

Rethinking the National Market System

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I. INTRODUCTION

In 2005, the Securities and Exchange Commission (SEC) adopted Regulation National Market System (Regulation NMS), a set of rules that instigated major changes in the structure of US equity markets.¹ Regulation NMS was controversial before it was adopted and has remained so a decade after its implementation. That regulation was the offspring of a much older statutory directive to the SEC to build a national market system. The Securities Acts Amendments of 1975 ('75 Amendments), among other things, attempted to integrate, coordinate, and modernize the equity markets.

The '75 Amendments—an ambiguous mandate to the SEC to remove barriers to competition in the equity markets, yet also to manage that competition for the public good—were a fitting product of their time. In many areas, the 1970s were a decade of deregulation born of a realization that heavily regulated industries, such as airlines and trucking, were not serving customers as well as they would if they were less regulated. In other areas, such as President Nixon's price controls and the environment, the 1970s saw experimentation with more centralized and comprehensive regulation. One contemporary author, looking back at the period from 1960 to 1979, explained: "all of us—scholars, legislators, the general public—are at this moment confronting the peculiar spectacle of two powerful trends that seem to be directly at odds with each other. One is toward greater government regulation, the other toward less."² The national market system embodied this

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1. 15 U.S.C. § 78k-1(a)(1) (2012) (listing Congressional findings about national market system).

2. THOMAS K. MCCRAW, REGULATORY CHANGE, 1960-79, IN HISTORICAL PERSPECTIVE, *in* JOINT

same tension—a recognition of the importance of the value of competition, but a belief that the government needed to manage competition to make sure that the market worked in the public interest as efficiently as possible.

This Article looks back at the adoption of the '75 Amendments and argues that it is time to reconsider the necessity of the law's national market system mandate. Part II introduces the national market system mandate in the context of the time in which it became law. Part III discusses the SEC's role in acting on the national market system mandate. Part IV discusses why a national market system could develop better organically than as the product of a statutory mandate. Part V posits that now is a good time to reconsider the SEC's national market system mandate, and Part VI concludes.

II. THE MUDDY 1975 CONGRESSIONAL VISION: A NATIONAL MARKET SYSTEM

Described both as “deregulatory”³ and as “the most fundamental restructuring of the securities industry since the adoption of the Securities Exchange Act of 1934,”⁴ the '75 Amendments were designed, among other things, “to facilitate the establishment of a national market system for securities.”⁵ This mandate grew out of a period of great interest in the securities markets during which people were asking questions such as whether the stock market could support the broader economy as it grew rapidly, how computerized the markets should be, and how investor confidence in the functioning of the markets could be strengthened.⁶ Congress and the SEC investigated these and other issues in a series of inquiries.⁷ According to Congress, the '75 Amendments were “the culmination of” Congress’ “most searching reexamination of the competitive, statutory, and economic issues facing the securities markets, the securities industry, and, of course, public investors, since the 1930’s.”⁸

A. The Genesis of the '75 Amendments

SEC and congressional interest in the securities markets was driven by the changes—some of them disorderly—occurring in those markets. Many of these changes were the product of a dramatic increase in institutional participation in markets—the institutional share of the market grew from 34% of the NYSE's volume in 1961 to 70% in 1974.⁹

ECONOMIC COMM., 96TH CONG., SPECIAL STUDY ON ECONOMIC CHANGE, VOL. 5, 2 (Comm. Print 1980).

3. Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. ILL. L. REV. 315, 315 (1985) (exploring SEC history of deregulation).

4. John G. Gillis & Robert G. Dreher, *Securities Law and Regulation: National Market System*, 38 FIN. ANALYSTS J. 13, 13 (1982).

5. 15 U.S.C. § 78k-1(a)(2) (2012).

6. See, e.g., H.R. REP. NO. 94-121, pt. 12, at 15138 (1975) (Conf. Rep.) (citing concerns about “sagging investor confidence” and the ability of the US securities markets to keep pace with the rest of the economy).

7. See, e.g., Ray Garrett Jr., Chairman, SEC, Future Securities Markets—Reform, Not Revolution, Address to the North American Securities Administrators Conference 19 (Sept. 8, 1975), <https://www.sec.gov/news/speech/1975/090875garrett.pdf> (“[T]he basic elements of the national market system grew out of Commission and Congressional studies over the last half-dozen years or so and were set forth in the Commission report on the central market system published in March, 1973.”).

8. H.R. REP. NO. 94-121, at 15138.

9. Philip A. Loomis Jr., Comm’r, SEC, The Central Market System, Remarks Before the Regional Member Firms ‘Round Table’ 6–7 (May 29, 1974), <https://www.sec.gov/news/speech/1974/052974loomis.pdf> [hereinafter Loomis Jr., Central Market System].

Increased trading volumes contributed to the paperwork crisis of the late 1960s and early 1970s, which shook the industry, led to special Wednesday closures of the NYSE, and caused many firms to fail.¹⁰ Regional exchanges began to challenge the competitive dominance of the New York Stock Exchange (NYSE),¹¹ which led to fragmentation of the markets.¹² In 1975, the SEC ended fixed commissions—an almost sacred hallmark of the brokerage business. The growing availability of new technology made possible changes in the market’s structure.¹³

The concept of a national market system did not originate with Congress. In its 1971 Institutional Investor Study, the SEC deemed the time to be right for a “strong central market system:”

our objective is to see a strong central market system created to which all investors have access, in which, all qualified broker-dealers and existing market institutions may participate in accordance with their respective capabilities, and which is controlled not only by appropriate regulation but also by the forces of competition.¹⁴

The Martin Report, an NYSE-commissioned study, called for a “[central market system] . . . to provide a single, national auction market for each security qualified for listing.”¹⁵ In 1972, the SEC issued a statement that embraced a central market system

10. See, e.g., Garrett Jr., *supra* note 7, at 5 (“The great back-office crunch led to four-day weeks on the New York Stock Exchange, widespread discontent among investors who waited weeks and months for delivery of securities, and ultimately to the financial collapse of scores of broker-dealer firms, including some of the largest and best known.”); Philip A. Loomis Jr., Comm’r, SEC, The Securities Acts Amendments of 1975, Self-Regulation and the National Market System, Address Before the Joint Securities Conference 1975 2 (Nov. 18, 1975), <https://www.sec.gov/news/speech/1975/111875loomis.pdf> [hereinafter Loomis Jr., Securities Acts Amendments] (“The origins of this legislation can be traced back at least to the distressing events of 1968-1971 when an unexpected surge in trading volume caused the securities industry to almost drown in a sea of paperwork.”).

11. The rise of competition to the NYSE should not be overstated. S. COMM. ON OVERSIGHT AND INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 96TH CONG., NATIONAL MARKET SYSTEM; FIVE YEAR STATUS REPORT 6 (Comm. Print 1980) [hereinafter HOUSE FIVE-YEAR REPORT] (citing the NYSE’s dominant market share as grounds for anticipating that change could not come from “within the industry”).

12. See, e.g., Letter from Bob Eckhardt, Chairman, Subcomm. on Oversight and Investigations of the House Comm. on Interstate and Foreign Commerce to Harley O. Staggers, Chairman, House Comm. on Interstate and Foreign Commerce (Aug. 26, 1980) (expressing concern about “fragmentation of the markets, an evil the [’75 Amendments] sought to correct”).

13. Loomis Jr., Central Market System, *supra* note 9, at 8 (“Fortunately, the technology necessary to meet these problems has been developed. It is no longer necessary, for lack of any other technically feasible method, to bring all orders together on one floor. A national market is a practicable alternative.”).

14. H.R. DOC. NO. 92-64, at xxv (1971), See also Ray Garrett Jr., Chairman, SEC, The Central Market System and Commission Rates, Address before the Pacific Northwest District Securities Industry Association 11 (Sept. 6, 1974), <https://www.sec.gov/news/speech/1974/090674garrett.pdf> (“The central market system concept was first enunciated by us in 1971, after our Institutional Investor Study—a study that commenced in 1968.”).

15. WILLIAM MCCHESENEY MARTIN, THE SECURITIES MARKETS; A REPORT WITH RECOMMENDATIONS 4 (Aug. 5, 1971), http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1971_0806_MartinReport.pdf. The New York Stock Exchange (NYSE) favored a requirement that all listed securities trade on a registered national stock exchange. See, e.g., James J. Needham, Chairman, NYSE, Fail-Safe or Fail Certain: The Final Push to Securities Legislation, Remarks before the Financial Executives Institute 11 (Apr. 2, 1974), <http://3197d6d14b5f19f2f440->

based, not on a centralized auction mechanism, but on composite quotation and transaction data.¹⁶ In 1973, then SEC chairman Bradford Cook pledged “to make the central market system an operational reality within two years.”¹⁷ His version of the central market system would ensure that the “public investor . . . has an equal crack at the best available price, no matter where it is being made.”¹⁸ Cook’s pledge was made at the same time the SEC issued a policy statement that embraced a central market system.¹⁹ Professor Oesterle described that statement as a “dramatic proposal” to “control[] order routing and execution for all the country’s markets.”²⁰

The SEC’s embrace of the national market system marked a departure from the SEC’s prior approach to regulating the equity markets. As Al Sommer, an SEC commissioner at the time, explained, the SEC shifted from taking “the industry as economics shaped it” to an “activist role”—undertaking “an effort . . . to order the emerging forces in a rational manner.”²¹

The ‘75 Amendments offered the SEC the statutory authority to pursue its new vision. The amendments became law on June 4, 1975. Of particular interest here is Section 11A of the Exchange Act, which begins by acknowledging that the “securities markets are an important national asset which must be preserved and strengthened.”²² Other congressional findings that formed the basis for the national market system were:

- (1) “New data processing and communications techniques create the opportunity for more efficient and effective market operations.”
- (2) It is both appropriate and in the public interest “to assure” “economically efficient” transactions, “fair competition” among market participants and trading centers, availability of transaction and quotation data to market participants, “the practicability of brokers executing investors’ orders in the best market,” and an opportunity for dealer-free execution of orders.
- (3) Market linkages “through communication and data processing facilities” are

5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1974_0402_NeedhamFail.pdf (arguing that absent authority for the SEC to require all trading occur on exchanges, liquidity could be internalized by broker-dealers, with harmful effects on price discovery).

16. See William R. Harman, *The Evolution of the National Market System—an Overview*, 33 BUS. LAW. 2275, 2279–80 (1978) (discussing the SEC’s Statement on the Future Structure of the Securities Markets).

17. G. Bradford Cook, Chairman, SEC, *The Central Market System: Putting the Markets to Work for the Investor 2* (Mar. 15, 1973), <https://www.sec.gov/news/speech/1973/031573cook.pdf>. Cook explained what he had in mind: “We view it as a communications and regulatory system with three parts: first, a network for reporting prices and volume as trades occur so that all the action in a given security can be viewed through a central source; second, a quotation system to capture and display all the bids and offers in these securities so the broker can see where the best price is available and direct the investor’s order to it; third, a regulatory framework to assure that the purposes and goals of the system are met.” *Id.* at 5.

18. *Id.* at 20.

19. Harman, *supra* note 16, at 2281–83 (describing themes of the March 1973 Policy Statement on the Structure of the Central Market System).

20. Dale A. Oesterle, *Regulation NMS: Has the SEC Exceeded its Congressional Mandate to Facilitate a “National Market System” in Securities Trading?*, 1 N.Y.U. J. L. & BUS. 613, 619–20 (2005).

21. A. A. Sommer Jr., Comm’r, SEC, *The SEC in the Midst of Revolution*, Address at the NYSE Marketing Conference 3–4 (June 10, 1974), http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1974_0610_SommerRevolution.pdf.

22. 15 U.S.C. § 78k-1(a)(1)(A) (2012).

beneficial.²³

Based on these findings, Congress directed the SEC, “having due regard for the public interest, the protection of investors, and the maintenance of fair and orderly markets, to use its authority . . . to facilitate the establishment of a national market system for securities.”²⁴ Congress directed the SEC to bind the markets together through “communications systems, particularly those designed to provide automated dissemination of last sale and quotation information with respect to securities.”²⁵ Accordingly, Congress gave the SEC “pervasive rulemaking power to regulate . . . all organizations engaged in the business of collecting, processing, or publishing information relating to quotations for and transactions in securities.”²⁶ Congress gave the SEC the option of setting up a governing body for the national market system, the nature and powers of which were unclear.²⁷

B. Discerning the Purpose of the ‘75 Amendments

Contemporaneous observers and those looking back over time have wondered exactly what the national market system was intended to be and how active a role in shaping it the SEC was intended to take. In the words of one commentator, “[t]he legislators hoped to improve an essential economic mechanism that they admired and respected without supplanting the existing market structure.”²⁸ Some observers read the mandate as a directive to forcefully meld trading venues together into one national computer platform for executing trades.²⁹ Others saw the statute as a mandate for industry-driven, incremental steps to improve communication among market participants and interaction between markets.³⁰ Still others read the statutory mandate as an intentionally broad invitation for the SEC to exercise its regulatory discretion.³¹ One longtime SEC staffer explained that

23. 15 U.S.C. § 78k-1(a)(1)(B)-(D) (2012).

24. 15 U.S.C. § 78k-1(a)(2) (2012). Congress envisioned the national market system encompassing more than common stocks. See H.R. REP. NO. 94-121, pt. 12, at 15119 (1975) (Conf. Rep.). This Article focuses only on market structure related to equity securities.

25. See H.R. REP. NO. 94-121, at 15139.

26. *Id.*

27. See, e.g., Ray Garrett Jr., Chairman, SEC, *The Markets: Nationalization or Centralization?*, Address before the New York Chamber of Commerce and Industry 18–20 (Mar. 20, 1975), <https://www.sec.gov/news/speech/1975/032075garrett.pdf> (discussing the controversy over a potential governing board for the national market system and whether it would have powers of self-regulation or even nationalization).

28. Donald L. Calvin, *The National Market System: A Successful Adventure in Industry Self-Improvement*, 70 VA. L. REV. 785, 790 (1984).

29. See, e.g., Gillis & Dreher, *supra* note 4, at 13 (“The ultimate objective . . . was to centralize all buying and selling interest so as to permit each investor the opportunity for the best possible execution of his order, regardless of where in the system it originated.”); Junius W. Peake, *The National Market System*, 34 FIN. ANALYSTS J. 25, 82 (1978) (“[T]he *only* system that will meet the two major objectives required by Congress—total order interaction and full market-maker competition” is “a computer-based system in which all orders would have the opportunity for interaction.”) (emphasis in original).

30. See generally Calvin, *supra* note 28 (discussing the attempt to develop the national market system through the ‘75 Amendments).

31. See, e.g., Oesterle, *supra* note 20, at 614 (“The 1975 Congressional amendments vested substantial discretion in the SEC to flesh out and implement Congress’s admittedly hazy, inchoate vision of what a national market system ought to be.”); Walter Werner, *Adventure in Social Control of Finance: The National Market System for Securities* 75 COLUM. L. REV. 1233, 1277 (1975) [hereinafter Werner, *Adventure in Social Control*] (“The concept of a central market system requires complex regulation of markets, both exchange and over-the-counter, and securities professionals.”).

the “NMS approach to market structure” seeks to preserve “the benefits of competition among markets,” while “minimiz[ing] any adverse effects of ‘fragmentation.’”³²

Congress chose the Senate’s phrase—“facilitating” the national market system—rather than the more interventionist-sounding “establishment” role envisioned for the SEC in the House’s version of the legislation.³³ The compromise nevertheless afforded the SEC substantial leeway to be an active facilitator:

It is the intent of the conferees that the national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed. The conferees expect, however, in those situations where competition may not be sufficient, such as the creation of a composite quotation system or a consolidated transactional reporting system, the Commission will use the powers granted to it in this bill to act promptly and effectively to insure that the essential mechanisms of an integrated secondary trading system are put into place as rapidly as possible.³⁴

Professor Walter Werner observed that “[n]either the SEC nor Congress ever defined what it meant by the term ‘national market system.’”³⁵ Professor Dale Oesterle has emphasized that Congress directed the SEC to oversee a “national market system,” rather than the “central market system” that had previously been contemplated. He argues that the distinction matters because it reflected a conscious decision not to unify trading across markets.³⁶ NYSE executive Daniel Calvin likewise emphasized the “central” versus “national” distinction:

The monolithic *central* market system that some observers, but not Congress, thought had or should have been mandated has never emerged from the shadows of its proponents’ imaginations; on the other hand, the *national* market system of separate, interlinked markets that Congress, in fact, called for, and that the securities industry and the SEC have pursued, has entered the sunlight of smoothly functioning reality.³⁷

For others, the distinction may not have been so important. In the view of then-SEC Commissioner Philip Loomis, a central market system and national market system were different ways of expressing the same concept, the product of a long line of thinking by policymakers and industry.³⁸ He focused instead on the word “system” as an indication that the focus was not on a particular central place, but on a mechanism for more efficient

32. Daniel M. Gray, *The Essential Role of Regulation in Promoting Equity Market Competition*, 1 BROOK. J. CORP. FIN. & COM. L. 395, 399 (2007).

33. See H.R. REP. NO. 94-121, pt. 12, at 15139 (1975) (Conf. Rep.). But see Calvin, *supra* note 28, at 791 (arguing that the relevant House and Senate committees “envisioned the national market system in essentially the same way”).

34. See H.R. REP. NO. 94-121, at 15139.

35. Walter Werner, *The SEC as Market Regulator*, 70 VA. L. REV. 755, 776 (1984) [hereinafter Werner, *SEC as Market Regulator*].

36. Oesterle, *supra* note 20, at 627 (explaining that “a national market system has room for many competitive trading centers”). But see Garrett Jr., *supra* note 7, at 16–17 (explaining that the “central market system” and “national market system” “allude to the same concept”); Loomis Jr., Securities Acts Amendments, *supra* note 10, at 10 (conflating the concepts of a national market system and central market system).

37. Calvin, *supra* note 28, at 807.

38. Loomis Jr., Central Market System, *supra* note 9, at 1; Loomis Jr., Securities Acts Amendments, *supra* note 10, at 10.

order execution.³⁹

The national market system mandate was, in short flexible enough to accommodate different goals and different ways for the SEC to achieve those goals.

III. THE SEC'S APPROACH TO FACILITATING A NATIONAL MARKET SYSTEM

Seemingly forgetting its own role in focusing congressional minds on a national market system, the SEC waded with a measure of uncertainty into the task of building the national market system.⁴⁰ The SEC largely continued its pre-existing plan, already underway,⁴¹ to centralize the market through, among other initiatives, consolidated quotations and trade reporting. However, as then-chairman Ray Garrett explained, its pre-mandate experience with the difficulty of micromanaging market structure may have led to a more restrained initial approach than the one envisioned by the SEC a few years earlier and embraced more recently:

[W]e observed closely the deliberations of our advisory committee on the central market system which was demonstrating how terribly difficult it is for even the most able men of good will to anticipate and resolve in advance all problems that might arise in this area. So we have changed course, and taken the simpler approach, and in so doing, we, in effect, have gotten out of the driver's seat, although we will continue to observe developments in this area closely from the back seat.⁴²

A. Early Implementation of the National Market System Mandate

As implemented by the SEC, the national market system included multiple components.⁴³ The SEC started working on the consolidated tape even before the '75 Amendments became law, and consolidated last sale data were available shortly after the law's passage. The Composite Quotation System and the National Securities Clearing Corporation started in 1978.

Despite progress on the reporting and clearing aspects of the national market system, the trading component was more difficult. For the cross-market trade execution piece of

39. Loomis Jr., *Central Market System*, *supra* note 9, at 2; Loomis Jr., *Securities Acts Amendments*, *supra* note 10, at 11.

40. Roderick M. Hills, Chairman, SEC, *A Report from the SEC, Address Before the Securities Industry Assoc. Annual Convention 9* (Dec. 5, 1975), <https://www.sec.gov/news/speech/1975/120575hills.pdf> (“The SEC did not lobby for this legislation, nor are we sure what it will take to fulfill its mandate.”).

41. See Harman, *supra* note 16, at 2280–83 (discussing the SEC's efforts to develop a central market system before the '75 Amendments).

42. Garrett Jr., *supra* note 27, at 18. As Chairman Garrett explained, the warning of Walter Werner also played a role in restraining the SEC:

And we kept reflecting on the remarks of Professor Walter Werner at our rate hearings last fall. He advised us that we were not smart enough to plan a complete central market system and added, lest our feelings be hurt, that neither was anyone else. He suggested that these things must evolve through the ingenuity and self-interest of all parties involved, and that we should simply remove the impediments and watch what happens.

Id. at 17–18.

43. Calvin, *supra* note 28, at 800–01 (discussing the components of the national market system); see Harman, *supra* note 16, at 2285–86 (discussing developments in national market system).

the national market system, the SEC looked to the Intermarket Trading System (ITS), which began its initial tests in 1978. The ITS was a system that allowed executions across trading venues.

Many proponents of the national market system believed that it required a trade execution system more aggressive than the ITS. For SEC Commissioner Loomis, for example, a “national book . . . available to all specialists” was an integral part of the central market system.⁴⁴ As he explained, “Perhaps the cornerstone of a national market system is the creation of a mechanism by which all, or at least most, of the orders for securities traded in the system are channeled into the system rather than being fragmented and dispersed.”⁴⁵

A January 1978 SEC release catalogued progress in achieving a national market system and laid out additional planned steps, including “a Central Limit Order File” to achieve nationwide price-time priority for public limit orders.⁴⁶ The SEC ultimately moderated its expectations in response to push-back from industry.⁴⁷ The SEC also moderated its proposed complete elimination of off-board trading restrictions.⁴⁸

B. Assessing the SEC's Early Steps Toward a National Market System

A five-year congressional report on the SEC's progress in establishing a national market system gave the SEC a failing grade: “the Commission has approached its task of shepherding the development of a national market with timidity and apparent purposelessness.”⁴⁹ The report opined with palpable impatience that, because of the SEC's inaction, “the linkage of all the markets is proceeding at the pace of an arthritic gastropod.”⁵⁰ The report accused the SEC of a “preference for passively watching the new market evolve, rather than utilizing its extensive authority to facilitate the development of a national market, system.”⁵¹

According to the report, the SEC's passivity derived from “a misreading of the history . . . and the underlying purposes” of the '75 Amendments.⁵² In particular, the SEC should have been more aggressive in eliminating exchanges' anti-competitive rules, such as prohibitions on members trading listed stocks off the exchange.⁵³ In addition, the SEC should have actively forced trading venues to form linkages because “appropriate linkages will not occur under a laissez faire philosophy of regulation.”⁵⁴ The report also took issue with the SEC's insufficiently aggressive approach to overseeing the development of

44. Loomis Jr., Central Market System, *supra* note 9, at 4.

45. Loomis Jr., Securities Acts Amendments, *supra* note 10, at 11. He reported—with some measure of surprise given the unclear nature of the idea—that there was broad agreement in Congress, the SEC, and “[m]ost segments of the industry” for such a system. Loomis Jr., Central Market System, *supra* note 9, at 1.

46. See Harman, *supra* note 16, at 2291–93 (discussing SEC Release No. 34-14415, 43 Fed. Reg. 4356 (Jan. 26, 1978)).

47. HOUSE FIVE-YEAR REPORT, *supra* note 11, at 43–47.

48. Macey & Haddock, *supra* note 3, at 336–37.

49. Letter from Bob Eckhardt to Harley O. Staggers, *supra* note 12.

50. HOUSE FIVE-YEAR REPORT, *supra* note 11, at 19.

51. *Id.* at 2.

52. *Id.*

53. *Id.* at 14–15. This issue was such a concern that the report reverted again to its gastropod analogy, this time with the added emphasis of “a drizzly day”: “That the rules are still in place five years after the legislation was enacted demonstrates that the Commission's process is about as speedy as an arthritic gastropod on a drizzly day.” *Id.* at 20.

54. HOUSE FIVE-YEAR REPORT, *supra* note 11, at 32.

effective consolidated quotation and order routing systems. Likewise, the report criticized the SEC for deferring to the industry on “the fundamental questions of what a national market system will be like—for example, time and price priority.”⁵⁵ The report’s congressional authors thought that the SEC was spending too much time thinking about detailed market function questions and too little thinking about bigger picture questions.⁵⁶

Questions about what the national market system mandate meant persisted. The ranking minority members of the relevant House subcommittees issued a dissenting view in which they argued that the majority report had mischaracterized the purpose of the ‘75 Amendments.⁵⁷ In their view, “a National Market System cannot be created by mere regulatory fiat.”⁵⁸ The SEC was supposed to “perform enlightened coaching,” not act as “coach and quarterback.”⁵⁹

Writing in 1985, Professors Jonathan Macey and David Haddock echoed the House’s five-year report: “Simply put, the world looks little different now than it did when Congress originally passed the legislation.”⁶⁰ An inactive SEC had squandered the “sweeping authority to guide the development of the national market system” that Congress had given the agency in 1975.⁶¹ In their view, to effect real change, the SEC should have taken a more aggressive approach in eliminating off-board trading restrictions.⁶² They used public choice theory to explain the SEC’s inactivity; in their view, the SEC was “acting to protect entrenched institutions.”⁶³

Perhaps it is not surprising that an enthusiastic defense of the SEC’s approach came in 1984 from NYSE Executive Vice President Donald Calvin. Taking specific issue with Professor Walter Werner’s criticism of the underlying premise of the national market system, he pointed, as evidence of the law’s success, to the development of the Consolidated Tape and the linkage of markets through the ITS.⁶⁴ Calvin pointed to fragmentation of trading venues as the remaining issue that needed to be resolved.⁶⁵

A later chairman, Harold Williams, likewise defended the SEC’s deliberate approach to implementing a national market system.⁶⁶ He rejected the idea that the SEC should

55. *Id.* at 46.

56. *See, e.g., id.* at 47 (“It is important that the Commission not allow itself to be diverted by the details of particular machinery or facilities. Rather it must focus its attention on the overriding purposes for providing price and/or price/time protection throughout a national system.”).

57. Separate Views of Norman F. Lent and Matthew J. Rinaldo, appendix to the HOUSE FIVE-YEAR REPORT, *supra* note 51 [hereinafter Separate Views].

58. *Id.* at 104.

59. *Id.* at 92.

60. Macey & Haddock, *supra* note 3, at 322.

61. *Id.* at 322–23.

62. *Id.* at 336–37.

63. *Id.* at 361.

64. Calvin, *supra* note 28, at 787–88.

65. *Id.* at 789.

66. Harold M. Williams, Chairman, SEC, The National Market System: An Update, Address Before the ALI/ABA Conference on Broker Dealer Regulation 6 (Nov. 30, 1979), <https://www.sec.gov/news/speech/1979/113079williams.pdf> (“[A]lthough some have complained that the Commission has moved too slowly in assuring the implementation of needed facilities and regulatory changes, we must weigh the benefits of rapid change against the risks to investors, the securities industry and the securities markets themselves, in the event the Commission’s assumptions, in a particular instance, are wrong or because other events make those assumptions no longer valid.”).

mandate an automated system,⁶⁷ but threatened a more aggressive SEC role “[i]f the industry fails to make acceptable progress. . . .”⁶⁸ Williams praised industry efforts such as ITS and a Merrill Lynch system for routing orders to markets with the best prices, but worried about the persistence of trade-throughs and the lack of progress on intermarket linkages.⁶⁹ Despite such defenses, the public perception remained that the SEC was not in a rush to push the national market system forward.⁷⁰

C. Regulation NMS—An Enthusiastic Embrace of the National Market System Mandate

The SEC’s initial reluctance to take an aggressive role in shaping the national market system eventually gave way to a deep-seated belief in the SEC’s integral participation in managing the market’s structure. In 1996, the SEC, using its authority under the ‘75 Amendments, adopted the Order Handling Rules “to address growing concerns about the handling of customer orders for securities.”⁷¹ The SEC waited three decades, however, before using its powers under the ‘75 Amendments to forcibly reshape the way trades are executed.

In 2005, the SEC adopted Regulation NMS.⁷² Regulation NMS has four major components: (1) the order protection (or trade-through) rule, which generally prevents orders from being executed at prices inferior to displayed top-of-book quotations on any market; (2) the access rule, which governs access to quotations; (3) the subpenny rule, which generally prohibits quotations in subpenny increments; and (4) market data reforms. The first component gave life to an interventionist conception of the national market system mandate that sought to drive where and how trades occur. Although the trade-through rule did not go as far as it might have, it nevertheless was an important step toward centralizing market decision-making.

Regulation NMS was an intentional and enthusiastic embrace of the ‘75 Amendments. William Donaldson, who was then chairman of the SEC, explained that “The Commission is acting pursuant to the mandate Congress gave us in 1975 to use our rulemaking authority to further the goals of the national market system—among them to enhance competition among markets and to enhance opportunities for the interaction of investor orders.”⁷³ Likewise, in adopting the rule, the Commission celebrated what its thirty-year old mandate had accomplished and would achieve in the future:

67. See *id.* at 7 (“If a transition to a fully automated trading system is to be developed, it should occur as a result of economic forces and acceptance by investors rather than by Commission mandate.”).

68. *Id.* at 9.

69. *Id.* at 9–14.

70. See, e.g., Laurie Cohen, *Industry Hopes Reagan Will Keep SEC Chief*, CHI. TRIB. (Nov. 19, 1980), <http://archives.chicagotribune.com/1980/11/19/page/71/article/lasalle-street> (“There is a general agreement that the SEC has moved slowly toward implementing the kind of market system Congress envisioned in the 1975 legislation.”).

71. Order Execution Obligations, 61 Fed. Reg. 48,290 (Sept. 12, 1996) (codified at 17 C.F.R. pt. 240). Specifically, the SEC “adopt[ed] a new rule requiring the display of customer limit orders and amending a current rule governing publication of quotations to enhance the quality of published quotations for securities and to enhance competition and pricing efficiency in our markets.” *Id.* at 48,290.

72. Regulation NMS, 70 Fed. Reg. 37,496 (June 29, 2005) (codified at 17 C.F.R. pts. 200, 201, 230, 240, 242, 249, 270).

73. William Donaldson, Chairman, SEC, Opening Statement at Commission Open Meeting (Apr. 6, 2005), <https://www.sec.gov/news/speech/spch040605whd-nms.htm>.

The Commission believes that the NMS approach adopted by Congress is a primary reason that the U.S. equity markets are widely recognized as being the fairest, most efficient, and most competitive in the world. The rules that the Commission is now adopting represent an important and needed step forward in its continuing implementation of Congress's objectives for the NMS.⁷⁴

Regulation NMS was when it was adopted—and has remained—controversial within and outside of the SEC. The most debated component is the order protection, or trade-through, rule. The SEC defended this rule as being entirely consistent with the principles underlying the '75 Amendments:

The most succinct statement of order competition is found in the House Report on the 1975 Amendments: “Investors must be assured that they are participants in a system which maximizes the opportunities for the most willing seller to meet the most willing buyer.” This Congressional mandate for the national market system is not achieved when trades occur at prices inferior to the best quotations that are immediately and automatically accessible.⁷⁵

The SEC also found support for the order protection rule in the Senate's report on the '75 Amendments, which observed that Congress was giving the SEC “complete and effective powers to pursue the goal to centralized trading of securities in the interest of both efficiency and investor protection.”⁷⁶

Two of the SEC's five commissioners voted against the rule. They too cited the legislative history of the '75 Amendments, but argued that the majority had ignored Congress' emphasis on competition as the preferred force for shaping market structure.⁷⁷ Separately, one of the dissenting commissioners, Paul Atkins, objected to the attempt to revive “discarded hyper-regulatory notions” and “the spirit of the 70's by continuing to experiment with market centralization.”⁷⁸ The dispute between the majority and the dissenters once again reflected the ambiguity of the Commission's mandate under the '75 Amendments.

That dispute has continued inside and outside the SEC. Ongoing discussions at the SEC's recent Equity Market Structure Advisory Committee illustrate the persistent lack of agreement on how the SEC should fulfill its national market system mandate.⁷⁹

IV. THE ABILITY OF THE MARKETS TO CONSTRUCT A NATIONAL MARKET SYSTEM

74. Regulation NMS, 70 Fed. Reg. at 37,497.

75. *Id.* at 37602 (citing H.R. REP. NO. 94-123 (1975)).

76. *Id.* at 37603 (citing S. REP. NO. 94-75 (1975)).

77. Cynthia A. Glassman & Paul S. Atkins, Comm'rs, SEC, Dissent to the Adoption of Regulation NMS, 70 Fed. Reg. 37,632, 37,633 (Sept. 12, 1996) (noting that, in dissenting, “we have been guided by Congress' clear preference that competitive forces, rather than unnecessary regulation, guide the development of the national market system”) (citing H.R. Rep. No. 94-229, at 92 (1975) (Conf. Rep.) (“It is the intent of the [House and Senate] conferees that the national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed.”)). *See also* Oesterle, *supra* note 20, at 615-16 (arguing that the SEC's trade-through rule and other efforts at “micro-managing the details of trading market structure” exceeded its statutory authority).

78. Paul S. Atkins, Comm'r, SEC, Enhancement and Modernization of the National Market System (Apr. 6, 2005), <https://www.sec.gov/news/speech/spch040605psa.htm>.

79. *Equity Market Structure Advisory Committee*, SEC, <https://www.sec.gov/spotlight/equity-market-structure-advisory-committee.shtml> (last visited Feb. 21, 2018).

ORGANICALLY

Although the precise parameters of the congressional mandate are unclear, the '75 Amendments embody the belief that the equity markets function best under the SEC's guiding hand. Although many of the problems identified by market observers in the 1970s were real, it is not clear that a statutory solution was needed. Market participants were responding to changes. The SEC, without needing new statutory authority to do so, took meaningful steps such as eliminating the NYSE's fixed commissions between 1973 and 1975.⁸⁰ Even before the SEC took this step, the market was addressing excessive commissions through regional exchanges that arose to compete with the national exchanges. In other words, the markets were changing organically within the pre-1975 regulatory framework.

The objectives of a national market system that were spelled out in the statute—"economically efficient execution," "fair competition," availability of quotation and transaction information, best execution of customer orders, and the execution of investor orders "without the participation of a dealer"⁸¹—did not require government management. A competitive market can achieve these objectives. Market forces drive toward efficiency, effective communication and integration of markets, and high-quality execution. Some market observers worry that absent a heavy government hand, a monopoly would develop,⁸² but—particularly given today's technology—market forces tend to erode monopolies.⁸³ Regulation can be helpful in establishing a framework within which these forces work and ensuring that barriers to entry are low, but the activist role enabled by the '75 Amendments goes much further.

The '75 Amendments encourage the SEC to ignore basic principles of how markets work. If markets work to match buyers and sellers effectively in other contexts, they are likely to function equally well in matching buyers and sellers of securities. Congress hoped to impose some order on the equity markets, but the push and pull of prices and profits imposes a much more efficient and responsive discipline. Congress asked the SEC to forge communications links between markets, but this role is a natural one for markets. Congress worried about price disparities across markets, but where there are price disparities, markets seek to eliminate them. Arbitrageurs step in to bring prices across different markets in line with one another. Congress feared that absent a central planner, our equity markets would lose their edge. As Hayek reminds us, planning is best done collectively, not centrally, because only then will knowledge dispersed across many people be able to inform the plan.⁸⁴ Markets are wonderful tools for allocating resources to their best uses.

Also important, markets offer a flexibility that no regulator, bound appropriately by administrative process constraints, can provide. Markets are better able than regulators to

80. See A.A. Sommer Jr., Comm'r, SEC, Interim Reflections on Mayday, Remarks at the Maryland Securities Bar Club (May 27, 1975), <https://www.sec.gov/news/speech/1975/052775sommer.pdf> (describing a history of the demise of fixed commissions).

81. 15 U.S.C. § 78k-1(a)(1)(C) (2012).

82. See, e.g., Gray, *supra* note 32, at 396 ("[I]n the absence of a regulatory scheme specifically designed to promote competition among multiple equity markets, there is unlikely to be significant competition because of the economic forces that drive markets toward consolidation.").

83. The immense computer power at the fingertips of amateur, let alone professional, traders makes it much harder for monopolies to survive (unless government rules create and perpetuate them).

84. See generally Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945) (discussing the importance of drawing on knowledge of all members of society).

tailor solutions for particular types of investors and companies. Competitive markets dynamically respond to changing customer needs and changing conditions. Regulators struggle to follow, let alone anticipate, such changes. The ability of markets to respond to change is evident from the way they have responded to regulatory changes, such as Regulation NMS. The dynamism markets offer is sometimes messy, but regulatory intervention often serves only to add to the complexity.⁸⁵

V. WHY RECONSIDERING THE NATIONAL MARKET SYSTEM IDEA MATTERS NOW

More than forty years have passed since Congress embedded the concept of a national market system into the securities laws. In the intervening four decades, the SEC has taken on the role of market designer. That role has brought with it many headaches for the SEC and for the investors and issuers that markets serve. During the same time period, the technology of markets has advanced markedly, so arguments for the government-directed development of the markets are even less compelling now than they might have been in the 1970s. It is time to reconsider the national market system mandate.

This Article is not the first to call for a reconsideration of the national market system mandate. Professor Werner was already asking questions about the logic of the national market system mandate in 1975.⁸⁶ After the mandate was in force for a decade, Professors Macey and Haddock noted that, in the absence of the mandate, “[m]arket forces would achieve the correct configuration of trading activity without regulatory supervision.”⁸⁷ In their view, eliminating off-board trading restrictions was the only thing the SEC needed to do to unleash these salutary market forces.⁸⁸ A NYSE executive, writing around the same time, suggested that repealing the national market system mandate “might attract substantial support among those who believe the law’s essential objectives have been achieved, as well as among those who share the conviction that Congress ought never to have intervened in matters involving market structure.”⁸⁹ This Article, by contrast, does not argue that the goals of the national market system have been met. A national market system is not a goal to be achieved, but a continuously developing system. The congressional mandate is not essential to the organic development, and may instead hinder it.

Even if a centrally planned national market system was needed in the 1970s, a lot has changed since then. Improved technology facilitates market integration and transmission of market data. The variety and number of trading venues has increased, and no one venue is dominant. The emergence of exchanges like the Investors Exchange (IEX) and the Long-Term Stock Exchange (LTSE) suggest markets’ ability to design solutions to problems

85. As a commentator writing about the SEC’s regulation of market structure in the 1970s wrote, “If the last several years have taught us anything about the regulatory process, it must be that excessive regulatory responses to the problems of the securities industry often result in complication of the issues rather than their resolution.” Harman, *supra* note 16, at 2301.

86. Werner, *Adventure in Social Control*, *supra* note 31, at 1283 (asking, for example, whether it made sense to replace “the competition among separate trading markets—a competition distorted by lack of government supervision for 30 years” with “a single market established by government and resting on a mass of new regulation”). Werner continued to ask questions about the national market system mandate. *See generally* Werner, *SEC as Market Regulator*, *supra* note 35, at 776.

87. Macey & Haddock, *supra* note 3, at n.29.

88. *Id.* at 361.

89. Calvin, *supra* note 28, at 808.

issuers and investors identify.⁹⁰ Additional desired innovations may not be able to occur because the statutory or regulatory national market system structure stands in the way.⁹¹ Eliminating the national market system mandate could open the door for more experimentation.

VI. CONCLUSION

In 1975, Congress—reflecting the conflicted mood of the times—asked the SEC to facilitate a national market system. From the beginning, this mandate meant different things to different people, but eventually it drew the SEC into many aspects of market management. If the ‘75 Amendments were to be “a major adventure in self-improvement of which [the public] would be the principal beneficiaries,”⁹² it is reasonable after four decades of the adventure to ask whether the public is benefiting as intended. Congress asked the SEC to take on tasks that markets are able to accomplish more effectively and efficiently. An SEC-designed national market system that manages how data are transmitted and orders executed may not only be unnecessary, but may also be destructive to the ability of equity markets to serve the needs of issuers and investors. Capital markets are the root of all other markets in the United States—the markets from which all others spring. Thus, statutory design problems in these markets bleed easily into the rest of the economy.

90. See, e.g., Ellen Huet & Brad Stone, *Silicon Valley’s Audacious Plan to Create a New Stock Exchange*, BLOOMBERG (June 12, 2016, 7:00 PM), <https://www.bloomberg.com/news/articles/2016-06-12/silicon-valley-s-audacious-plan-to-create-a-new-stock-exchange> (“If all goes according to plan, the LTSE could be the stock exchange that fixes what [Eric] Ries sees as the plague of today’s public markets: short-term thinking that squashes rational economic decisions.”); John McCrank, *NYSE Plans NYSE American to Counter ‘Flash Boys’ Exchange IEX*, REUTERS (Jan. 25, 2017, 9:37 AM), <http://www.reuters.com/article/us-ice-nyse-speedbump-idUSKBN1591YE> (“IEX has said its speed bump was meant to even the playing field between fast traders and slow traders, while NYSE said its speed bump was to offer investors more choice.”).

91. See, e.g., Christopher A. Iacovella, *How to promote Small-Business Jobs and Protect Investors*, INV. BUS. DAILY (May 23, 2017), <http://www.investors.com/politics/commentary/how-to-promote-small-business-jobs-and-protect-investors/> (arguing that Regulation NMS blocks trading venues from meeting the full panoply of issuer needs because it “is a one-size-fits-all regulation that focuses on price and not on execution quality, and while it may be an efficient model for large-cap stocks that trade millions of shares a day, it is not appropriate for illiquid small caps with limited research coverage”).

92. Calvin, *supra* note 28, at 791.