects;
(m) the company's authorized/issued capital;
(n) a summary of operations during the preceding three years;
(o) details of any group to which the company belongs (if applicable);
(p) the company accounts;
(q) financial information for last three years; and
(r) details about company management.

139. See Silverman, supra note 6, at 6; SEC Release No. 34-38672, supra note 45, at 12.
140. See Letter from Neuberger, supra note 70, at 1. Neuberger describes how “[i]t is . . . a transparent market where all users of the system have access to exactly the same information at exactly the same time.”
141. The Financial Services Act 1986 provides the standard to which the U.K.’s markets are subject. See James, supra note 32, at 212.
142. See id. at 209-10. The USM is comprised primarily of newer and smaller companies than the Official List. See Huang, supra note 32, at 8.
143. See James, supra note 32, at 213.
144. Id. at 213-14. A complete listing of the requirements is located in sections 5 and 6 of the Yellow Book, the Exchange's Listing Rules. Id. at 212. See also Poser, supra note 2, at 314.
The disclosure requirements in the United States differ from these. In brief, a prospectus in the United States is required to include:

(a) a description of the company;
(b) a description of the securities;
(c) the terms of the offering;
(d) the capitalization of the company;
(e) market and dividend information;
(f) the compensation to be paid to underwriters of the issue;
(g) risk factors associated with the offering;
(h) a detailed description of the business;
(i) an identification of the directors and executive officers;
(j) related party transactions;
(k) the principal stockholders;
(l) management’s discussion and analysis (MD&A) of the company’s financial condition and results of operations;
(m) the financial statements of the company; and
(n) selected financial information for the last five years.\[145\]

While the United States requires the disclosure of certain risks, the United Kingdom does not. Instead, the requirement regarding the financial condition of the firm is to include “the group’s prospects for at least the current fiscal year” as well as profit forecasts, both of which might serve as a window to its stability.\[146\]

In addition to these initial requirements, the LSE has formal requirements for quoting a security on its exchange. These requirements include the following provisions:

The company must be a plc; its accounts must be prepared in accordance with UK Accounting Standards or their equivalent; all the securities of that class must be admitted, be freely transferable (subject to some minor exceptions), . . . [and undergo] . . . speedy registration; the directors [of the firm] must adopt the Model Code on dealings in securities; and, the sponsors or nominated adviser must ensure that the directors of the business understand their responsibilities as directors of a quoted company.\[147\]

Listed companies also have continuing disclosure obligations. These obligations include disclosing annual audited financial statements within six months of the close of the company’s fiscal year, an annual report detailing any changes in management, new contracts entered into by the firm, information as to whether profit forecasts were met, and additional financial data.\[148\] In U.S. securities law, there are proscriptions against

\[145\] James, supra note 32, at 228-29.
\[146\] Poser, supra note 2, at 314.
\[147\] ROBERT C. ROSEN, INTERNATIONAL SECURITIES REGULATION 23 (1986). To list securities, the company must have been run by the current management for three years; must show it’s independent of any holder who has 30% of stock; “and at least two brokers must be willing to make a market in the securities.” Id.
\[148\] An annual report must include:
   (1) any departures from standard accounting practices; (2) any differences between its operating results and previous forecasts; (3) a geographical analysis of its operations; (4) major holdings in other companies; (5) bank loans and other borrowings; (6) significant contracts with the company of its subsidiaries
violating the registration requirements as well as exemptions from regulatory oversight in certain situations. Nonetheless, if the SEC were to rely solely on the U.K.'s supervision of Tradepoint, these would be the only checks on market transparency.

E. Creation of a New Access Provider Classification

As an "intermediate approach" between no regulation and traditional exchange regulation, the SEC has suggested "access provider" regulation of ATSs in the course of its dialogue. An access provider classification would include all "entities that provide U.S. persons with direct access to foreign markets." The proposal of such a new regulatory classification for foreign markets operating in the United States has received some support.

A. Jared Silverman suggests that these access providers "could be required to comply with limited record keeping, reporting and disclosure requirements, and antifraud provisions" rather than the exhaustive list of BD or exchange requirements. He suggests that access providers could register as securities information processors (SIP) that "could be limited to trading registered foreign securities or to dealing with sophisticated parties." This limitation poses no problem for entities such as Tradepoint as it is used solely by institutional investors and only executes trades in which a director or substantial shareholder has a material interest; and (7) biographical information about the company's outside directors.

Poser, supra note 2, at 316. Yellow Book, at 5.16-5.27. For further discussion of an issuer's continuing obligations, see Rosen, supra note 147, at 23.

149. See Poser, supra note 2, at 322.

150. The standard exemptions are:
(a) Private offers: there are no regulatory requirements to circulate an offer to existing shareholders where private issues are concerned. For example, no prospectus or listing particulars are necessary on a private placement. (b) Public offers: no disclosure document is needed where the securities offered are: (i) shares allotted by a capitalization issue, known as a bonus issue, to holders of shares already listed; (ii) small share issues, such as where the shares to be issued do not exceed those already listed by 10 per cent; or (iii) issues to employees, if shares of the same class are already listed.

Id. at 214. In the United States, there are numerous exemptions for non-public offerings. See id. at 225.

151. SEC Release No. 34-38672, supra note 45, at 30487.

152. Id.

153. See Silverman, supra note 6, at 6 for discussion of foreign market activities alternatives.

154. Id. at 6.

155. Id. Silverman also advances the idea that BDs that are access providers should be regulated in the same manner as SIPs. He suggests that "[t]hese broker-dealers could also be permitted . . . to provide retail and sophisticated investors with electronic links to foreign markets and to foreign markets that trade U.S. and foreign securities, regardless of U.S. registration." Id.

156. See Letter from Steil, supra note 87, at 1. Steil supports Tradepoint's application "on the basis that it offers U.S. institutional investors an excellent low-cost non-intermediated mechanism for trading U.K. stocks."
III. Permitting Tradepoint to Operate “In” the United States Was Proper; but the SEC Should Eventually Regulate It Under a New Access Provider Classification

Until a new regulatory procedure for foreign ATSs is established, granting Tradepoint the Section 5 exemption was proper. This decision will provide new opportunities for U.S. investors by widening their choice of investments and setting higher transparency and openness standards than the LSE. Presently, if a U.S. investor wishes to buy on the LSE, it must act through a broker transacting on the LSE or a London affiliate, or buy a listed U.S. depository receipt listed on a domestic exchange. Both of these procedures are expensive because of commissions and fees. These added expenses would be eliminated under a Section 5 exemption and “U.S. based fund managers and brokers” would be able “to trade in U.K. equities without incurring the expenses of having to go through an intermediary.” However, the Section 5 exemption should not be the guiding example of how an entity gains entry “into” the United States. It is simply a means of avoiding the classification controversy and fails to set a viable precedent. In addition to the short-sightedness of Tradepoint’s low-volume nature, “it makes no sense to provide special exemptive treatments for alternative trading mechanisms that are of low volume.” This is because:

This would simply allow competitors to avoid burdensome regulation by remaining small. The sheer number of alternative trading systems would proliferate not for reasons of market demand, but rather simply to avoid the costs of complying with burdensome regulation. Moreover, this requirement

157. Silverman also suggests that in addition to requiring access providers that link U.S. members and foreign markets to register as SIPs, “foreign markets, information vendors, and other access providers could be required to register as SIPs or to conduct their U.S. activities through another registered SIP.” Silverman, supra note 6, at 6.
158. See Letter from Neuberger, supra note 70, at 1.
159. See Ip, supra note 48, at A6. See also Faith Glasgow, Survey — Share Dealing: Trade’s up at Tradepoint — The UK’s most recent stock exchange distinguishes itself from competitors by offering direct access for fund managers. How viable an alternative is it to the main exchange?, INVESTORS CHRONICLE, Nov. 20, 1998, at 58. From the buy side perspective, “[i]t makes no sense for a US broker to have to pay brokerage commission to a UK broker - why pay commission to your competitor when you don’t need to? By joining the Tradepoint Stock Exchange, they are given true independence.” April 1999 Newsletter <http://www.tradepoint.co.uk/newslet_apr99_3.html>. In addition to Tradepoint being less costly due to the lack of a middleman, Tradepoint was “launched on the back of the theory that phone trading was inefficient and that the market would welcome a cheap and efficient alternative.” Glasgow, supra, at 58.
160. SEC Approves Tradepoint to Enter U.S., supra note 34.
161. While Benn Steil “endorsed direct U.S. investor access to Tradepoint,” he “questioned the need for the exchange to win SEC approval on the grounds of its size.” Kentouris, supra note 22, at 21.
162. Macey & O’Hara, supra note 49.
would seriously impair technological innovation. Technological innovations often require economies of scale to be cost-effective.\textsuperscript{163}

Though this argument focuses on domestic ATSs, similar arguments could easily apply to Tradepoint.

According to Laura S. Unger, Commissioner of the SEC, the Commission granted Tradepoint an exemption based solely on its limited volume nature. Ms. Unger stated that “[i]f Tradepoint’s worldwide average daily trading volume exceeded ten percent of the volume of the LSE . . . the Commission would reevaluate Tradepoint’s exemption from exchange registration.”\textsuperscript{164} This statement reflects a recurring critique of the SEC in commentary prior to the exemption order. It appears that using volume as a standard fails to address the larger and newer issues that systems such as Tradepoint present. Unger suggested the uncertainty of this approach by noting that the SEC is “still assessing the impact of U.S. investors trading unregistered foreign securities and the long-term regulatory approach that we should take.”\textsuperscript{165} Thus, the volume approach may very well be only a temporary solution and the SEC must undertake further regulatory work. While the SEC officially granted the exemption to Tradepoint because of the benefits its competition would provide, the permanency of this solution is still questionable.

Cross-border and international securities matters create inherently conflicting problems for the SEC. While the Commission continues to recognize the need for investment protection, it also recognizes the need to provide “U.S. investors” with “greater and more instantaneous access to foreign securities markets” so that they can “trade securities more efficiently.”\textsuperscript{166} Currently, such instantaneous access is not permitted because of the dissimilar disclosure requirements between U.S. and foreign exchanges differing accounting standards. Therefore, in order to open up U.S.-foreign trading, the Commission would have to reach a point of acceptable shared accounting standards.

In order to achieve this goal, U.S. and foreign securities commissions are working to establish a set of core accounting standards for international use. Rising to this challenge, the International Accounting Standards Committee completed a proposed set of core standards in December 1998. Both the SEC and the International Organization of Securities Commissions (IOSCO) are now in the process of evaluating the proposed framework. If the IOSCO approves the criteria, it appears that the SEC would follow suit, thereby abandoning its long-held U.S. GAAP reconciliation rule. Such abandonment would open the door to an entirely larger market of opportunities for U.S. investors. However, these changes are still to be determined. Until they are, Tradepoint’s low-volume status will have to remain in order for it to continue operations under this exemption.

\textsuperscript{163} Id.
\textsuperscript{165} Id.
\textsuperscript{166} Id.
The progress in the SEC's Tradepoint decision is no small matter even if its form is flawed. By all accounts, the SEC has permitted a foreign exchange to operate in the United States. Stephen Lofchie, a U.S. attorney, recognized the impact of the SEC decision: "This is the most significant liberalization of international securities trading since the adoption of rule 15a-6 of the SEC rules in 1989."167

Despite the inadequacy of this approach, it is not unsafe for Tradepoint to function under the exempt exchange classification until the SEC sets a clear ATS guideline for foreign systems. This is mainly because only institutional investors can access Tradepoint.168 While there are certainly protection concerns regarding institutional investors, they are not as crucial as those involving the general investing public, and, more importantly, these sophisticated investors are already "allowed to purchase foreign securities in an initial sale under Rule 144A of the Exchange Act."169 Rule 144A is "a training ground for foreign companies' seeking U.S. investors," since it allows these foreign firms to execute a private placement offering and then convert it to a public offering, thereby complying with all of the disclosure requirements a public offering demands.170 This vehicle is widely used and already has exposed U.S. investors to foreign securities.

There are further reasons why Tradepoint has the opportunity to be a valuable addition to the U.S. securities market. Beyond its order-based, screen-operated nature, the anonymity and level of transparency that Tradepoint affords are unique to the system and contribute to its popularity.171 Anonymity is maintained since parties to a trade are not disclosed on the screen, and the system executes settlement via the London Clearing

167. He further noted how this option is not available to larger institutions: "The conditions that the Commission has set won't allow the major European stock exchanges to qualify for U.S. operation." Tradepoint Becomes First U.S. Foreign Stock Exchange to Operate in U.S. (last modified June 15, 1999) <http://www.tradepoint.co.uk/news_sec.html>. Rule 15a-16 is the "Exemption of Foreign Brokers or Dealers" regulation. See Securities Exchange Act of 1934, Broker-Dealer Regulation Registration and Regulation of Brokers and Dealers, CCH ¶ 25,006B.

168. See Letter from Steil, supra note 87, at 1.


170. Burns, supra note 169. The practice of converting a private placement to a public offering was at one time prohibited. However, the SEC reversed this policy in its 1988 Exxon Capital decision, in which Exxon Corp's financing unit was permitted to convert a private-placement debt offering to a public one. This was most important to foreign issuers because they gained a means of performing a public offering in the United States. Private placements are "booming." Yet, the SEC is considering slowing this tide by amending U.S. securities laws to "reduce the use of private placements by encouraging companies to issue stocks and bonds through public offerings." This proposal is called the "aircraft carrier." Id.

171. See Glasgow, supra note 159, at 58. Glasgow and Jones describe the positive aspects of Tradepoint as: its lack of middleman fees as compared with the LSE, its anonymity and transparency as well as its low trading costs and entry fees.
House.\textsuperscript{172} This is important because according to SEI Investments, "the largest transaction cost is not the commission or market-maker's spread, but this 'market impact' as other traders move market prices in reaction to block trades."\textsuperscript{173} When coupled with the system's overall operating efficiency, Tradepoint becomes an attractive option. However, some disagree with this perception of the system. Commentators complain that the system lacks the same liquidity as the LSE and that it focuses on institutional sized deals.\textsuperscript{174} However, as stated previously, less liquidity does not ensure a safer environment for investors,\textsuperscript{175} and its institutional bent conversely contributes to its easing of protection concerns. Moreover, an order on Tradepoint is virtually indistinguishable from a domestic one.\textsuperscript{176} Thus, there appears to be no strong reason for banning Tradepoint from operating in the United States.

\textsuperscript{172} The London Clearing House is an independent entity serving as a central counterparty which "financially assure[s] all of the trades executed via Tradepoint." Clive Davidson, \textit{London Clearing House Uses Technology to Reinvent Itself}, \textit{Secs. Industry News}, Feb. 8, 1999, at 2. \textit{See also} Glasgow, \textit{supra} note 159, at 58 (stating that settlement occurs at the end of every business day through the clearing house); and Tradepoint Financial Networks PLC (last modified June 15, 1999) \texttt{http://www.tradepoint.co.uk/pr990323.html}.

Now more than 100 years old, LCH was, until two years ago, much like any other clearinghouse: a low-profile, back-office service center for the London International Financial Futures and Options Exchange, London Metal Exchange and International Petroleum Exchange (in 1995 it also took on the clearing for the Tradepoint Stock Exchange). Then in October 1996, its members, which now number 114, plus the exchanges, bought LCH from its previous owners, a consortium of six clearing banks. Now the clearinghouse could respond to the wishes of the broader community of its members, who made it clear they wanted to expand the role of the organization.

Davidson, \textit{supra} at 2.

\textsuperscript{173} Alpert, \textit{supra} note 13, at 22. The system maintains anonymity since "[t]raders can buy or sell UK stocks without having to disclose their complete trading intentions." Members achieve this as they "are given the opportunity to advertise their own IOIs (via AutEx and Bloomberg) without disclosing their trading intentions." \textit{SEC Approves Tradepoint to Enter U.S.}, \textit{supra} note 34.

\textsuperscript{174} See Jones, \textit{supra} note 34, at 39. Unfortunately, however, few small investors have access to Tradepoint because only a handful of private-client stockbrokers are members of the exchange. And Tradepoint isn't suitable for all deals. Liquidity on the market is thin compared with the LSE. Mr. Urquhart Stewart says: "it's all very well them saying they can beat the LSE's prices, but when you try to deal you find you can only do so in institutional sizes."

\textit{Id.}

\textsuperscript{175} See Letter from Steil, \textit{supra} note 87, at 1.

\textsuperscript{176} See Silverman, \textit{supra} note 6, at 6. According to Silverman, orders are indistinguishable due to technology.

It is possible for United States investors to obtain real-time information about trading on foreign markets from a number of different sources and electronically to enter and execute orders from the United States. Enhanced technology can make U.S. originated orders indistinguishable from orders originating in the country in which the market is situated. Technology also permits members of foreign securities markets to trade without being physically present on the market floor or establishing a physical presence in the market's home country.

\textit{Id.}
A. Registration as An Exchange: Not a Solution

Registration under Section 6 of the Act was never a viable option for Tradepoint. While exempt exchange status is not desirable as a permanent solution, neither is traditional exchange registration. A Section 5 exemption seeks to avoid many of the burdens of traditional exchange registration. Though most arguments are against exchange regulation of ATSs in general, and not of Tradepoint specifically, the same reasoning applies. First, commentators have pointed out that this "regulatory approach is highly inconsistent with modern theories about how to regulate complex systems." It would "undermine the operations" of ATSs as they would be "(1) unable to protect their customers' property rights in information; (2) unable to solve the conflict of interest problems that exist within firms that act simultaneously as brokers and dealers; and (3) unable to innovate to further improve market conditions by reducing the transactions costs associated with secondary market trading." Bloomberg addresses the more administrative drawbacks of exchange registration for ATSs. It cites the length of the registration process and the "cumbersome" nature of attempting to change regulatory rules as reasons against exchange registration. It, too, echoes the protection concerns by complaining that "the statutory protections for ATS exchanges may well prove insufficient." This concern is most pertinent to systems such as Tradepoint as it involves the additional foreign securities element that many fear. Though some may disregard the critiques of exchange regulation as trivial reasons for advocating an alternative plan, administrative concerns are of paramount importance. The whole basis for the success of computer-linked systems such as Tradepoint is the efficiency resulting from their electronic nature. By using Tradepoint, there is no need for intermediaries and the cost disadvantage of the U.S. distance from local foreign markets would be eliminated. This cost advantage is characteristic of most non-traditional markets. Because they are private, small, and do not involve middlemen in each transaction, "the alternative trading systems are driving down the cost of trading and spurring innovations such as extended hours and lightning-fast Internet trades." With Tradepoint, U.S. investors would be on an "equal playing field" with U.K. brokers since

177. Macey & O'Hara, supra note 49.
178. Id.
179. See Letter from Bloomberg, supra note 28.
180. Id. The letter discusses the "extraordinarily protracted" process of registering as an exchange "particularly for a start-up entity but also, [they] expect, for an ATS that has been in business for some time." Id. It continues to detail the administrative burdens that accompany registration.
181. Id.
182. See Letter from Stell, supra note 87, at 1; Blanc, supra note 32, at 34.
183. Ip, supra note 3, at A1. The cost difference can be significant. "Market makers pocket the spread between the bid and ask prices for a stock - that can range between five cents and 75 cents. When an ECN processes trades, it charges a fee of a couple of cents per share." Alpert, supra note 13, at 19. Because of this, Tradepoint's "aim is to be the lowest cost stock exchange in the world." SEC Approves Tradepoint to Enter U.S., supra note 34.
the U.S. investors would have equal access at equal cost for both buy and sell side participants.\textsuperscript{184} Therefore, imposing unruly administrative burdens would have been counterproductive.

Moreover, regulation of Tradepoint as an exchange would have been unattractive since it is likely that under an exchange classification, the SEC would have imposed additional conditions on the system.\textsuperscript{185} Specifically, the SEC would have required that it be able to gain access to books and records, lists of U.S. members, daily activity summaries (pound versus dollar equivalents), total trade volume numbers, the system’s surveillance procedures, and response time comparisons for U.S. and non-U.S. Members.\textsuperscript{186} Tradepoint would also

\textsuperscript{184} See Kentouris, supra note 22, at 21. This argument, according to Kentouris, was put forward by Bloomberg “which provides its users with access to Tradepoint prices.” The SEC noted in its recent release that “[a] number of commentators stated that the Tradepoint System would enable broker-dealers in the United States to compete on equal footing with foreign broker-dealers with respect to trades in U.K. securities.” SEC Release No. 34-41199, supra note 23. The buy/sell side differentiation is important. While most stress the benefits to buy-side participants, “[t]he sell side can also take advantage of the benefits of direct membership of a UK exchange, such as a stamp duty tax relief, enabling trading on the same basis as UK based Market Makers. Tradepoint is the only exchange to provide stamp duty relief in the USA.” Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/newslet_apr99_3.html>.

\textsuperscript{185} See SEC Release No. 34-40161, supra note 29, at 5. “The Commission proposes to impose other conditions on the Exchange besides the low volume requirements discussed above. In general, these conditions would allow the Commission to monitor the Exchange for compliance with all applicable sections of the Securities Act and the Exchange Act (such as the anti-fraud and securities registration sections), and would ensure that the Commission has access to books, records and personnel of the Exchange should the need arise.” In SEC Release No. 34-41199 the Commission enumerated the conditions for the low-volume exemption. Among the finalized requirements are:

(a) Daily summaries of trading and time-sequenced records of each transaction involving a U.S. Member; (b) Information disseminated to U.S. Members; (c) Daily pound and the equivalent dollar value of transactions; (d) A list of securities for which U.S. orders are accepted; and (e) Copies of Member applications and standards for admission to the Exchange . . . (it) will also be required to provide 30 days prior notice to the Commission of any material changes in the operation of the Tradepoint System . . . direct access to real-time quotes and trading information . . . on a quarterly basis within 30 days of the end of each quarter . . . (a) Total volume and average daily volume . . . (i) Number of units of securities . . . (ii) Number of transactions . . . (iii) Monetary value . . . and (b) Records regarding the identity of U.S. Members . . . and the identity of those denied participation in the Tradepoint System and the reason for such denial . . .


\textsuperscript{186} See SEC Release No. 34-40161, supra note 29, at 37150. Response time concerns factor highly in Bloomberg's proposal regarding the regulation of ATSs generally. Bloomberg advocates two separate supervisory models based upon the manner of response an ATS uses.

Our proposal set forth in the Bloomberg October Letter asks the Commission to distinguish between those ATSs that respond to non-participant orders immediately and that provide direct connection to such non-participants on request, and those that do not. If an ATS responds immediately to non-participants orders and provides a direct connection on request, it should qualify to receive order messages, not executions, [whereas] . . . [if an ATS does not meet the
have had to maintain an agent for service of process in the United States.\textsuperscript{187}

Furthermore, a Section 5 exemption was inapplicable because while Tradepoint is presently a low-volume creature,\textsuperscript{188} there is no guarantee that it will remain a minor player in the securities world. Despite its fiscal losses,\textsuperscript{189} and financial difficulties,\textsuperscript{190} Tradepoint is strategically growing in its global presence and experienced a record month in January of

\textsuperscript{187} See SEC Release No. 34-40161, \textit{supra} note 29, at 37150.

\textsuperscript{188} As of November 20, 1998, Tradepoint had "85 fully signed up members (both stockbroking firms and institutional investors), and is handling around £35m of business per day, compared with the LSE’s turnover of pounds 3bn - roughly one percent of the market." Glasgow, \textit{supra} note 159, at 58.


Tradepoint Financial Networks ... has plunged further into the red. The group revealed its half-year losses had widened from GBP 3 million to GBP 3.6 million, mainly due to higher development costs. Tradepoint conceded it was unlikely to become self-financing in the short term and would require additional funds. However, there has been ‘solid growth’ in order book volumes.

\textit{Tradepoint’s Troubles Grow}, \textit{Evening Standard}, Nov. 27, 1998, at 34. Despite this, for the year ending March 1999, the company’s pre-tax loss was (7.30) £m. as compared to (6.67) £m. for 1998. Tradepoint Financial Networks PLC, Five Year Summary P&L with Balance Sheet (Mar. 10, 1999) <http://www.hemscott.co.uk/EQUITIES/company/corp/crpo3067.html>.

\textsuperscript{190} In December of 1998, Tradepoint announced that it was “seeking renewed financing.” Suzy Jagger, \textit{U.S. Group Seeking Tradepoint Stake}, \textit{Daily Telegraph}, Feb. 17, 1999, available at 1999 WL 12600741. Presently, [\textit{It is understood that Cantor Fitzgerald is seeking to buy venture capitalists Apax Partners’ 29pc stake in Tradepoint. And insider said: ‘It is well-known that Tradepoint will need to re-finance over the next few months. Cantor’s are rumored to be in talks with Tradepoint which would fulfill their ambition to have an exchange facility in Britain.}]}
The system's "[t]ransaction volumes [grew] considerably in [1998]" though as of the end of the year "the company ha[d] not achieved the market share necessary to reach profitability. Income from operations" for 1998 reached 675,235 pounds. This represented a 38% increase from the prior year, yet as of January 2000, Tradepoint "still has only about 0.5% of the U.K. share-trading volume." On August 14, 1998, Tradepoint became the first exchange outside Hong Kong to receive approval by the Hong Kong Securities and Futures Commission to serve as a direct channel for Hong Kong equities brokers and fund managers to access the U.K. equity market. In addition to its U.S. approval, Tradepoint is also growing within Britain itself.

Though some have always felt that Tradepoint "needs direct U.S. participation if it wants to undercut LSE business," the company has made strides within its own geographic borders when it entered into an agreement with Royalblue's Fidessa system, a British financial trading system. Fidessa is capable of "handl[ing] SETS, the London Stock Exchange's new

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191. On January 20, 1999, trading "totaled more than pounds 200 million." Nick Goodway, Business Day: Tradepoint Teeters on Brink of Red Alert, EVENING STANDARD, Jan. 29, 1999, at 42. However, this is not to say that the financial situation of Tradepoint is anything but dismal. In fact, Goodway writes that the British system is in danger of running out of money again. The electronic stock market . . . revealed that it lost pounds 2 million, up from pounds 1.78 million, in the three months to 31 December. By the same date, cash in the bank had dwindled to just pounds 2.08 million which at current rates would see it in the red by April. But Tradepoint is hopeful of raising more money before that dreaded overdraft appears. It said today that it is talking to advisers about a number of new financing options.

192. These options can include "another rights issue and partnerships with institutional investors and Internet brokers, particularly in the United States, who could direct order flows through Tradepoint. The company last raised pounds 11.4 million through a rescue rights issue in August 1997." Id.

193. See Unaudited Results for Three Months Ended 30 June 1998, supra note 189; see also Glasgow, supra note 159, at 58.

194. See Glasgow, supra note 159, at 60. "Inroads" refers to its application's progress within the SEC. "In early July, the U.S. Securities and Exchange Commission (SEC) approved for publication in the Federal Register its application for exemption from registration as a National Securities Exchange." Id.

195. See id.

196. Kentouris, supra note 22, at 21. Thus far, Tradepoint has only been operating in the red. Commentators such as Kentouris feel that the achievement of U.S. participation is the primary means for Tradepoint to pose a threat to the established LSE.

order driven market." According to the agreement reached, investment banks that use Fidessa will be able to "execute orders on either Tradepoint or SETS." This may open an entirely new customer base not only because the "trading costs and the entry fee [of Tradepoint] are markedly lower" than that of SETS, but also because SETS has been criticized by users since its October 1997 introduction. Although Tradepoint only realized 2% of its targeted market share as of December 1998, the organization "produced research showing that brokers trade on a daily basis on the LSE at worse prices than they would have got on [Tradepoint's] own electronic exchange." This information eventually could help bolster Tradepoint's standing within the United Kingdom.

However, most important to the growth of Tradepoint is the activity of a consortium in May 1999. This group, composed of Instinet, Warburg Dillon Read, Morgan Stanley, American Century, J.P. Morgan and Archipelago "paid about $21 million to rescue the floundering London-based elec-

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199. See QL Stock Market Letter, supra note 197 (emphasis added).

200. Glasgow, supra note 159, at 58.

201. See London Stock Exchange, Dancing to a New Tune, Euromoney Magazine, Aug. 10, 1998, at 24. According to Legal & General Group PLC's investment director David Rough, SETS is "not a success" "since it has made it harder to trade in all but thirty London-quoted equities." Legal & General Investment Director Criticises SETS Trading System, AFX (U.K.), Apr. 2, 1998, available in 1998 WL 17622163. Rough states that for the top thirty FTSE 100 stocks, SETS have "made a big improvement - spreads have narrowed and there is greater liquidity," however, "outside that group this is not the case." Id. Rough also criticized the system, claiming that it only works "efficiently" between the hours of 9:30a.m. and 3:30a.m. because of the LSE's new dealing system. Id. Nic Stuchfield, chief executive of Tradepoint, suggests that SETS has not been more successful for the same reasons that Tradepoint has only made "relatively little headway into the London Stock Exchange's territory." Id. This reason, according to Stuchfield, is that "there's a natural resistance in the U.K. to the idea of posting bids and offers publicly on the screen, rather than privately through a broker."

202. Nick Goodway, Business Day: Tradepoint 'fair play' call to SFA, Evening Standard, Dec. 9, 1998, at 41 [hereinafter Goodway 2]. In order to show this, the company monitored deals struck on the LSE's electronic trading system over the past three months against the prices showing on its own system at exactly the same time. The result invariably was that the LSE price, both for selling and buying, was worse by anything from 12p to 5p per share. The price also tended to be worst on small, usually retail, trades of 10,000 shares or fewer. The net shortfall on such trades ranged from only a few pounds to several hundred and in a few cases thousands of pounds. An example was Halifax on 13 October. In the half hour from 11:20a.m., 57 trades on SETS ranged from 0.5p to 5.3p a share higher than the bid price on Tradepoint. So in that period alone investors lost a total of more than pounds 800, ranging in individual amounts from pounds 1 to pounds 200 and all for trades of 10,000 shares or fewer.
Tradepoint's financial woes had been continuing, as the entity suffered an $11.5 million loss in the fiscal year ending March 1999 "on revenue of just $1 million." Because the exchange had only captured less than one percent of the LSE's volume by that point, profit seemed unlikely. However, "Tradepoint's new 54% shareholders bring plenty of liquidity, accounting for about a quarter of the LSE's volume, between them." The power of this combined grouping brings with it several "potential opportunities" for Tradepoint, one originally thought to use the establishment of a Frankfurt European trading system anticipated for the Summer 2000, but now a potentially much larger project of establishing a pan-European market is planned. The consortium's action has

Id.

203. Alpert, supra note 13, at 22. See also Tradepoint Financial Networks PLC (last modified Sept. 7, 1999) <http://www.tradepoint.co.uk/pr990709.html>. This money was vital as "the Company required additional finance to ensure its long-term viability. Cash resources would without an injection, have fallen below the regulatory minimum required as a Recognised Investment Exchange." Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/pr990615.html>. See also David Fairlamb & Stanley Reed, Frankfurt's Power Play, Bus. Wk., Dec. 27, 1999/Jan. 3, 2000, at 80EB (listing the amount of money injected into Tradepoint by the Consortium as $22.4 million). Due to this change in the shareholder base, Tradepoint has decided to no longer be listed on the Canadian Ventures Exchange (formerly the Alberta and Vancouver Stock Exchange) as of January 31, 2000. Originally, Tradepoint was listed on the Vancouver Exchange because a large portion of the Company's shares were held by Canadians. Tradepoint Financial Network PLC – Tradepoint Financial Delists from CDNX, CANADIAN STOCK WATCH, Jan. 20, 2000, at 2000 WL 6296194. See also infra note 207 (discussing an addition to the consortium).

204. Id. The highlights from the company's unaudited financials for the year ended 31 March 1999 are as follows: "Loss for the period of £7,295,677 (1998: 6,669,990), Operating costs £8,240,856 (1998: 7,561,566), Depreciation and amortisation £1,035,962 (1998: 1,090,869), Secured a long term refinancing package with a Consortium led by Instinet Corporation, Subject to shareholder approval, the refinancing package will raise approximately £13,100,000 net of expenses." Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/pr990615.html>.

205. See Alpert, supra note 13, at 22.

206. Id.

207. In June of 1999, the Frankfurt plan was considered as well as various other identified opportunities including:

- the use of the Tradepoint Stock Exchange by Consortium members could substantially improve the level of Tradepoint's trading volumes; the global presence of the Consortium members and their focus on reducing transaction costs, together with market and technological efficiencies, should assist Tradepoint's participation in the evolution of a global market exchange model; a planned electronic link between Instinet and Tradepoint, to allow Instinet customers to route orders to the Tradepoint Stock Exchange; and working in co-operation, Tradepoint and the Consortium will have opportunities to maximise the use of the Tradepoint technology and regulatory license by broadening the range of securities traded.

Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/pr990615.html>; see also Fairlamb & Reed, supra note 203, at 80EB. Yet now, the scope of Tradepoint's expansion plan is far greater. Recently joining the consortium is ABN Amro Holding NV. ABN is hoping Tradepoint will succeed in its plan to launch a Pan-European market by the end of 2000 as a rival to the combined eight European Exchanges. See John Carreyrou, Deals & Deal Makers: ABN Amro
helped to increase the value of Tradepoint's shares "and boosted the firm's stock market value from $50 million to $300 million." Because of this, it has been observed that "Tradepoint is now a credible rival to the LSE." This stride has added to the optimism of Tradepoint's management as plans for future growth are again taking form. Within a year, "Tradepoint expects to offer its own trading in Europe's top 300 stocks," and with the addition of the U.S. approval, low-volume may no longer be a characterizing element of the system. Tradepoint's growth is furthered by several U.S. institutions that are currently completing their membership applications in an effort to begin trading through the system. To accommodate the anticipated growth, the company has added new enhanced features to the system in an effort to monopolize on the new U.S. entry. An easier "point and click method for building rules" has been introduced. This will help to save time and "reduce the risk of incorrect data entry." The company also added a "new timer function" to the system that allows one to "release orders at specific time intervals," "the ability to accumulate and monitor the total value of executed orders and a library of sample rules."

Decides to Back Tradepoint, Buying 9% Stake, WALL ST. J., Dec. 30, 1999, at C18. Tradepoint is hoping to lure "big international investors who are frustrated at the bureaucratic logjam holding up attempts to meld the existing eight European stock markets . . . ." Andrew Garfield, Tradepoint Signs up Partners for European Exchange, THE INDEPENDENT - LONDON, Feb. 11, 2000, at 20. If successful, the Company's growth potential could be seemingly limitless.

208. Alpert, supra note 13, at 22.

209. Id.

210. In the United States, "Tradepoint's target market on the buy and sell side is 100 firms . . . but that could get much bigger if the exchange expands trading to include European equities - expected to be in place before the end of 1999." Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/news_sec.html>.

211. U.S. approval can be a major help for the company. According to Tradepoint's sales literature, U.S. fund managers are used to using electronic trading systems. Domestic Electronic Crossing Networks (ECNs) and new electronic matching systems seem to proliferate by the week in the U.S.A. Yet, U.S. fund managers have never been able to trade directly in an overseers order book before, without having to pay a broker to access it. Until now, that is. Tradepoint has a completely unique offering, with no competitors to its services in the U.S.A., so strong demand is expected from the U.S. buy-side and sell-side.

212. Id. Tradepoint's flexibility allowing "any customer demand for trading in euros or other currencies" is an added attraction to U.S. institutions. Tradepoint Financial Networks PLC (last modified June 15, 1999) <http://www.tradepoint.co.uk/news_launched.html>.


214. Id.

215. Id.

216. Id.
Also contributing to Tradepoint’s national growth prospects is the chorus of criticism the LSE has received for its perceived “overbearing manner.” Because of this discontent, many brokers are “consider[ing] routing their business through Tradepoint.” While the LSE seeks to fight off any opposition and engages in new arrangements such as that with the German exchange in order to strengthen its European and worldwide presence, the alternative Tradepoint presents could prove appealing, especially in light of its recent financial boost. Its presence has already been considered partly responsible for the LSE’s establishment of SETS in the first place and currently, the LSE has entirely moved to an electronic system.

In an attempt to address the possible growth of Tradepoint, the SEC has conditioned “[Tradepoint’s] operation in the United States upon it remaining a low volume exchange in the U.K.” Such a condition achieves little in terms of precedential value and in the fostering of positive growth of the firm. With Tradepoint’s management continually seeking profits and looking for new opportunities in the international equity markets, remaining a limited volume exchange may not always be a reality or a desired course and should not be a term to its U.S. existence. And even if Tradepoint specifically never succeeds on a larger scale, the possibility of another entity doing so is certainly not inconceivable.

Dismissing concerns regarding investor protection, one commentator has pointed out that U.S. investors already directly trade on foreign exchanges by means of electronic brokerage systems and London-based affiliates. These brokerage systems have received less public attention.

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217. See London Stock Exchange, Dancing to a New Tune, supra note 201, at 24.
218. Id. Though not necessarily a direct correlation, Tradepoint has reported “solid growth” in its order book volumes as of the end of November, 1998. Tradepoint’s Troubles Grow, supra note 189, at 34.
219. The alliance between the LSE and Frankfurt seeks to “develop a common platform to combine the trading of stocks.” London Stock Exchange, Dancing to a New Tune, supra note 201, at 24.
220. See Glasgow, supra note 159, at 58; see also Siegel, supra note 70, at A34.
221. SEC Release No. 34-40161, supra note 29, at 37149.
222. See Unaudited Results, supra note 189, for Peter R. Stevens’ (chairman of Tradepoint) outline of the company’s “Building and Developing” plans, as well as for his description of the company “Outlook.” (“The international equity markets are changing at an unprecedented rate. We are confident that your company is well positioned both to respond to and take advantage of these changes.”).
223. See Kentouris, supra note 22, at 21. The NYSE recently complained that “there is no basis to grant Tradepoint’s exemption request without requiring it to provide U.S. investors with full-sale and quotation information as mandated for all other public markets trading registered equity securities ... To allow otherwise will permit those market players that have accesses to Tradepoint data to have significant informational advantage over other investors, raising serious investor protection concerns.”
224. See Letter from Steil, supra note 87, at 2. See also Kentouris, supra note 22, at 21. However, the “larger buy-side players, which Tradepoint targets, typically prefer to deal directly with an exchange.” Id. See also London Stock Exchange, Dancing to a New Tune, supra note 201, at 24, discussing how Tradepoint “focus[es] on large trades for institutional investors.” At present, Instinet is an example of an instrument which provides
than Tradepoint, yet they provide similar services.\textsuperscript{225} Therefore, one may seriously question whether the SEC's continuous protection-related concerns are well-founded.

Even if the Commission were to revise existing exchange requirements as Bloomberg and others have suggested, regulation of ATSs as exchanges is rife with shortcomings and obstacles. Not only does it fail to allow investors to take advantage of the strengths of these electronic trading systems (such as efficiency, lesser costs, etc.), it will inhibit further growth.\textsuperscript{226} While Tradepoint should operate under a Section 5 exemption so that it can operate in the United States,\textsuperscript{227} this should not be considered an acceptable regulatory scheme. It can only serve as a temporary solution.

B. Registration as a BD: Not a Solution

Applying a BD classification to Tradepoint also would have been an awkward fit. It would have involved applying an artificial label to the system, it would have demanded the ATS to fulfill requirements inapplicable to the services it provides, and it would have failed to address the aspects and functions of Tradepoint which do require regulation.\textsuperscript{228} While the SEC believes it can "permit broker-dealer access providers to provide both retail and sophisticated investors with electronic links to foreign markets, and to provide such links to foreign markets that trade U.S. and foreign securities,"\textsuperscript{229} attempting to apply the traditional BD label to Tradepoint would not have been ideal.

Although the filing amendments discussed in Part II.B. of this Note might ease the registration process, there are other attendant problems. Bloomberg has commented that registration of ATSs as BDs "could severely alter, and perhaps even eliminate, the role of ATSs in the marketplace."\textsuperscript{230} Bloomberg also suggested that BD classification "could create a central market system that controls all order flow and distributes executions, not orders, to ATSs."\textsuperscript{231} This consolidation to a central market should be feared, according to Bloomberg, because "[t]aken to its logical and practical conclusion, such centralization of the market could severely truncate, if not
eliminate, the role of ATSs and stifle competition, restricting investors’ opportunities."232 This concern mirrors the one previously voiced in the discussion of exchange classification in that the coordination requirement imposed upon exchanges could eliminate the benefits of ATSs and thereby threaten their continuation.233

Not only could classifying ATSs as BDs hinder progress in the electronic market arena, but this classification is insufficient in what it does mandate. Currently, BD requirements do not touch upon “system access criteria, terms of trade execution, or the handling of quotations.”234 These are three areas applicable to the surveillance of ATSs, yet they remain unmonitored in the BD regulatory framework. Therefore, if the SEC had provided foreign ATSs with the similar option between BD and exchange status that the Commission has afforded to domestic electronic exchanges in the past, the SEC would once again have failed to adequately address the aspects of ATSs which require monitoring and would have continued to impose needless restrictions.

C. Functional Approaches: Not a Solution

The functional approach the SEC has adopted with respect to domestic ATSs also would have failed as a viable solution. Although proponents of functional classification believe that it would promote innovation and growth since the ATS is not confined by the approved list of activities that BD or exchange registration would permit, it does require new filings every time an ATS expands its breadth of services thus adding to administrative obligations.

The arguments that defenders of the purely functional method235 cite are all compelling. Fairness, flexibility, and the reduction of the haphazard nature of regulation are attractive benefits of the purely functional approach. Providing an arena conducive to the promotion of innovation is a goal of the SEC.236 As the Commission recently stated in its Release pertaining to regulation of ATSs dealing in domestic securities (codifying the use of function and volume as the standards by which to determine whether an entity should be deemed a BD or an exchange), it wishes to cultivate “innovative new markets.”237 Nonetheless, the Commission could achieve the same benefits from a clearer method.

While supporters of the purely functional approach feel it is quite straightforward in its simplicity — if one performs an activity, that activity must be regulated — some vagueness exists. What level of activity does one have to perform to trigger regulation? Would an ATS which, as a courtesy to its members, provides a service in its most limited extent still have

232. Id.
233. See Macey & O’Hara, supra note 49.
234. Domowitz, supra note 8, at 98.
235. See supra Part II.C.
236. See supra notes 46 and 63 regarding the SEC’s goals and its forward looking concerns.
to make filings with the SEC regarding the activity? What type of administrative burden would that impose on the firm's compliance obligations? Finally, for a system like Tradepoint, how would the SEC factor in the foreign securities element? Trading in international markets might need to be a separately regulated activity, and since there is no set standard at present, other than Tradepoint's recent Section 5 exemption, the SEC would have to determine a procedure for regulating that function. This form of regulation, in addition to the vagueness problems discussed earlier in the Note, can be a large administrative burden. And the revised functional approach that the SEC has set for domestic ATSs suffers from the same inadequacies from which BD and exchange classifications separately suffer.

D. Access Provider Regulatory Classification: The Solution

The Commission should establish a new access provider regulatory classification and should regulate Tradepoint as such. The Commission can structure this new category to address the unique characteristics of foreign ATSs, eliminate superfluous registration requirements, and provide a more hands-off regulatory policy. The benefit of a new access provider classification would mainly lie in its simplicity and freedom from extensive regulatory burdens. Because these access providers are simply links within the securities market system, checks and supervisory protections are already in place. Adding extensive regulation of the middle-man achieves nothing, weighs down the system, and basically eliminates the advantages of an electronic intermediary.

This new classification would require an ATS to: (1) provide terms of execution, (2) ensure that non-U.S. orders do not receive precedence and that response time to U.S. and non-U.S. orders is equal, (3) provide information about the handling of quotes, (4) furnish basic information regarding the company and its management, (5) file quarterly financial statements, and (6) agree to provide all new members with a written explanation of the risks involved in trading foreign securities.

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238. For example, if a large shopping store were to be regulated by an agency it would have to have its sales monitored. If the store had a café, it would be wise to regulate the kitchen and survey the food that the café dispenses. If the store had a playroom for children, for safety reasons it would probably be wise to make certain that the children were properly supervised. But, should the store have to fill out the same paperwork that a full-service child day care facility would? And what if the store did not have a café but rather had vending machines in the basement for its workers? Would that store have to comply with the same filing requirements as a café? Or how about a change machine located beside the vending machine — would the store then have to fill out paperwork for performing currency exchange services?

239. See supra note 228 regarding areas of ATSs which require supervision.

240. See SEC Release No. 34-40161, supra note 29, at 37150, for discussion of the need to ensure equivalent responses time for orders placed by U.S. and foreign investors. This form of equity is important in assuring that American investors are not only protected, but that they have a fair shot at succeeding in this market.

241. See id.

242. See id. This quarterly information would include: "total volume and average daily volume of transactions effected through the system during the period and year-to-
This laissez-faire methodology is desirable because the electronic nature of ATSs provides a high degree of surveillance.\textsuperscript{243} Systems like Tradepoint provide "less opportunity for fraud or manipulation to occur."\textsuperscript{244} Because they are computer linked, "a perfect audit trail" is available "if manipulation nevertheless is suspected."\textsuperscript{245} This feature is crucial, as one of the SEC's tasks is to protect against such manipulation of the market.\textsuperscript{246} The technologically advanced systems, such as Tradepoint, allow surveillance "by supplying regulatory organizations with access to the alternative trading system's computer facility" making surveillance easier and thereby lessening the need for additional regulation.\textsuperscript{247} This is a key argument in proposing a more arms-length regulatory relationship between the SEC and Tradepoint-like entities.

A hands-off regulatory policy is also attractive because lessening bureaucratic requirements will allow the SEC to encourage innovation. Market participants are likely to recognize change and improvement in trading systems if the SEC removes some of its regulatory restraints. The access-provider classification will open the door to new competitors as participants will no longer be banned from U.S. entry, nor deterred from operating by exhaustive SEC requirements. This competition will help regulate ATSs as market forces will effectually guide them.

Additionally, an access provider classification can furnish a degree of regulatory flexibility not associated with any other type of classification. As opposed to traditional BD and exchange registration, an access-provider category would be most able to adapt to future changes. Presently, there is a high level of uncertainty as to what financial instruments and trading mediums will develop in the next century. Drastic changes are already occurring at a spiraling rate as the stock market that we have come to know no longer looks familiar.\textsuperscript{248} The surge in after-hours trading is evidence of the rapid trend away from the traditional stock market system.

date aggregates of these numbers, expressed in (a) number of units of securities . . . ; (b) number of transactions; and (c) monetary volume . . . ." Id.
\textsuperscript{243} See Blanc, supra note 32, at 33. Blanc addresses surveillance issues in his discussion of "Proposed Regulation of ATSs as Exchanges."
\textsuperscript{244} Id.
\textsuperscript{245} Id.
\textsuperscript{246} See supra note 68 regarding the SEC's Congressionally established responsibilities.
\textsuperscript{247} Macey & O'Hara, supra note 49. According to Macey and O'Hara, as technology improves, so, too, will monitoring capabilities. Currently, all transactions executed in the over-the-counter markets must be reported through the NASD's transaction reporting system, thus creating in the over-the-counter markets an audit trail of the same quality as the NYSE is able to produce. The proposed OATS system which would monitor orders from submission to execution (or cancellation) ultimately would improve dramatically the market's monitoring capabilities. While these developments may be good for market participants, they have hurt the NYSE by eliminating the NYSE's historic "franchise" in the field of monitoring services.
\textsuperscript{248} One example of change is the fact that as of January 25, 1999, "roughly 5 million amateur investors . . . do their occasional trading on the Internet . . . ." Day Traders Under Close Eye of Regulators Series: Money Monday, FLA. TODAY, Jan. 25, 1999, at 02E.
Until recently, only large sized investors have had their own after-hours market.\textsuperscript{249} When the 4 p.m. New York Stock Exchange and NASDAQ bells struck on Wall Street or 4:30 p.m. tolled on regional exchanges, these institutional entities could continue trading.\textsuperscript{250} Instead of placing an order to be executed the following business day as was always done,\textsuperscript{251} these groups could trade shares among themselves. This was achieved generally through ATSs such as Reuters Group’s Instinet Corp.\textsuperscript{252} Extended trading has proved to be a crucial new venue for large investors since news from West Coast companies, such as Intel, often is disseminated publicly only after 4 p.m. EST.\textsuperscript{253} Small investors could not participate in such a market. Therefore, these small groups and individuals were deprived of the opportunity to monopolize on information dispensed post-closing,\textsuperscript{254} placing them at a severe disadvantage.

Yet, this slanted playing field is changing. In August 1999, the Chicago Stock Exchange “approved a plan to offer after-hours trading to institutions and individuals, starting in October” \textsuperscript{1999.255} This is the first such move by a traditional exchange. Alternatively, “E*Trade made a deal with Instinet,” that had already been involved in after-hours trading,\textsuperscript{256} “to allow customers to trade stocks until 6:30p.m. Eastern time, away from traditional exchanges.”\textsuperscript{257} Most recently, REDI Book, another ECN, announced plans of a deal involving Archipelago Holdings, Island Trading, and MarketXT, in which it will “be linked” to these other ECNs “for distribution of after-hours prices and orders” as “[it] will consolidate pricing data for these venues.”\textsuperscript{258} From a regulatory perspective, the idea of opening the

\textsuperscript{249.} Big-time investors, such as institutions, execute post-closing trades among themselves through the use of electronic trading systems. See Online Firms Want to Trade Stocks Around the Clock: the surge in individual investors and frequent trading helps fuel the after-hours trend, BLOOMBERG NEWS, OMAHA WORLD-HERALD, Feb. 8, 1999, at 12 [hereinafter Online Firms].

\textsuperscript{250.} See Greg Ip, Soon, Online Investors May be ‘All-Day’ Traders, WALL ST. J., Feb. 10, 1999, at C1.

\textsuperscript{251.} See id.

\textsuperscript{252.} See id.

\textsuperscript{253.} See Online Firms, supra note 249, at 12. “An after-hours market would help individual investors trade on news that breaks after the stock market closes. Many companies such as Intel Corp. release earnings after the market closes at 4 p.m. New York time.” Id.

\textsuperscript{254.} Because of this disadvantage, online investors who wanted to buy after 4 p.m. are able only to place their orders with online brokers such as Charles Schwab Corp. and E*Trade Group Inc. In turn, the orders are executed only “at the next day’s opening — one of the causes of the burst of activity that occurs then.” Ip, supra note 250, at C1.

\textsuperscript{255.} Robin Goldwyn Blumenthal, ed., Reviews and Previews: Trading, BARRON’S, Aug. 23, 1999 at 12 (emphasis added). See also Extension of NASDAQ Trade Reporting and Quote Dissemination Systems Also Approved (Oct. 14, 1999) <http://www.sec.gov/news/chxhars.html> (announcing the SECs approval of “two pilot programs that would allow after-hours trading by the Chicago Stock Exchange (CHX) and extend the NASDAQ Stock Markets (NASDAQ) trade reporting and quote dissemination systems”).

\textsuperscript{256.} Ip, supra note 250, at C1.

\textsuperscript{257.} Blumenthal, supra note 255, at 12.

\textsuperscript{258.} REDI Book ECN Announces After-Hours Links, Buy-Side Connections, PRNewswire (Feb. 3, 2000) <http://www.prnewswire.com/cgi-bin/...Y=www/stay/02-03-2000/0001132041. REDI Book executes an average of 70 million shares a day. See id.
after-hours market to individual or "retail" investors is a major step.

Foremost are protection issues akin to those discussed regarding domestic ATSs and Tradepoint. Additionally, there is apprehension regarding the possibly low level of liquidity by which this market will be characterized if professionals choose to not participate in it. It is true that order-flow is crucial towards the success of systems such as Wit Capital (the world's first on-line investment banking firm). Without enough participants, there cannot be a liquid market. One observer stated that "commitments from three of the top five on-line brokers" would be necessary "to make this thing... work."

While liquidity is an ever present concern, it may not prove to be problematic in the least for groups such as Wit. There seems to be an increasing interest involving participation in after-hours trading specifically and on-line trading generally. More and more retail investors are transacting trades through the Internet daily. Though MarketXT says

259. "John Markese, president of the Chicago-based American Association of Individual Investors, said individuals may be trading without advantages that some big investors may have, such as company conference calls. 'After hours, who gets the information first? My guess is it's still institutions.'" See Ip, supra note 250, at C1.

260. See id. The greater the number of system participants, the greater the liquidity of the market. While it has been argued that liquidity does not necessarily equal stability (see note 78 for Benn Stell's argument regarding the relationship between liquidity and safety), many believe a wider pool of investors will help toward the success of Wit.


262. Online Firms, supra note 249, at 12 (quoting Bill Burnham, "who follows on-line companies for Credit Suisse First Boston Corp.").

263. See id. This is due to the increasing interest in trading online and even after-hours.

264. See supra text accompanying note 259 ("A study by Burnham found that on-line stock trading rose 122 percent in the fourth quarter of 1998 from the same period a year earlier. One in seven trades took place over the Web in the 1998 quarter, he said."). Id. See also Ip, supra note 250, at C1: "After-hours trading seems a natural service to offer to the mushrooming population of online investors who often buy and sell a stock in as little as a day (a practice called day trading)." Id.

265. About 15 percent of the securities brokerage commissions generated last year resulted from discount brokerage transactions. Increasingly, this business has gone online. And a number of financial service companies operating here have sought to capitalize on the trend. A Credit Suisse First Boston report said 222,000 securities trades per day were executed during the second quarter of [1998] by about 80 'online broker' computer stock-trading services, such as ETrade, Accutrade, Ameritrade and Datek Online. Volume soared from 117,600 trades in 1997 second quarter, on the strength of general stock market activity and because 'new customers have continued to stream into the industry,' said Bill Burnham, who prepared the report. Contributing to the trend are Internet growth and the fact that 'employers are essentially forcing their employees to become self-directed investors,' he said. In the past, many corporations offered defined benefit pension plans, guaranteed monthly payments based on salary and years of service. But today, most firms have shifted to defined contribution plans, such as 401(k) plans, which depend on employees to decide how much to invest and where to put their money, he said.

“research shows that many online investors are interested,” the organization does believe that its plan to restrict their potential market to only “‘limit’ orders, which can be executed only within prescribed price limits” will “address the unique risks of trading after hours.”

Fundamentally, the very concept of on-line investing has raised various concerns. The volume of online investments is no longer immaterial. Charles Schwab, “the country’s largest cyber-trading firm” was recorded to place “an average 153,000 trades a day on its Web site in January [1999] a 65% increase over its average daily trading volume of 93,000 in the fourth quarter” in 1998. In fact, Schwab handled in excess of “1 million online orders” in the week of January 11, 1999 alone, and reached a staggering level of customer trades totaling “$2.6 billion worth of securities online each day during January [1999]” and has maintained this pace. The first month of 1999 witnessed a surge of online trading across the board, not only for Schwab, and as of September 1999, ECNs accounted for approximately 300% of NASDAQ’s trading volume. Certainly, such a high degree of securities activity cannot go without notice, especially from a regulatory perspective.

Issues of fraud rank high on the list of fears by investors. In late October of 1998, the SEC announced its “first ever Internet investment fraud sweep.” This was no inconsequential matter. As part of this sweep, the SEC “open[ed] ... cases against 44 individuals and companies in 23 separate actions through the U.S.” The charges brought against these groups involved “illegally pumping stocks and then taking big compensation and selling off their shares, causing the stock prices to plunge and leaving other

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266. Ip, supra note 250, at C1. At the time of this comment, the company was called Eclipse Trading. Since that time, it has renamed itself MarketXT. Citigroup Unit Will Offer After-Hours Stock Trading, WALL ST. J., Sept. 2, 1999, at C15. On February 10, 2000, Tradescape.com Inc. announced its purchase of MarketXT for $100 million in private stock. Tradescape.com plans on increasing the ECN’s trading hours and hopefully making the system more competitive with systems such as Charles Schwab Corp. Greg Ip, Deals & Deal Makers: Tradescape.com to Acquire Market XT for Private Stock Valued at $100 Million, WALL ST. J., Feb. 10, 2000, at C22.

267. Id.

268. A potential result of an unlimited market is that “an investor ... can end up paying more or getting far less than expected for a stock.” Id.


270. Id. Michael Schroeder & Greg Ip, Levitt Urges Central Market to Price Stocks, WALL ST. J., Sept. 24, 1999, at C1 (describing that while 30% of NASDAQ’s trading volume has been taken by ECNs, “an insignificant share of Big Board trading” is executed by these entities “because of rules limiting trading Big Board away from a ‘stock exchange’”).

271. See Online Trading Hits Snag at Schwab: Computer Problem Shut Down System for an Hour, KANS/CITY STAR, Aug. 31, 1999, at D34 (stating that as of August 1999, Schwab was handling approximately “147,700 online trades a day for its 6.2 million active investor accounts”).

272. See id.


274. Id.
investors out in the cold.” Commencing these actions sent a clear signal to online entities that an unruly Wild-West atmosphere will not be tolerated on the Internet trading scene. Securities fraud and investor manipulation are still enforceable actions, even on this new medium.

Another investor concern is “system failure” — when the system is not accessible, or “down” due to technical problems, thereby preventing investors from executing trades. For example, “online securities brokerage E*Trade experienced a series of very public system failures caused by a software change. These failures prevented customers from making trades and checking their account balances.” This malfunction was more than a mere annoyance. Not only did this frustrate E*Trade’s customers, and anger securities regulators, it also “prompted an investigation by the New York Attorney General into the practice of online trading.” This is because the repercussions of system failure are many. What happens if an investor puts in a buy or sell order only to find out then that the system crashed moments after? What happened to the trade? More importantly, what about the great loss one could have avoided or gain that one could have realized if the trade had been properly executed? Does an investor simply accept that risk by engaging in on-line trading or should he or she expect the same level of execution as if the trade were placed with a traditional brokerage house?

How does this apply to Tradepoint? What does after-hours trading

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275. Id.
276. E*Trade is the second ranked “online trading shop.” Charles Schwab is the number one online firm. On February 16, 1999, E*Trade announced that “it got approval from securities regulators to begin selling mutual funds and money market accounts over the Internet.” Feldman, supra note 269, at 29.
277. Stephanie Stahl, Cutting-Edge IT Can’t Guarantee Perfection, INFORMATIONWEEK, Feb. 8, 1999, at 181 (“Those few hours of instability were enough to enrage many customers and cast doubt on E*Trade’s ability to handle spikes in transactions.”).
278. The malfunction involved a 90 minute crash on February 3, 1999 and a two hour gap on the following day. Net Consumers Face a Virtual Standstill (E’Ttrade Securities Online Outage), SAN JOSE MERCURY NEWS, Feb. 5, 1999, at 1A(2) (stating that “industry analysts believe that companies like E*Trade must anticipate the worst-case scenario and have a contingency plan in place”).
279. One explanation for problems in online trading is that “the incredible pace of change in markets, business, and technology, combined with technical complexity, often make all of this difficult to manage. E*Trade’s problems are proof that even the most prepared and cutting-edge companies are susceptible to the vagaries of the unknown.” Stahl, supra note 277, at 181.
280. See E*Trade Delays Spark Inquiry (The Online Securities Trader's System Problems), PC Week, Feb. 8, 1999, at 1999 WL 9711389, (discussing how “[a] series of network failures . . . put E*Trade, the online stock trading company, in hot water with both users and securities regulators”).
281. Stahl, supra note 277, at 181. New York attorney general Eliot Spitzer addressed the complaints of online investors by “probing online trading firms this month.” Feldman, supra note 269, at 29. See also E*Trade Delays Spark Inquiry, supra note 280, at 1999 WL 9711389 (discussing that “New York officials said they were going to take a hard look at the online stock trading industry after three days' worth of problems prevented online traders from conducting transactions through the E*Trade Web site.”).
and the expansion of on-line investing\textsuperscript{282} mean to this British ATS and the SEC’s foreign ATS regulatory scheme? Conventional methods of SEC classification will not smoothly apply to Wit, MarketXT, and other future market systems. The extensive administrative burdens and strict limitations as to what falls within the established categories cannot properly address these new technologies.

We are clearly moving toward a world with twenty-four hour global trading for institutional and retail investors alike. This progress should not automatically be curtailed by excessive regulation or adhesion to archaic classification rules. While we continually hear the echos of protection concerns, if the SEC were to permit domestic ATSs such as Instinet and Datek to expand their services to retail investors online, protection issues may be less of a concern to the SEC. While Tradepoint deals solely with institutional investors, Instinet and Datek would enjoy much greater breadth operating in the retail investor element. Certainly, the protection issues involved in retail sales is much greater than those which Tradepoint triggers.

Moreover, the fact that Tradepoint is foreign does not obfuscate the issue. The risk to U.S. retail investors dealing in U.S. securities via Wit as opposed to investors accessing U.K. securities through Tradepoint is insubstantial. U.S. investors are already indirectly dealing in foreign securities. In fact, trading on Wit or its equivalent can be even riskier than trading on the Tradepoint system. This is because Tradepoint requires membership. Presumably, its members are familiar with trading risks, unlike many who trade over the Internet, unaware of the dangers involved.\textsuperscript{283}

Only an access provider classification can adapt to these modernizations. A less rigid and non-traditional format can be flexible enough to accommodate innovative new domestic and foreign systems\textsuperscript{284} while still

\textsuperscript{282} Predictions as to the growth of on-line investing are universal. “A survey last year by Jupiter Communications, for example, forecasts that discount brokerages would control more than 50 percent of personal finance activity online by 2002 and that online trading would be carried out by 31 percent of the entire investing market. In addition, the investment bank Piper Jaffray, a leading industry tracker, predicted that online trading volumes would amount to more than 27 percent of all retail trades by the end of 1998, compared with 17 percent in 1997. Piper Jaffray also reported that the top ten online brokerages had 5.8 million accounts between them at September 1998, more than double the figure of one year earlier.” *The Widening Web (Part 1 of 2)*, *Funds Int’l.*, Feb. 1, 1999, at 8.

\textsuperscript{283} One commentator remarked that “... it raises concerns that online trading, risky enough for unsophisticated individuals, could be riskier still in the relatively murky, lightly traveled after-hours market.” Ip, supra note 250, at C1. In addition, most every-day investors probably won’t be looking to invest heavily in British stocks.

providing a basic supervisory structure. Supervision is still a forefront concern. While the SEC has an obligation to deter fraud and manipulation of electronic markets, it also has an obligation to foster a reasonably level playing field. The ways to achieve fairness are guaranteeing equal response time and immediate re-routing of orders. Surveillance of these factors should be a primary task of the SEC. Current SEC regulations do not address such issues and these matters are but minor reflections of what might be to come.

IV. The Impact the SEC's Decision Regarding Tradepoint Will Have on the U.S. Market and Future Regulation

The Commission's recent decision regarding Tradepoint has the potential to contribute to a possible proliferation of similar exchanges. The SEC could apply a similar standard as the one it has applied to Tradepoint if it finds that a new entity is organized so as to comply with the rules and regulations applicable to it and to provide a fair and protective environment for investors. Since access to the U.S. market creates a solid opportunity for smaller exchanges, there is a strong possibility that if the Commission were to expand its application of such a means of registration, there could be a rise in applicants. If the SEC were to use the low-volume exemption as a standard for entities analogous to Tradepoint, without expressly limiting its breadth, it would most assuredly be promoting the establishment of

W-Trade's Wireless Internet Trading System, the industry's first wireless trading system, used by InvesTrade, employs AT&T's Pocket Net Wireless service to deliver its Internet trading capability via Palmpilots, smart cellular phones and other devices. Customer trades go through W-Trade's computer servers, from where they are routed to InvesTrade's trading system and, eventually, to InvesTrade's clearing agent, the BHC Securities unit of Fiserv.

Kountz 2, supra, at 1. GTE, which "unveiled what observers say is the securities industry's second wireless Internet-based trading system," "builds on GTE's previous wireless experience, including development of wireless trading technology now in use on the floor of the New York Stock Exchange . . . ." Kountz 3, supra, at 11. "Like W-Trade's creation, GTE's Wireless Trader allows retail clients of the e-brokerage community to trade, receive alerts and tap stock quotes via portable cellular phones called 'smart' phones." Kountz 3, supra, at 11. Reality, combines with "wireless computing middleware developed by Aether Technologies." "The Reality/Aether wireless system allows investors to enter and execute orders, retrieve real-time quotes and news and query their account data via hand-held computers, digital assistants and so-called smart phones." Kountz 1, supra, at 17.

285. In an effort to respond to what the Securities and Exchange Commission has identified as an increase in fraud concerning online investing, the Commission "has created the Office of Internet Enforcement." Internet Enforcement, FLORIDA TODAY, July 29, 1998, at 10C. Provisions such as these are positive steps in the SEC's move to adapt to the changing needs of the securities industry. The Office of Internet Enforcement will enable the SEC to address the specific and unique issues of the Internet while maintaining its broader goal of investor protection.


If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.
nurseries small exchanges. Such ATSs would spring-up in small form in order to take advantage of the low-volume exemption rather than forming based on need or demand.\textsuperscript{287} Though competition often positively stimulates improvements,\textsuperscript{288} this overflow risks compromising overall efficiency.

Regardless of the means of regulation, Tradepoint will certainly not be the last foreign ATS to attempt U.S. registration. With the need for a physical trading floor no longer necessary and computers providing the basic link between systems’ participants, location is not an impediment to global growth. The historic barriers to expansion are disappearing.

The Tradepoint decision may also have a profound effect on the U.S. securities market. The SEC has continually expressed its concern regarding the inferior dissemination of information the foreign firms and markets provide\textsuperscript{289} and direct U.S. investor access hits this issue squarely. The Commission has also conveyed its concern that trading systems “have no obligation to provide investors a fair opportunity to participate in their systems or to treat their participants fairly.”\textsuperscript{290} Yet, these concerns were voiced regarding domestic ATSs, and as evidenced by the Commission’s concept release regarding the regulation of ATSs, it would appear that the

\textsuperscript{287} See Macey & O’Hara, supra note 49. Macey and O’Hara commented that “special exemptive treatment for alternative trading mechanisms that are of low volume” would be illogical as it “would simply allow competitors to avoid burdensome regulation by remaining small. The sheer number of alternative trading systems would proliferate . . .” for non-demand related reasons. Id.

\textsuperscript{288} The theory that monopolies deter innovation is a common one. See Scott McNealy, What Constitutes a Monopoly? Software Serenade Before the Courts, Wash. Times, Jan. 17, 1999, at B3 (discussing the Microsoft suit, stating that “[w]hile history shows, when the government has moved against monopolies, innovation and competition have flourished.”) See also Andrew J. Glass, Economist Says Microsoft is Guilty, Atlanta Const., Jan. 6, 1999, at D11 (quoting Massachusetts Institute of Technology Professor Franklin Fisher’s comment regarding the Microsoft situation: “If software developers believe that Microsoft will engage in anti-competitive acts to impede any innovation that threatens its monopoly, they will have substantially reduced incentives to innovate in competition with Microsoft.”) For a more relevant example of this monopoly concern, Bloomberg suggested that “[i]f the Commission were to adopt its proposal to establish NASDAQ as the market center and sole source of executions, the chances of NASDAQ voluntarily upgrading its technology in the future become slim.” Letter from Bloomberg, supra note 28, at 7. This is usually true since there is no incentive to improve one’s capabilities when there is no competitor lurking around the corner, looking to take away one’s market share. Of course, there are exceptions to the rule. Take for instance, “government-granted monopolies (patents)” that “spur innovation” in the prescription drug industry. This does not “interfere with the free market” according to this article’s authors, due to the fact that there is no free market for prescription drugs. Alan Sager & Deborah Socolar, A Fairer Prescription Plan, Boston Globe, Jan. 26, 1999, at A19.

\textsuperscript{289} See SEC Release No. 34-40760, supra note 13, at 70846. In order to achieve the “benefits of both market centralization — deep, liquid markets — and competition” the national market system “has maintained equally regulated, individual markets, which are linked together to make their best prices publicly known and accessible.” However, because “[a]lternative trading systems have remained largely outside the national market system,” the SEC is concerned about the lack of duty the ATSs owe to their investors. Id. at 70845. This Release discusses the system’s lack of obligation to provide fairness to investors as well as their vulnerability to manipulation and fraud.

\textsuperscript{290} Id.
SEC has overcome these matters. Nevertheless, the above concerns can easily be addressed under an access provider regulatory system.

The more important concern still outstanding is the ramifications Tradepoint will have on the market in its entirety. Trading in foreign securities is accompanied by a certain degree of risk, as is trading in domestic securities. There are various uncertainties since political and legal changes within a country have a significant impact on the market.291 If U.S. investors are to trade heavily in a country's stock and that country is to then undergo a turbulent event, it is inevitable that there would be a ripple effect. However, U.S. investors are already executing trades in foreign securities indirectly. While investors should only do so fully aware of the risk factors, it would not appear that merely eliminating the middleman would create any drastic results. Clearly, the SEC has recognized this by allowing Tradepoint to win the Application process and continuing to monitor the company's progress.

There is evidence that direct trading would have a minimal impact on the U.S. market. One reason for this is the anonymity trades executed on the system enjoy. Because "[b]rokers and other traders cannot . . . draw conclusions as to the dealing intentions or positions of trading parties," and because they are unaware of the parties' identities, they are prevented from "act[ing] speculatively on them,"292 thus lessening the market impact. This is crucial since many continue to fear the volatile nature of foreign market trading and are apprehensive that the riskiness of these trades will disturb the stability of the U.S. market.293 By maintaining anonymity,

291. The last major reform of the London Stock Exchange, commonly referred to as the "Big Bang," took place on October 27, 1986. It was on this day that a formal agreement was made regarding the reformation of the Exchange. The reforms mainly centered around negotiated rates by class of security, commissions, and discount rates. Cecil Parkinson, Trade Secretary, was the individual who sparked this movement when he asked the LSE to prepare reform proposals in July of 1983. After much debate, variations of the changes were put into place. See IAN M. KERR, BIG BANG 32-34 (1986).

292. Glasgow, supra note 159, at 58. This anonymity is a key element of the Tradepoint system.

293. One must remember that Tradepoint currently offers trading only in securities listed on the London Stock Exchange, not in securities of other more unstable nations. While there is most definitely risk involved in the trading of U.K. stocks, the relative stability of the United Kingdom contributes to the lesser level of concern regarding turbulent side effects of direct U.S. access to these securities. This is not to say, however, that if a large increase in the investing of British stocks were to occur, and the United Kingdom were to subsequently undergo a major crisis, that there would be no ripple effect. The Asian crisis of 1998 is evidence of what can occur. "When Asian markets slumped last year, most U.S. businesses denied it would have much of an impact on the American economy. Only recently have we felt the extent to which Asian economic woes affect us directly. Failure in one part of a system always exposes the levels of interconnectedness that otherwise go unnoticed -- we suddenly see how our fates are linked together. We see how much we are participating with one another, sustaining one another." John J. Petersen, Margaret Wheatley, Myron Kellner-Rogers, Computers and the Years 2000: What Will Happen?, CURRENT, Jan. 1, 1999, at 3. Yet, if a slump in the U.K. were to occur, and an impact in the United States were to be felt, the source of the impact would not be Tradepoint. This is because the institutions that will trade on the system already are trading these British securities, simply through an extra intermediary. Additionally, without grossly oversimplifying the situation, the Asian market crisis did not
future expansion into markets such as Hong Kong’s and possibly those of other European countries could likewise have minimal repercussions. Traders will still want to avoid unwise trades, and the ones that they do execute will not have a magnified effect.

Systems such as Tradepoint also are impacting the best execution rule. The obligation to obtain the best price for an order is a broader responsibility than in the past. One scenario exposes the dilemma these systems present:

On 13 October 1998, at 11:39:08 am, ten thousand shares in Commercial General Union (symbol CGU) were traded at a price of 960p on the London Stock Exchange. At that exact time, there existed a firm sell order on the order-book of the other stock exchange (Tradepoint) at a price of 951p, in the same size - ten thousand shares. By dealing at 960p on the LSE instead of dealing on the (9p better) Tradepoint price, the buyer in this instance paid at least £852 too much.294

Apparently, similar instances are not hard to find.295 Therefore, it has become evident that immediate execution is not always the most economically sound alternative for an investor. Rather, patience on a trade may prove more fruitful.296 Clearly, these electronic systems are exposing the flaws inherent in the best execution rule and demonstrating the need for reform. With companies such as Tradepoint advocating their own proposals for the best execution rule,297 we will certainly see impact in this regulatory area in the future.

Tradepoint’s entrance into the United States might also impact the SEC’s approach to domestic ATSs. If a new, successful, and less cumber-

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295. See id.
296. See Tradepoint Financial Networks PLC, supra note 294.
297. Tradepoint’s proposed solution for the best execution rule was:

When considering Best Execution, regulated entities should: have access to all relevant publicly available information as well as taking reasonable care to solicit private information from intermediaries, deal (or instruct their agents to deal) in such a way as to gain the best advantage for their clients, consider the commission costs, spread costs and market impact costs, consider the cost of immediate execution relative to patient execution as well as the risks involved in price movement, consider the existence or otherwise of conflicts of interest when choosing agents, especially where the order concerned is not being executed directly, through a public limit order system.

Id. Additionally,

Tradepoint proposes an analogous structure to the U.S.: an inter-market trading system combined with a consolidated ticker. This would have a number of highly beneficial effects: It would make compliance with the improved Best Execution rule, by brokers, much more straightforward; it would reduce the costs of dealing to investors; and by encouraging the provision of liquidity, it would improve the quality and liquidity of the UK equity market.
some access provider classification were to be established for foreign ATSs, applying it to domestic electronic systems would seem a natural progression. Freeing the systems from the current exchange/BD requirements may be a desirable alternative, more so if Tradepoint's transition is smooth. The Commission has noted its need "for a more forward-looking regulatory approach" in relation to both domestic and foreign technological developments. Therefore, its adoption of analogous means of regulation for these classes of ATSs makes sense, especially since the ultimate goal is to provide for the protection of U.S. investors.

Creating a clear and consistent means of regulation would also be advantageous to U.S. investors. Such a defined framework would promote the growth of ATSs. No longer would systems be deterred from attempting the possibly costly and uncertain application process to operate in the United States. Instead, they would be able to confidently enter the process, aware of what to expect. This will encourage better established systems to apply and, if approved, provide additional opportunities for American traders.

Conclusion

This Note examined the various regulatory procedures the SEC could have applied to foreign and domestic ATSs in general and to Tradepoint specifically. It described the shortcomings of the various existing regulatory classifications when extended to ATSs, discussed additional means of registration, and explained why Tradepoint's Application for a Section 5 exemption was correctly approved provided it remain only on a temporary basis. Further, it presented a new, alternative means of registration for Tradepoint and similar systems: the access provider classification.

This new designation would allow the SEC to maintain its supervisory role over the foreign ATSs in the same way it oversees BDs and exchanges. Yet, because it would exercise less control over an ATS, it could also allow for progress. An access provider classification would continue to require standard financial reporting, disclosure of basic information, and fair and equitable treatment of investors, but would not shackle the electronic system with outdated and unnecessary requirements. Additionally, an access provider classification would not restrict the creative and innovative power of these entities. The creation of a new regulatory classification would require a substantial investment from the SEC now, but would ultimately prove efficient, eliminating many future problems. The SEC could thereby create a category flexible enough to accommodate future technological advancements not presently existing, nor imaginable today. We must move beyond the traditional requirements and historic classifications of the Securities Exchange Act of 1934 and broaden the assortment of opportunities available to U.S. investors.

Id.