Individual Investors Win a Few, Lose a Few, Tie a Few

By James B. Cloonan

Over the last month or so there have been a number of actions on securities matters that are of concern to the individual investor. These matters include stockholder rights, arbitration and market volatility. The actions have come both from the industry and from the Securities and Exchange Commission.

We didn't do too well in the final versions of the long-awaited SEC rules on voting rights. Apparently the concept of "one share, one vote" is going to be enforced only in the case of future reductions of current voting rights; companies that have already reduced the voting rights of some classes of stocks are exempted. The concept also will not affect new issues if voting disparity is disclosed in the original prospectus. I can't really fault the SEC. While I believe in "one share, one vote," the SEC is probably not empowered to deal with corporate governance unless there is a securities law issue. In addition, I am enough of a free market person to believe that individuals are entitled to give away rights or to buy inferior stock if they choose—as long as they are made aware of the situation.

The SEC backed off completely from the contemplated recommendation that legislation be passed prohibiting brokerage firms from requiring that customers agree to arbitrate disputes rather than go to court. In most cases, I believe it is better to arbitrate than to file a lawsuit. But it is nice to have a choice, particularly if there may be fraud. Customers can, of course, refuse to sign such agreements, so read the fine print.

NASDAQ has made participation in small order execution systems mandatory for market makers and the ability to handle individual investors' orders will be greatly enhanced. The New York Stock Exchange will give priority to orders from individuals on days that the Dow Jones industrial average moves more than 25 points, and this should increase market liquidity.

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The recent agreement between the New York Stock Exchange and the Chicago Mercantile Exchange regarding market volatility was probably most important in that they were able to agree to work together on market problems such as intermarket front running and market closings.

The actual rules announced may be more important in showing concern about the problem than in their effectiveness. The restriction on program trading after a 50-point movement in the Dow was eliminated. Instead, we have the following new rules:

- If the S&P 500 futures contract falls 12 points (about 96 points on the Dow), that price would become a floor and trades on the contract could not take place at lower prices for one-half hour.
- When the 12-point S&P 500 trigger is reached, the New York Stock Exchange would prevent program trading from entering its automatic system (Super Dot). Program trades would be handled by computer matching (for five minutes) and then they would be released to the floor where any imbalance would bring about trading halts in those stocks that are the major components of the S&P 500.

If other exchanges and NASDAQ go along, additional circuit breakers would be put in place. These would include a one-hour close of markets if the Dow fell 250 points, and a two-hour close if the Dow fell another 150 points after reopening.

While cooperation between stock exchanges and exchanges trading derivative products is essential, I am not sure that the steps taken are as effective as simply putting limits on the futures, as we do with agricultural commodities. The final circuit breaker proposals are probably meaningless; by the time the market officially closes, it is already effectively closed since trading has been halted in a large proportion of stocks. It is critical, however, that if a significant number of index stocks are not trading, the futures should not trade. Thus, coordination between stock and futures exchanges is essential and hopefully the Chicago Mercantile and New York Stock Exchanges' agreement is a start.