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## **SECURITIES INDUSTRY RESULTS: Slow Growth Seen for 2002; 2001 Estimates On the Mark**

*George R. Monahan*

## **NEW YORK EMPLOYMENT BENCHMARK REVISIONS Counter-Intuitively, Securities Industry Job Losses Revised Downward Revisions Still Show Record Industry Job Losses for 2001**

*George R. Monahan*

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*Grace Toto*



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## **SECURITIES INDUSTRY RESULTS:<sup>1</sup>**

### **Slow Growth Seen for 2002; 2001 Estimates On the Mark**

We estimate that 1Q 2002 pre-tax profits reached \$3.25 billion, a 15% increase over the \$2.83 billion posted in 4Q'01, but still 21% below the \$4.14 billion posted in 1Q 2001. For the quarter just underway, we foresee a similar bottom line of \$3.2 billion. We see moderate improvement in profits and revenues in 2002's second half. We are tentatively forecasting a total of \$13.2 billion for full-year 2002 U.S. broker-dealer pre-tax profits. This is 27% above last year's profits, but 37% below 2000's record \$21.0 billion.

We also note that our forecast of \$10.2 billion for 2001 industry profits, provided months ago before the year had closed, was a mere 2% below the official total released last month of \$10.4 billion. We were further pleased that our forecasts for most major reporting lines, i.e. net revenue, commissions, trading, and compensation, were either right on the mark or less than 1% off the final figures.

### **First Quarter 2002 Highlights**

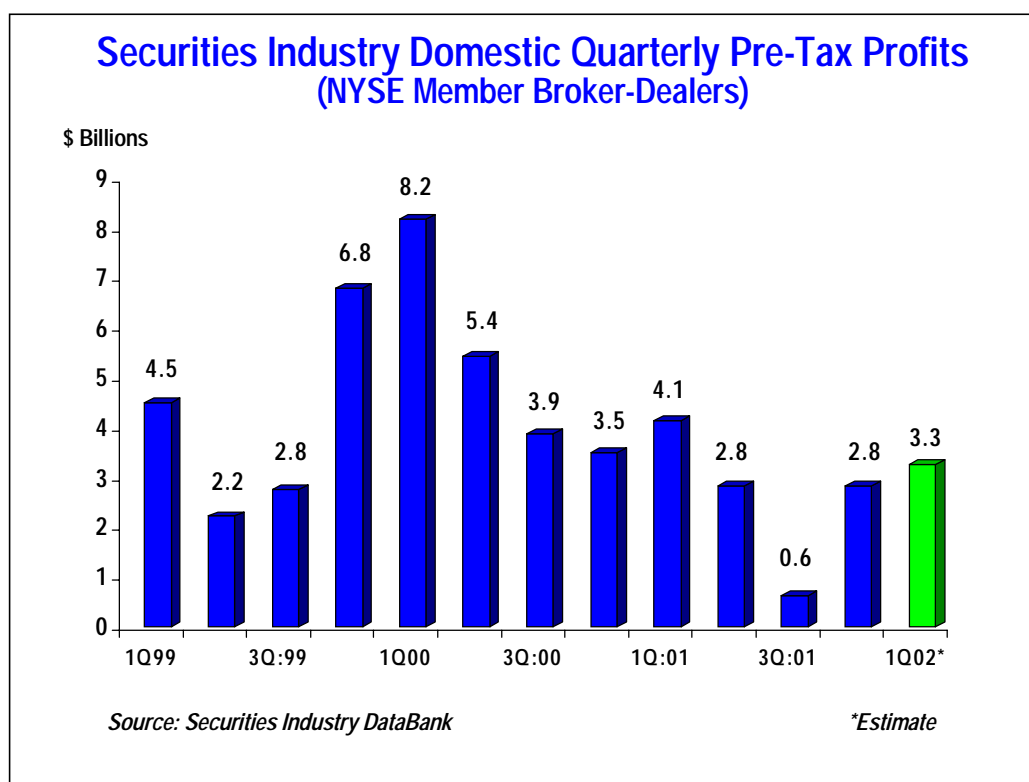
The handful of February reporting firms just released their fiscal first quarter results and provided a pleasant surprise by surpassing consensus earnings estimates. This was mainly due to significant fixed income trading gains as well as greater-than-expected declines in interest expense. While financial results are not yet available for March reporting firms, indicators of market and industry activity suggest firms continued to show improving results last month.

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<sup>1</sup> This article features highlights from the April 2002 issue of SIA's *Securities Industry Trends* of the same title. This *Trends*, a subscription-based product, is a 24-page issue covering the quarterly and estimated annual financial performance of the US securities industry for 2002. The expanded version includes discussion of both domestic and global revenues and profits, interest rates, margin, compensation costs and employment, mutual funds and asset management, commodities, and individual business line performance such as commissions. The full report will be available for *subscriber* viewing, or for *ordering*, at: [http://www.sia.com/reference\\_materials/html/securities\\_industrytrends.html](http://www.sia.com/reference_materials/html/securities_industrytrends.html).

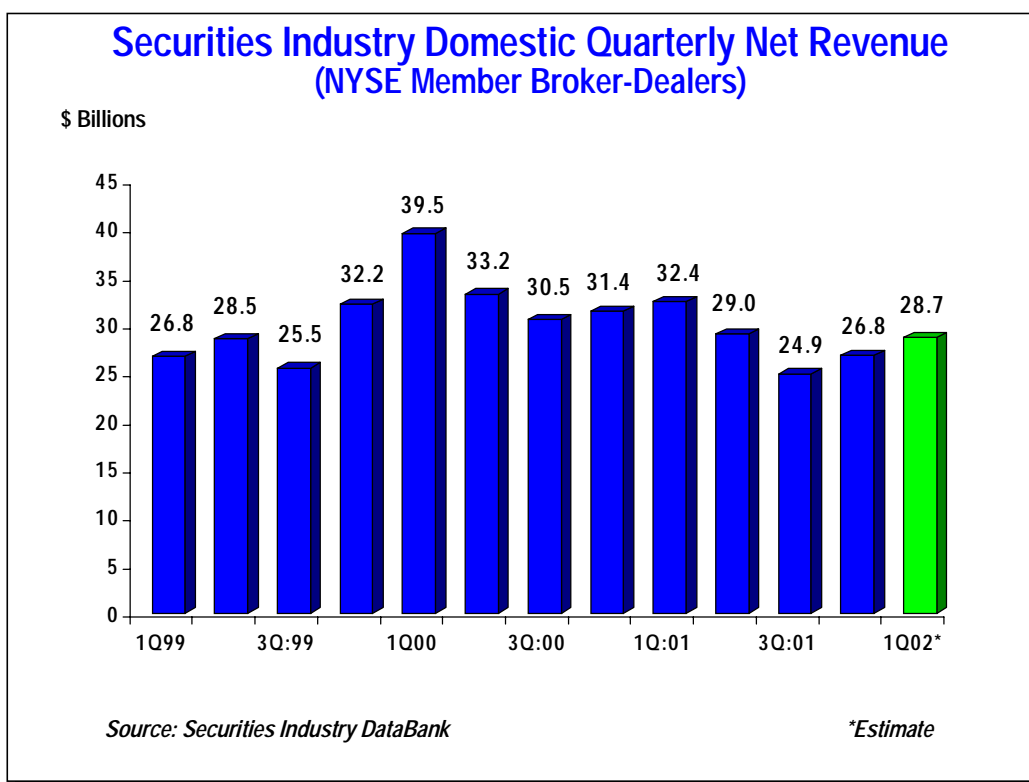
Pre-tax profits for NYSE-reporting firms doing a public business are estimated at \$3.25 billion for 1Q 2002, a 15% increase over the \$2.83 billion result recorded in 4Q 2001. This is the highest quarterly profits recorded in a year, but still 21% below 1Q 2001 profits of \$4.14 billion. Despite lackluster revenues from most business lines, most notably still depressed investment banking fees, most firms, and the industry as a whole, managed to show an improvement in profits over the prior quarter.

However, the better “bottom line” had to be wrung from a still declining gross revenue base. Total gross revenues fell to \$41.5 billion, 2% below the \$42.3 billion taken in during 4Q’01, nearly 29% below results for the same, year-earlier quarter and the lowest quarterly *gross* revenue for the industry in three and one-half years, when in 3Q’98 gross revenue fell to \$39.1 billion. Fixed-income trading gains, strong fee income from record bond issuance activity and higher mutual fund sales revenues helped offset the impact of falling equity underwriting fees and reduced net interest income.



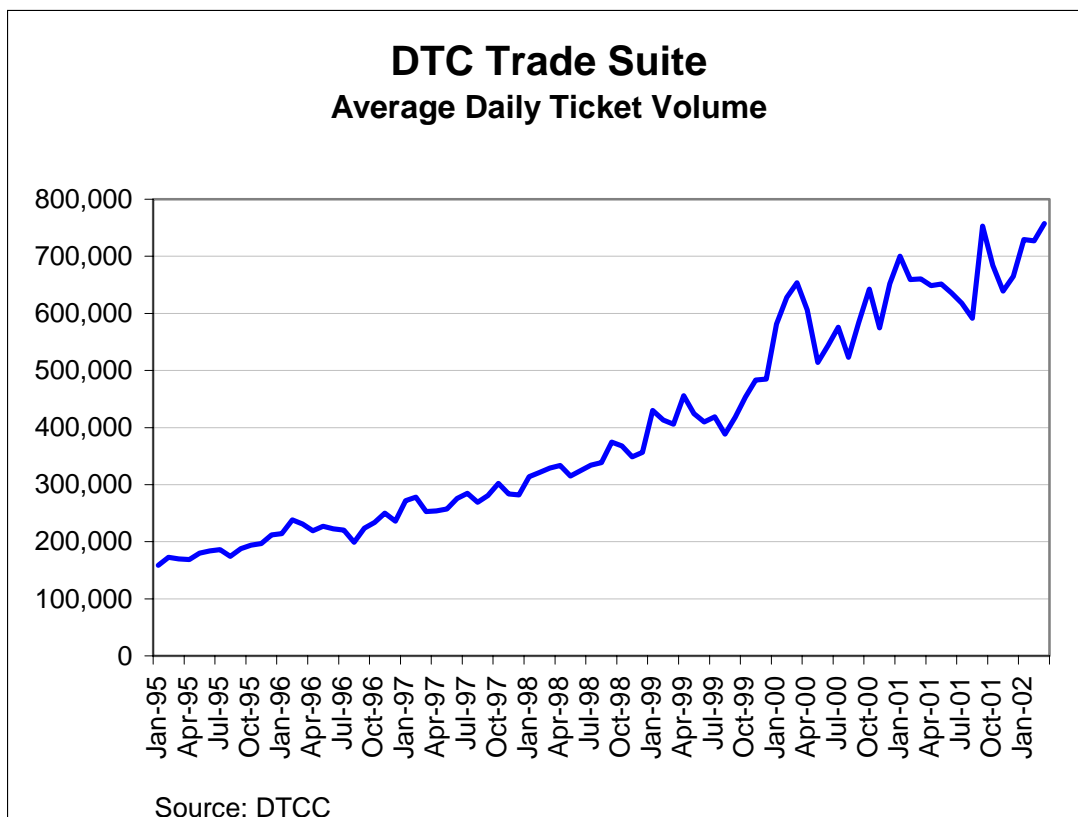
## Near Term Outlook

We expect a similar bottom line for the quarter just getting underway with increased investment banking (at least underwriting with M&A still stuck in the doldrums) and brokerage business offset by decreases in fixed income trading. This, along with the potential for slightly higher interest rates, leaves the current outlook at \$3.2 billion in profits for 2Q'02 which, combined with moderate growth in the second half, gives us a full-year 2002 profit of \$13.2 billion. That would be a 27% improvement over last year's \$10.4 billion but would still trail 2000's record pre-tax profits of \$21.0 billion by 37%. Nevertheless, this will edge out 1997 by \$1 billion to become the third best profit year ever, but well below 1999's second-best result of \$16.3 billion.

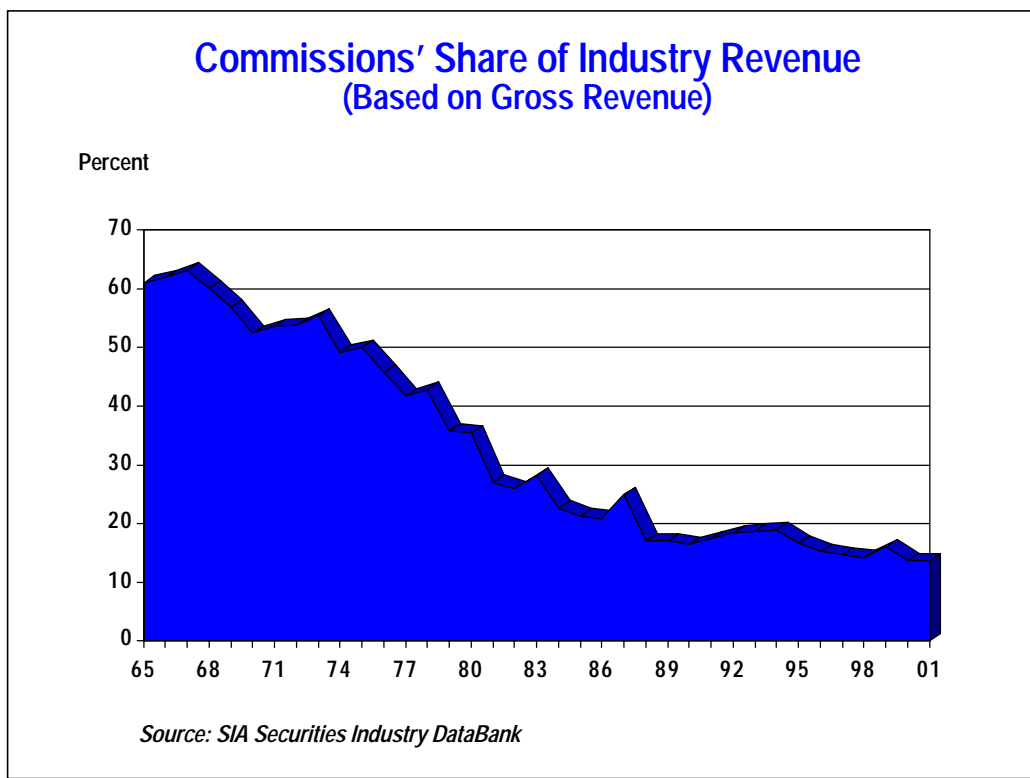


Interest rates will remain one of the lynchpins for industry profitability in the near term. Net interest income (interest revenue minus gross interest expense), which rose in each of the last three quarters of 2001, appears to have declined less than expected in 1Q'02, and these wider net interest margins are expected to narrow gradually across the course of this year. Some firms have lengthened the maturity of their leveraged capital-based borrowings to take advantage of the lower interest rate environment, which will help check interest cost over the long haul.

Fixed income, both trading and issuance activity, made the last quarter. Revenue from principal transactions are unlikely to repeat the 20% jump estimated for 1Q'01, but underwriting revenues driven by record quarterly corporate bond issuance in 1Q'02 is likely to stay strong in the current quarter. Although commercial paper issuance by non-financial firms has tumbled, lower fees on this low-margin business will be more than offset by higher revenue from increased issuance of medium-term bonds as these firms find alternative funding.



Commissions are also expected to be up, as firms appear to have absorbed the impact of decimalization and adapted. New commission policies for Nasdaq trades, switching from “mark up only” pricing and still strong secondary volume will support this trend and may have arrested the long-term decline in commission’s share of total revenue.



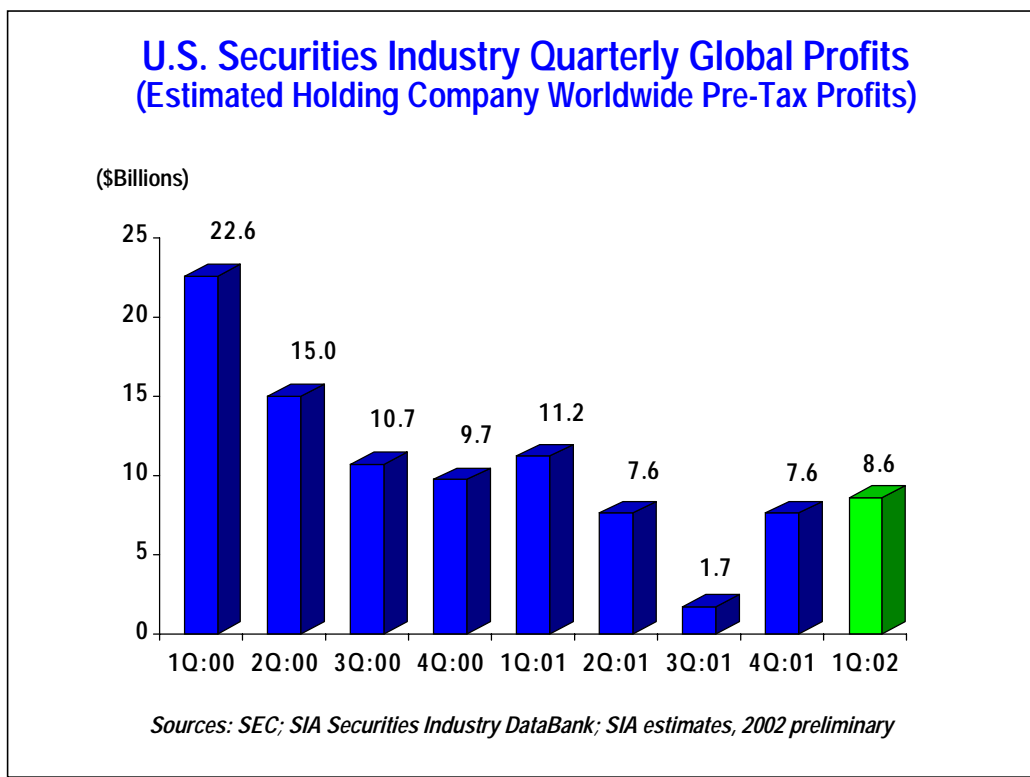
Mutual fund revenue and asset management fees had been a continuous source of increased revenue each year for the past two decades, growing in excess of 20% per annum in the 1990s, before faltering last year as, for the first time, outflows from equity funds were recorded in five months. During 1Q'02 both revenue lines picked up, but growth for the remainder of this year is expected to be anemic by historic standards.

Non-interest expense appears to be declining in line with expectations. Past cost-cutting efforts are trimming expenses, with appropriate lags as severance packages end and many extraordinary charges and expenses have already been absorbed. Expenses, other than interest and compensation, should also decline reflecting savings from a lower headcount and reduced rents, vendor prices and prices of supporting services.

It must be noted that these early 2Q'02 and full-year estimates are very preliminary, and will need constant revision throughout the year. We are expecting moderate growth for the second half of 2002, with full-year net revenue up slightly from 2001, but no return to quarterly levels seen in 2000 or even first quarter 2001, until at least next year.

## Worldwide Holding Company Highlights

Based on our domestic estimates and our lowered outlook for overseas earnings of U.S. securities firms, we expect a \$1 billion, or 13% increase in global, worldwide pre-tax profits for the U.S. securities industry (including U.S. broker-dealer operations of foreign owned firms) in the first quarter to \$8.6 billion vs. last year's fourth quarter total of \$7.6 billion.



Again, we expect the second quarter to be similar for the bottom line, with \$8.5 billion forecast for 2Q'02 pre-tax global profits. With reduced revenues expected overseas this year, higher U. S. profits will support our projection for full-year 2002 global profits of \$35.1 billion, up 25% from last year's \$28.1 billion.

While domestic gross revenue this year is expected to decline 9% from 2001 results, overseas revenue is expected to decline approximately 15% from the prior year, mainly from a slowdown in Europe, and a pullback from operations in Japan and emerging markets. Taken together, global worldwide revenue for the U.S. securities industry is expected to fall 10.6% in 2002 to \$338.3 billion from \$378.7 billion in 2001. This will also be 32% below the record achieved two years ago.

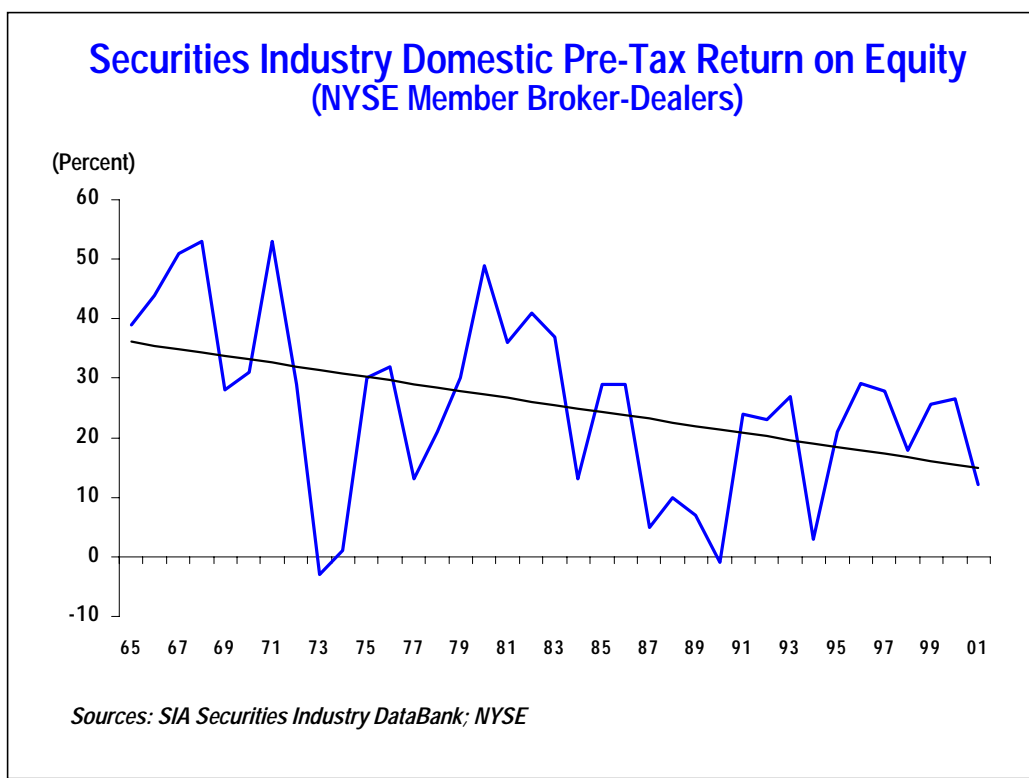


## Return-on-Equity

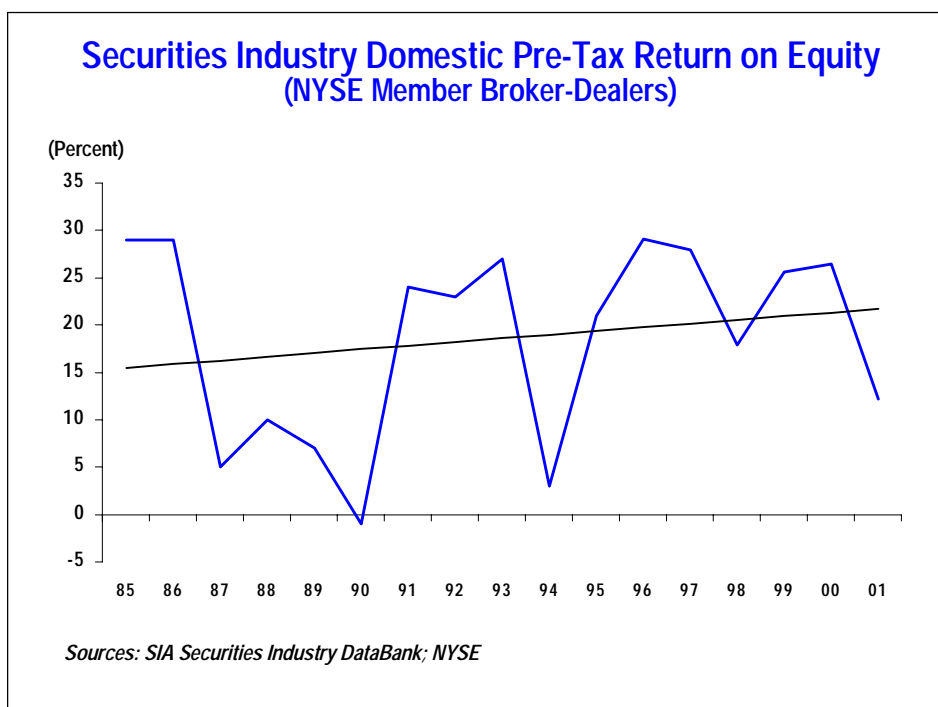
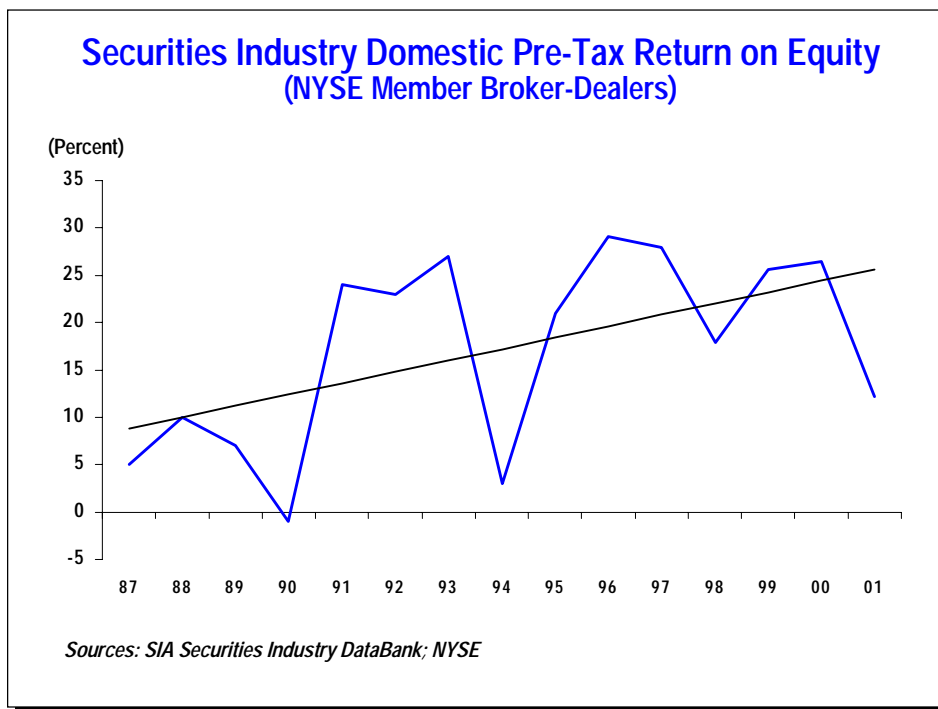
There has been some mention over the years that securities industry ROE has been in a long-term decline. Often cited as the chief culprits are competitive price-cutting pressures and poor expense control. While there is some truth to both points, they do not take into account the ongoing, accelerating pace of structural change in the industry, nor more recent dramatic improvements in efficiency and productivity and current cost-cutting efforts.

Data back to 1965 does show a clear downward, long-term trend in industry ROE. However, until the mid-1970s, stockbrokerage (and it was mainly just that – stocks and commissions) was a cottage industry, run by partnerships, not corporations, operating off of individual partner's own personal capital wealth, microscopic in size vs. today's global financial giants, and totally feeding off one business line, commissions, which were price fixed until 1975. Comparing today's financial services industry to stockbrokerage prior to 1975 has to take account of dramatic growth and expansion and significant evidence of continuing structural

change as the industry modernizes and firms consolidate. It has adapted to: sweeping alterations of the supervisory and regulatory landscape; an "overhaul" in systems and operations (efficiently adopting and adapting to a revolution in communications and information technology); and equally profound changes in the demographics of its customer base. More recently, the industry absorbed the impact of decimalization, an increase in disclosure and reporting requirements and the latest in a series of "shocks" (the "clustered" impact of a major market correction, recession and terrorist attacks). Evidence of structural shifts appears in the data in response to other global financial "shocks" that coincide with "dips" in industry ROE for the years 1987, 1990, 1994, 1998 and 2001. Currently, the industry is benefiting both from dramatic improvements in productivity, as it reaps the dividends of high rates of investment spending in the late 1990s and from current cost-cutting efforts. All this and more must be taken into account to "divine" the underlying direction of industry profitability.



So if we take the trend line a little closer into modern times, say 1987, or even 1985, we see a rising trend line for industry ROE. The 1990s and 2000 saw some pretty good 20%+ ROE years (pre-tax). It really just depends on the base year – picking 1973 as the beginning year shows a relatively flat trend line while 1980 shows a slightly declining trend line. The following ROE trend lines are simply meant to show that it's not really cut and dried as to what the "long-term" trend is.



## Forecasting: Demand & Supply

Last year was a particularly demanding time for accurate assessments of the declining profitability of the securities industry, particularly from New York policymakers since Wall Street so directly impacts the personal and business tax base in the state and city. It was also one of the most difficult climates, both personally and statistically, in which to prepare estimates – the aftermath of 9/11 included unprecedented industry and communication disruptions (including our own, located one block east of the WTC), physical and human losses, uncertain and then changing special accounting treatments, a cyclical market spiraling rapidly downward, an unexpectedly brief recession, massive job dislocations, relocations and downsizing, to name but a few. The demand was not just for a quarter or year just ended, but also for the likely results of periods still in progress. There was even demand for immediate updates if the forecasts changed.

To meet that demand, we researched underlying revenue trends in individual business lines and collected more detailed data on the principal expense items: compensation, interest expense and investment spending and continuously supplied updated industry profitability estimates throughout the fall and winter. With official profitability figures released last month, it's gratifying to see our forecast of \$10.2 billion for 2001 pre-tax profits, released in early December before the year had even closed, was on the mark, a mere 2% below actual profits of \$10.4 billion. We were also pleased that our net revenue forecast of \$114.1 billion for the industry was only 0.7% higher than the final figures, \$113.2 billion, while commission revenue of \$26.8 bil-

lion was a mere 0.3% higher than our forecast \$26.7 billion. Trading gains of \$24.9 billion matched our estimate while underwriting revenue of \$15.6 billion was just 1% above our forecast of \$15.4 billion. Compensation costs for 2001 came in at \$60.6 billion, just 0.9% under our forecast of \$61.2 billion.

More importantly, the research has helped identify what we believe are significant trends which will positively impact industry ROE in the near term. For example, recently we witnessed dramatic improvements in risk management and administrative systems and in operational efficiency in response to the global financial crisis of the fall of 1998 and in the run up to Y2K. This helped the industry weather the downturn in industry returns which bottomed, violently, in 3Q'01. Similarly, the industry's response to the events of last year, applying the lessons learned in business continuity planning, are leading to dramatic improvements in efficiency and productivity, which have already touched every sequence of the trade cycle, from order execution to final settlement. Applying these lessons in a constrained budget environment has forced this intensely competitive industry to do more with less. These and other elements underlying our outlook for securities industry performance are examined in more detail in our forthcoming issue of *Trends* (see footnote 1 on page 3) where we dust off the crystal ball again to peer into first quarter and full-year 2002 financial fortunes.

**George R. Monahan**  
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## **NEW YORK EMPLOYMENT BENCHMARK REVISIONS**

### **Counter-Intuitively, Securities Industry Job Losses Revised Downward**

### **Revisions Still Show Record Industry Job Losses for 2001**

The latest monthly employment statistics from the New York Department of Labor include annual benchmark revisions<sup>1</sup> which shed a puzzling light on 2001's employment picture for the state and city. On one hand, the revised estimates show a total loss of 132,400 jobs in the city last year, one third higher than the originally reported loss of 96,500 jobs. Given 2001's slow economy and the effects of the WTC attacks, higher total job losses were not surprising; in some cases they were even expected.

On the other hand, revised data now show 2001 job losses for the securities industry coming in *more than one third lower* than the previously reported record attrition because the benchmark revisions dramatically raised the industry's overall headcount in both the state and city. This was not only surprising but counter-intuitive, since the securities industry was one of the most physically impacted industries from last year's WTC attacks and was already deep into a cycle of layoffs from a two-year bear market further exacerbated by a four-year rash of industry mega-mergers. Furthermore, the revisions were particularly puzzling since they now push the peak employment month for both New York State's and City's securities industry from August 2000 (although layoffs even preceded that date) to August 2001, well into this two-year period of layoffs.

### **Revisions or Not, One of the Worst Years for Wall Street Jobs**

This bipolar revision, with total layoffs revised upward but securities industry layoffs revised downward, led to a decline in the industry's relative impact to total job losses in the city from 23% to 12%. Within the industry itself, job losses in the city last year were revised down to 13,500 from the previously reported loss of 21,900 jobs, resulting in a 7.1% decline in securities industry jobs rather than the previously reported 11.6% drop.

The benchmark revisions boosted the industry's total citywide employment up by 10,100 jobs at year-end 2001 to 175,500, or 6.1% higher than previously reported. Statewide totals were markedly increased also, but by a puzzling 2,000 fewer positions than the city's upward adjustment. Still, no matter how you look at it, New York's securities industry was hard hit last year, with declines far exceeding the industry's overall share of the city's total labor pool which is only 4.7%.

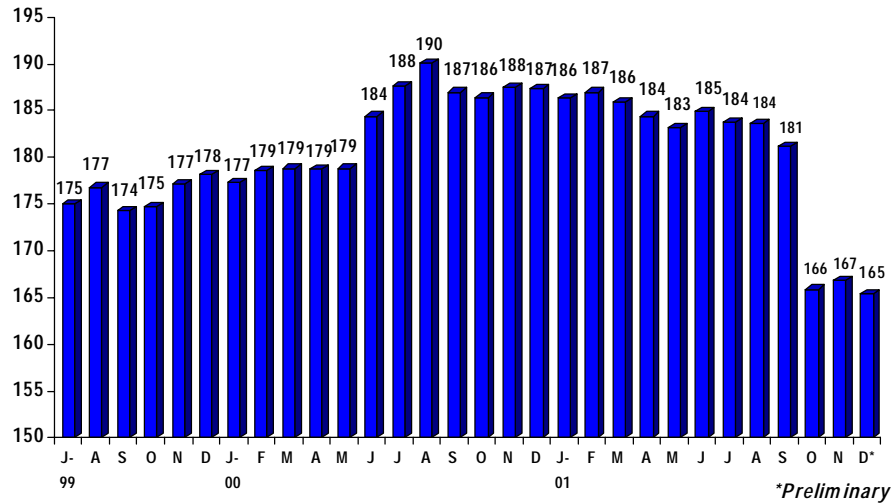
Furthermore, by either measure, the figures confirm that 2001 was one of the worst years ever for securities industry employment in New York. Even though they were revised downward, the aggregate drops were still the worst on record for both the state and city. On a percentage basis, the revised 7.5% statewide drop was the largest decline in 27 years while the revised 7.1% drop for the city was the largest since 1988 (the 11.6% decline, prior to the revision, would have been the worst since 1973).

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<sup>1</sup> Employment benchmarking is a process in which sample-based employment estimates are replaced with a comprehensive count of jobs derived principally from state unemployment insurance tax reports. These are again revised (usually a year later) to include the new benchmark for the previous year and revised benchmarks for the year preceding that, mainly due to respondents who reported too late for the original benchmarking. Here, the new benchmarking was for March 2001 (monthly reporting since then had been based on sample reports pushed against the old 2000 benchmark) combined with the new revised March 2000 benchmark.

## Previous New York City Monthly Securities Industry Employment

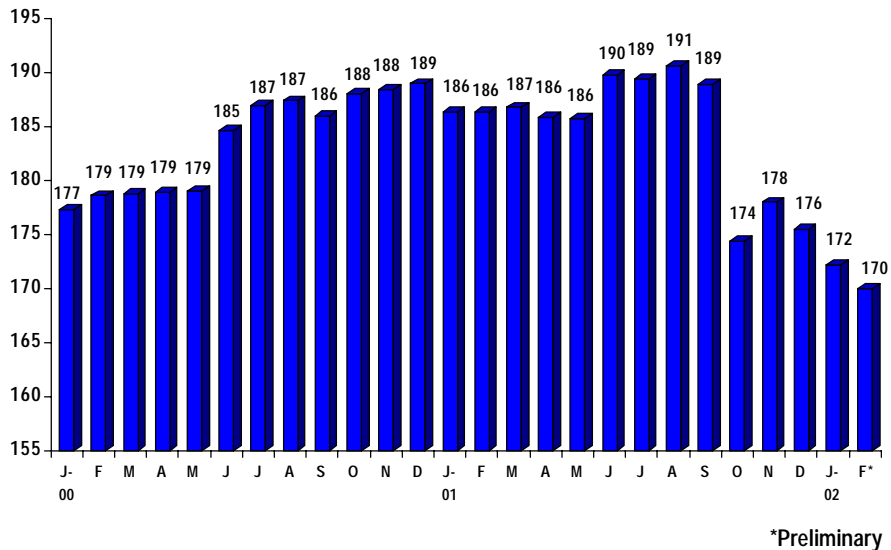
Thousands



*The benchmark revisions for securities industry jobs in the city showed a 1% upward revision, or 1,700 jobs, for year-end 2000 and a huge 6.1%, or 10,100 jobs, upward revision for 2001.*

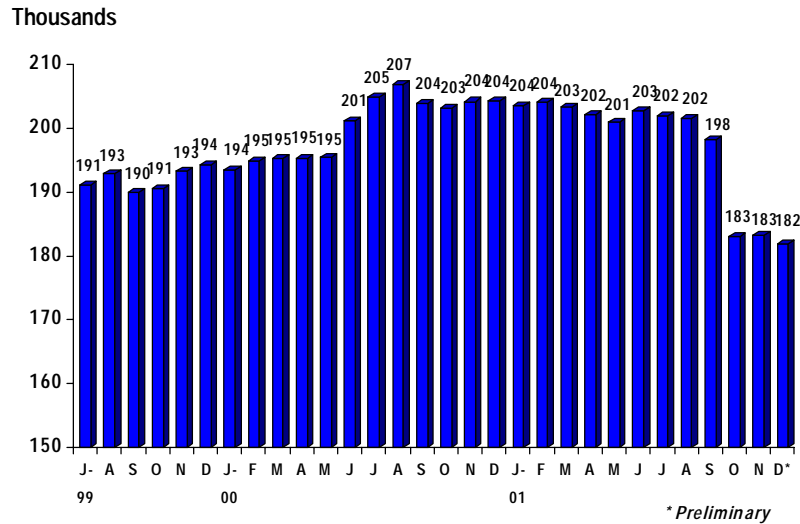
## Revised New York City Monthly Securities Industry Employment

Thousands

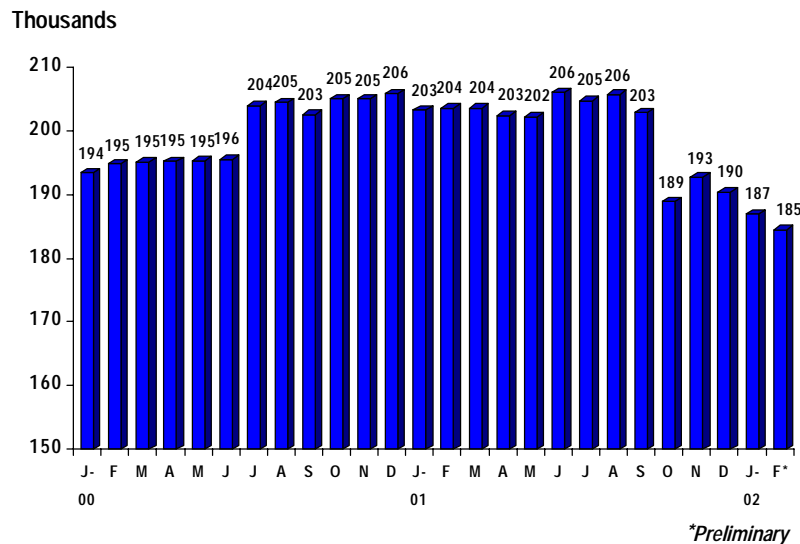


Statewide, the picture was similar to that of the city, but the industry's impact was more diluted because 92% of New York's securities industry positions are located in the city (principally in Manhattan). Adjusted estimates of New York State securities industry employment show an annual job loss of 15,500 in 2001, 30% less than the originally reported loss of 22,100 jobs. Still, this represents 10.1% of the state's total non-farm job losses last year and remains significant, given that the industry only accounts for 2.1%, or 190,400 jobs out of the state's 8.7 million worker base (at year-end 2001).

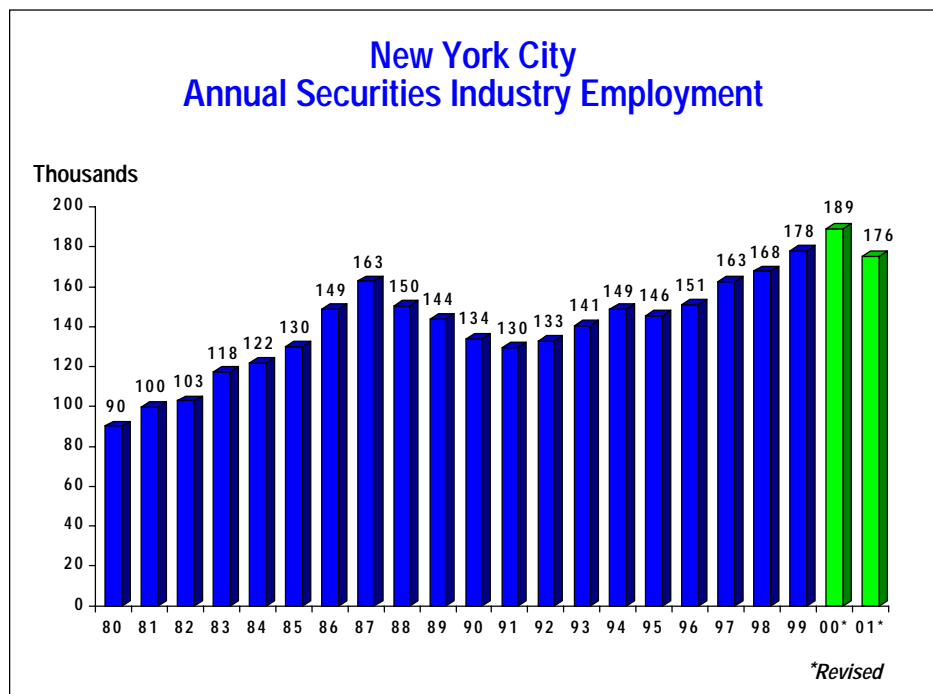
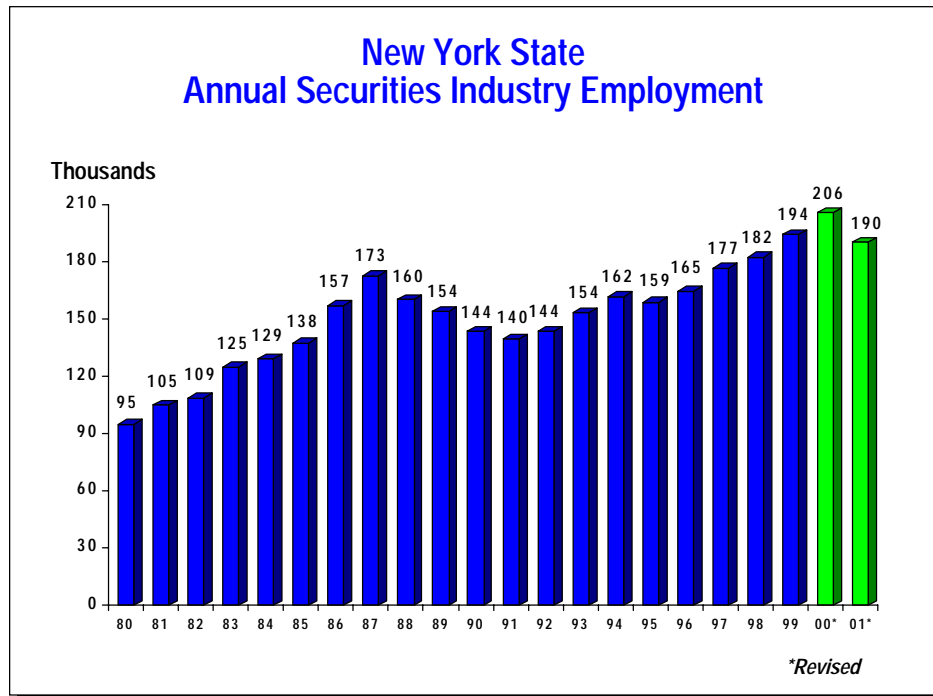
### Previous New York State Monthly Securities Industry Employment



### Revised New York State Monthly Securities Industry Employment



The revisions affected the year-end outlook for the past two years. Previous estimates showed a 11% decline, or a 22,100 loss of securities industry jobs in New York State last year. Now, however, year-end (and monthly) data have been revised upward: year-end 2000 figures were increased by 2,000 jobs while year-end 2001's figures were increased dramatically, by 8,500 jobs. Thus, 2001's heavy adjustment upward reduces the impact of the losses following the WTC attacks – the revised decline is just 70% of the previously reported decline. The same was true for the city's revised figures.



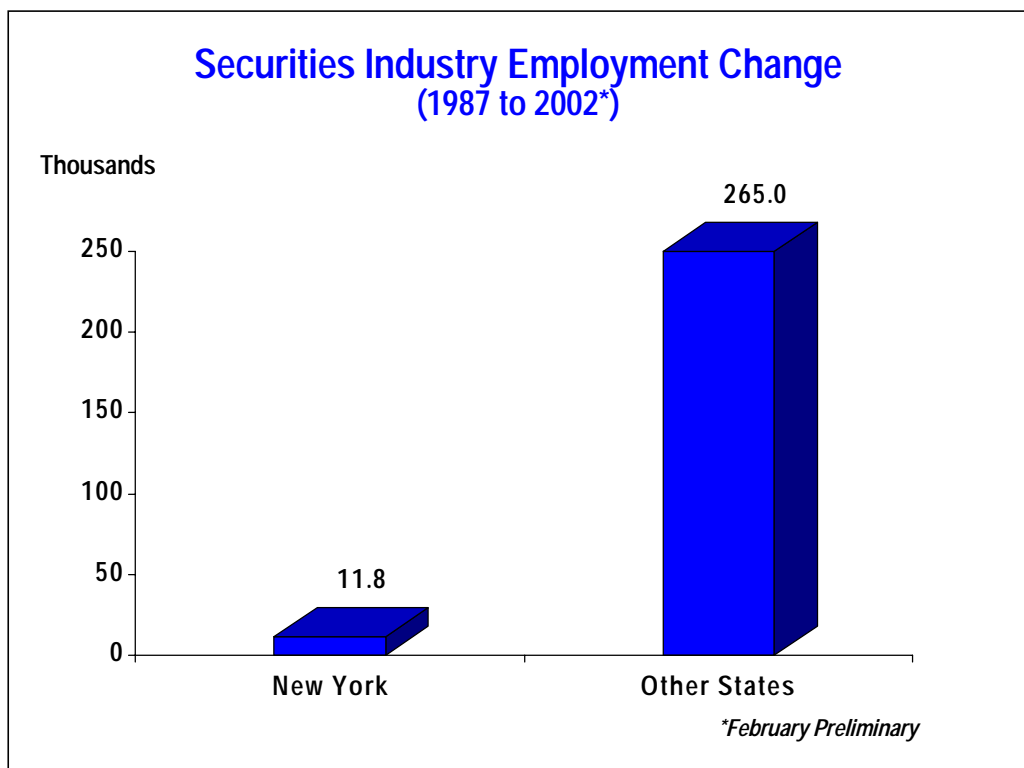
## Bulk of Wall Street Job Losses Followed WTC Attacks

Despite the differing estimates, the dramatic drops in securities industry employment all came after the WTC attacks. This holds true for both New York State and City and, given New York's importance to the U.S. totals, the overall national numbers.

Following the WTC attacks, through February 2002, the city lost 20,000 securities jobs, or over 10% of its September 2001 staffing levels. The biggest drop occurred in the immediate aftermath, October, when 15,500 jobs, or 8.1% of the city's total, were lost -- dropping from 189,900 in September to 174,400 in October. This was a monthly record job loss for securities industry positions in the city in both aggregate and percentage terms. Most of this drop was due to relocations from downtown sites out of the city, previous downsizing now hitting the books, some problems in sample firm reporting, and, unfortunately, from victims of the attacks.

In November, there was a one month spike in job recovery as 3,600 securities positions returned to the city from employees returning to work, or returning from temporary locations out of the city, mainly New Jersey. Further layoffs in the following three months, December through February (so far), pared that total by an additional 8,000 to 170,000 by February's close, the lowest level in nearly three years, May of 1999. Still, the 2001 year-end total of 175,500 city-wide securities industry positions is the third highest year-end total after 2000's 189,000 and 1999's 178,200 positions.

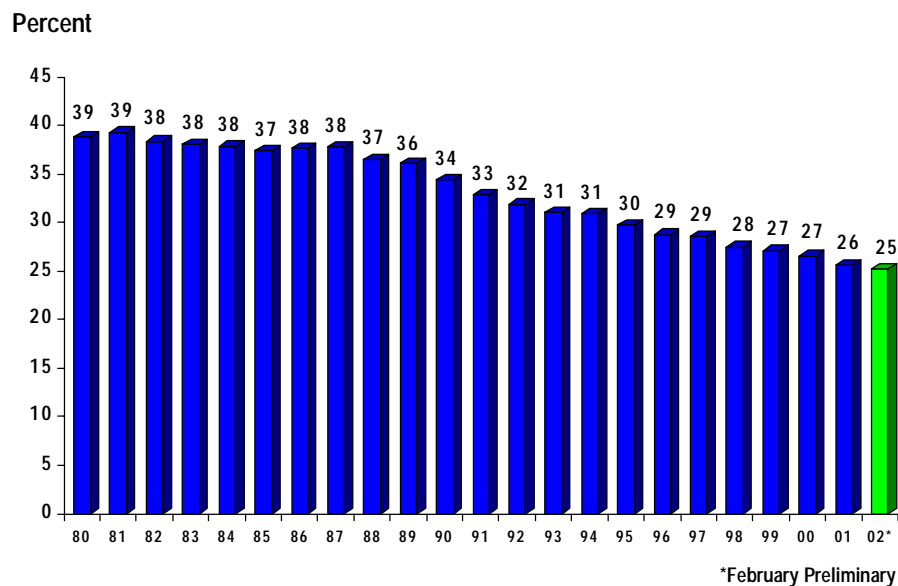
## New York's Waning Centrality to the U.S. Securities Industry





The job losses in New York last year were more severe than anywhere else in the country while its job growth during good years severely lagged that in the 49 other states. Comparing the securities industry job base today (February 2000) to its prior peak at year-end 1987 (before the post 1987 market crash layoffs began), New York is up only 11,800 net positions vs. 265,000 for the rest of the country. That's less than a 7% net gain in over 14 years for New York vs. a 93% net gain for the 49 other states.

## New York State's Share of Securities Industry Jobs

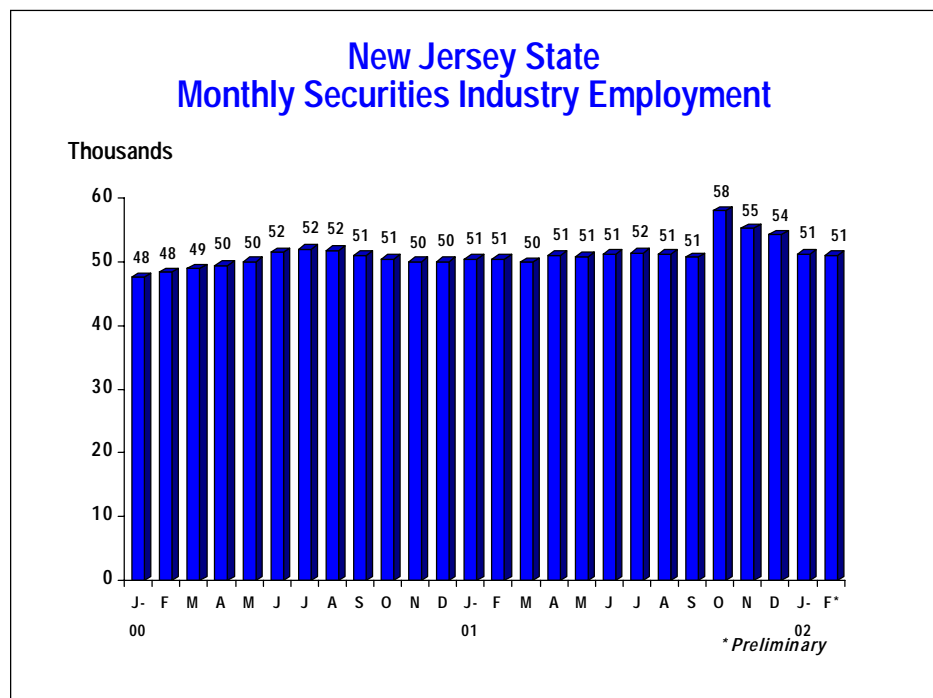


Although securities industry employment nationwide has tripled since 1980, New York State's share of that employment has steadily declined from about two out of every five U.S. positions in 1980 to one out of four today. Although New York's cost disadvantages vs. other states has long been the case – New York, in most respects, has higher rent, labor, tax and other costs of doing business than many other locations -- these disadvantages are far more significant in today's post September 11 environment.

Particular challenges come from business continuity plans calling for geographic dispersal across the Hudson River or elsewhere, for back-up or redundant facilities for technology, communications infrastructure, physical plant and, of course, personnel. These, along with transportation problems downtown and psychological reactions to the WTC site, are just some of the many issues that need to be addressed to prevent further permanent relocations from downtown for the securities and other industries. Even if migration continues from lower, or even midtown, Manhattan, these positions do not necessarily have to leave New York if addressed immediately. Furthermore, New York's securities industry still faces continued intense competition among both non-New York domestic and global financial service conglomerates for New York brokerages.

## New Jersey's Temporarily Stabilized Job Base

New Jersey's securities industry job base has steadily grown for years but shot up massively in October following the WTC-necessitated relocations. Some of these jobs have migrated back to New York City (as November through February data show), but many will not, as securities firms, and some of their vendors, are now building or leasing across the Hudson for redundant back-up facilities. In October 2001, New Jersey gained a monthly record of 7,300 new securities industry positions, a monthly record percentage increase of 14.3%. That one month gain for New Jersey was also larger than any annual aggregate or percentage gain for the state and came at the expense of New York City, which lost a record 8.1% of its securities industry employment in the month of October.



Put another way, New Jersey's securities industry's job gain of 7,300 in October equaled half of New York City's October job loss of 15,500 securities professionals. Of course, as temporary relocations reverted back to New York, combined with the industry's woes also causing layoffs across the Hudson, New Jersey's securities industry job base fell back to 51,100 by February 2002, just below its August 2001 level of 51,300.

Thus, both the temporary and permanent job gains enjoyed by New Jersey only held in abeyance the inevitable effects of the nationwide downturn in securities industry jobs. Given still weak industry conditions and the fact that further relocations back to New York are underway, i.e. Merrill Lynch began re-occupying the World Financial Center in March, New Jersey's figures will decline even more to late 1999 or early 2000 levels as March and April 2002 data are posted.

**George R. Monahan**

*Vice President and Director, Industry Studies*

## **SINGLE STOCK FUTURES: An Overview of Market Structure and Regulation<sup>1</sup>**

### **Background**

Single stock futures are futures contracts on individual stocks that are traded on exchanges. Each contract designates, for example, 100 shares of a specific stock, as well as an expiration date. On that date, the buyer is obliged to settle in cash or accept possession of the stock. Single stock futures are different from stock options, which give the buyer the right to buy or sell the underlying security, as opposed to the obligation to do so. Experts predict that single stock futures could be used to enhance trading, risk management, and operational benefits for customers as well as brokers and dealers. Some of these benefits could include freeing up dealer credit lines, providing optimal margin treatment for offsetting exposures held in listed accounts, and hedging temporary volatility that may surround a company's earnings announcements.<sup>2</sup>

Single-stock futures are currently traded outside of the United States in U.K., Swedish, Canadian, and Hong Kong markets, among others. However, in U.S. markets, the regulation of securities products and futures products was kept separate by the 1982 Shad-Johnson Accord. Therefore, trading products that contain elements of both securities and futures such as single stock futures and futures on narrow based indices was not allowed. However, in December of 2000, the Commodity Futures Modernization Act (CFMA) was signed into law. The CFMA repealed the Shad-Johnson Accord, so that for the first time both U.S. securities and futures exchanges will be eligible to trade security futures. It is crucial that the necessary regulatory framework, including rules that clarify margin requirements and tax implications of this new product, be in place before trading begins. In mid-March 2002, the Chairman of the Commodity Futures Trading Commission (CFTC) reiterated his original goal to have these final rules ready for the second quarter of this year.<sup>3</sup>

### **Market Structure for Single Stock Futures**

#### **Exchanges' Opposing Structures**

Thus far, four exchanges have formally announced their intention to offer trading of single stock futures. Two of these exchanges have been created for the purpose of trading these products. These are: 1) OneChicago, created by owners of CBOE, CME and CBT; and 2) NQLX, a joint venture of Nasdaq and Liffe. Two markets are adding single stock futures to what they currently offer: the AMEX and Island ECN. Reportedly, as of the beginning of March, NexTrade ECN was preparing to apply to the CFTC to be able to trade these products, and two others, Instinet ECN and Archipelago ECN were "exploring the option" to do so.<sup>4</sup>

The four exchanges that have formally announced, OneChicago, NQLX, AMEX, and Island, are characterized by similarities across some market structure and design and listing dimensions, but do vary substantially across several other important dimensions.<sup>5</sup> In terms of **similarities**, all four exchanges have designated a **contract size of 100 shares** of the underlying stock in question. They will all **settle** through the National Securities Clearing Corporation (NSCC), and **clear** through the Options Clearing Corporation (OCC), though joint members of CME and OCC will be able to choose either one through which to clear. All of the exchanges will require a **minimum price fluctuation of \$0.01**. NQLX and Island will have a crossing facility; OneChicago and AMEX have not yet announced whether they will also have one. OneChicago and Island will have a block trading facility; Island and AMEX have not yet announced whether they will also have one. None of the four exchanges have been able to announce a firm launch date, because regulators have not yet released all the final rules that need to be in place before trading commences.

**Two major differences** across market structure dimensions among the four exchanges are: 1) the type of **order execution engines** that will be used, including the extent to which market makers will have a role in the execution, and 2) the issue of **product fungibility**. The AMEX is going to use its currently existing open outcry system with designated specialists to execute orders. Under what is called the “modified specialist market maker system,” these specialists have an affirmative obligation to provide two-sided continuous markets. Smaller orders that will have minimal market impact are most often executed electronically on the AMEX Auto-Ex system or on the AMEX Options Display Book (AODB) system, which delivers orders to the Specialist Post. Approximately 60% of the options volume is executed on these systems; 40% of the volume is manually executed through a floor broker.<sup>6</sup>

OneChicago will trade the security futures electronically using their Lead Market Maker model. Lead Market Makers are allocated products and also have an affirmative obligation to provide two-sided continuous markets and liquidity in those products. Member firms may use the CBOEDirect system or the Globex2 system in order to enter orders for security futures.<sup>7</sup> In contrast, NQLX’s orders will be executed using a central limit order book that is electronic, transparent, and anonymous. Orders will be executed in strict price-time priority. Their orders will be matched using Liffe’s electronic trading program, LIFFE CONNECT. Island will also execute orders using an electronic central limit order book that is transparent and anonymous, also executed in price-time priority. Island will not have the obligation to maintain two-sided quotes.

The second major difference among the exchanges relates to the key issue of product fungibility. Fungibility of listed options, for example, refers to **the substitutability of these options**, which depends on the products having **common strike prices and expiration dates**. Common strike prices and expiration dates allows the investor to close positions by offsetting the transactions through the OCC. Fungibility is **currently not a legal or regulatory requirement for security futures**, but both AMEX and Island’s products will be fungible. AMEX has suggested that everyone offering single stock future products should design them using characteristics similar to options. The products at OneChicago, on the other hand, will not be fungible, as they will be modeled after the futures that currently trade in Chicago. NQLX has also decided against fungibility.<sup>8</sup>

The SIA believes that futures fungibility would help broker-dealers to fulfill their best execution obligation, a duty imposed under federal securities laws and SRO rules, particularly in the absence of intermarket linkages

(and therefore a trade-through rule), and consolidated quotations. However, the SIA believes that it would not be appropriate for the SEC to impose intermarket linkage or trade-through disclosure requirements on security futures trading at this stage. The SIA recommends, therefore, that the SEC clarify that a best execution obligation does not require a broker-dealer to evaluate security futures contracts based on the same underlying security traded on competing exchanges that are not fungible, or in the absence of an effective composite price reporting system.<sup>9</sup>

There are also operational issues that, if addressed, will help broker-dealers and others to ensure smooth trading. The Financial Information Forum is spearheading an effort through a working group that includes representatives from firms, market data vendors and clearing organizations to create an instrument identification syntax that will help to avoid an increase in symbol conflicts of different products in trading systems. They report that there are many futures root codes currently in use that directly conflict with listed equity symbols. These conflicts could be exacerbated by the introduction of single stock futures.<sup>10</sup>

There are additional differences among the four exchanges. All of the exchanges are CFTC designated, except for AMEX, which is SEC registered. Surveillance and compliance services will be provided by NASDR for NQLX, and by the National Futures Association (NFA) for Island; OneChicago will employ a proprietary surveillance and compliance system. An arbitration forum will be also provided by the NASDR for NQLX, and the NFA will provide arbitration for OneChicago and Island. AMEX has not yet announced the details of its surveillance, compliance and arbitration procedures.

In terms of differences in the range of products, OneChicago and Island will offer

security futures only, and NQLX will offer security futures and broad-based security indices. AMEX has not yet announced its range of products, but has declared that they will initially offer between 50 and 100 products. NQLX will begin by offering 50 products, and OneChicago and Island have not yet disclosed how many products will be available upon the launch of their exchanges. Some products that at least two of the exchanges will be offering initially include futures on Cisco Systems, Nokia, Qualcomm, Dell, IBM, J.P. Morgan Chase, Merrill Lynch, Morgan Stanley, and AT&T.

## Regulation of Single Stock Futures

The CFTC was established as an independent agency in 1974, based on the model of the SEC. The primary statute that has governed futures in the United States since 1936 has been the Commodity Exchange Act (CEA). The CEA also designated Self-Regulatory Organizations to be overseen by the CFTC, the National Futures Association (NFA) and the commodities exchanges.

The 1982 Shad-Johnson Accord temporarily resolved a jurisdictional dispute between the CFTC and the SEC. The SEC retained jurisdiction over options on stock indexes, single stocks and foreign currencies traded on a securities exchange, and the CFTC was granted jurisdiction over futures contracts and options on futures contracts of broad-based stock indexes, as well as foreign currency products not traded on a securities exchange.<sup>11</sup>

The CFMA of 2000, however, stipulated that single stock futures be treated as both securities and futures, requiring joint regulation by the SEC and the CFTC. Therefore, any firm selling single stock futures must be registered both as a broker-dealer with the SEC and as a futures commission merchant with the CFTC.

Both broker-dealers and futures commission merchants will be able to trade single stock futures on existing and/or new commodities and securities exchanges.

## Joint Rulemaking

The CFTC and SEC have already engaged in **joint rulemaking** regulating security futures.<sup>12</sup> Specifically, there is now one joint final rule, one joint final order, and three joint proposed rules. The one joint final rule regards the definition of a narrow-based security index, exemptions from this definition, and how to treat an index subject to the rules of a foreign board of trade. In order to determine whether a security index is narrow-based or not, the agencies have stipulated methods to arrive at variables like dollar value of average daily trading volume and market capitalization. The one joint final order regards **futures on depositary shares** and the conditions under which they are allowed to underlie security futures.

One joint proposed rule addresses **cash settlement and regulatory halt requirements**. For example, when a regulatory halt is in place for a certain security, trading also must be stopped on any futures product based on that security. A second joint proposed rule regards **customer protection, record keeping and reporting**. Futures commission merchants (FCM) and broker-dealers are allowed to choose whether to place single stock futures in a futures account or a securities account, and are also allowed to let their customers make that choice. Products held in the different types of accounts, however, would be subject to different rules, either SEC rules or CEA rules.

Third, and most importantly, there is a joint proposed rule that addresses the key issue of **customer margin**. Securities future margin refers to “the amount, type, and form of collateral required to secure any extension or maintenance of credit, or the amount of

margin required as a performance bond related to the purchase, sale, or carrying of a security futures product.”<sup>13</sup> Congress gave the Federal Reserve Board the authority to create rules, such as margin requirements, that would level the playing field between security futures and comparable options products; initial and maintenance margin levels for these products may not be lower than the lowest level of margin set for the comparable products. The Fed then delegated this authority to set margin to the CFTC and the SEC.<sup>14</sup>

This rule, among other things, sets customer margin levels at 20 percent of current market values for long and short security futures positions, establishes rules regarding the use of collateral for these products, and identifies exceptions to these rules. The comment period on this rule proposal has ended. The short sale rule does not apply to security futures.

## Separate Agency Rulemaking

The CFTC and the SEC have both created separate rules affecting single stock futures. **The CFTC has released four final rules, one proposed rule, and has approved NFA rule amendments.** The first final rule addresses notice designation of contract markets for security futures, establishing procedures for national securities exchanges, national securities associations or alternative trading systems can register as a “notice-designated” contract market, and how to apply for an exemption from CEA provisions. The second final rule outlines procedures by which broker-dealers can register as FCMs or introducing brokers (IB). The third final rule establishes procedures by which FCMs and IBs can apply for CEA exemptions.

The fourth final CFTC rule regards listing standards and conditions for security futures. Organizations wishing to trade security futures must satisfy criteria of physical delivery



of products, and must have in place rules regarding who is allowed to trade the products, as well as rules providing for coordinated surveillance, audit trails, regulatory halts, margin requirements and rules against dual trading and price manipulation. There are also limits on speculative positions outlined. The one proposed rule by the CFTC addresses restrictions on dual trading and potential exemptions to this rule.

**The SEC has released three final rules and one fee exemption.** The first final rule addresses notice procedures for registering as a security futures product exchange. Regarding products traded, the CFMA stipulates that listing standards requirements for security future products must be no less restrictive than comparable listing standards for options. The second final rule distinguishes between rule-filings on issues that do not require SEC approval to take effect and issues that do require SEC approval to take effect. The third final rule addresses procedures for CFTC-regulated FCMs and IBs to register as broker-dealers for the limited purpose of trading security futures products, and also addresses privacy provisions that must be followed. Finally, the SEC issued an exemption from Section 31 fees for futures on narrow-based security indices. This exemption is a reflection of the fact that there is a very low amount of Section 31 fees currently collected on options on narrow-based security indexes, and that it would be a burden for the exchanges to calculate whether an index is narrow-based or broad-based.

**The Treasury and IRS have also had to address tax implications** for single stock futures. The goal, as is the case with other regulatory initiatives in security futures, is to tax these products similarly to single equity options. Therefore, security future products for dealers will be “treated as sold taxed as sold for its fair market value (the “mark-to-market” rule) and any gain or loss with respect to the contract is treated as a 60

percent long-term capital gain or loss and a 40 percent short-term capital gain or loss (the “60/40” rule).”<sup>15</sup> New tax rules establish that a person is a dealer in these products if he or she performs functions similar to those performed by options market makers or specialists.

## **SRO Rulemaking**

The relevant SROs, including the National Futures Association (NFA), the National Association of Securities Dealers (NASD), and the Options Clearing Corporation (OCC) have made rules addressing single stock futures to coordinate with the regulatory changes. The NFA has created training rules for its members with regard to single stock futures. NFA members must also comply with anti-fraud, business conduct, and consumer protection rules. The NASD has created record keeping requirements about security futures for Alternative Trading Systems (ATS), and to make sure that these organizations institute trading halts on these products when other markets do. The OCC proposed amendments and rules to allow it to clear and settle security futures transactions, which the SEC has approved.

**Judith Chase**

*Vice President and Director, Securities Research*

## FOOTNOTES

- <sup>1</sup> This article is based in part on presentations given at the SIA-FIA Security Futures Conference on February 25, 2002 in New York City. See <http://www.sia.com/siafia/html/presentations.html>.
- <sup>2</sup> Peter Borish of OneChicago, "New Market Opportunities in Security Futures," presented at the SIA-FIA Security Futures Conference, February 25, 2002, New York City. See <http://www.sia.com/siafia/html/presentations.html>.
- <sup>3</sup> Michael Forman, "NQLX Names CEO, Cements NASD Reg Deal," *Securities Industry News*, Vol. XIV, No. 11, March 18, 2002, p. 20.
- <sup>4</sup> "ECNs Gear Up For Futures Trading," *Wall Street Letter*, March 4, 2002, p. 7.
- <sup>5</sup> See Eileen T. Flaherty of Aubrey G. Lanston & Co., Inc., "Exchange Rules: Responding to Joint Regulation," presented at the SIA-FIA Security Futures Conference, February 25, 2002, New York City. See <http://www.sia.com/siafia/html/presentations.html>.
- <sup>6</sup> Steve Ciccarello of AMEX, "Exchange Rules: Responding to Joint Regulation," presented at the SIA-FIA Security Futures Conference, February 25, 2002, New York City. See <http://www.sia.com/siafia/html/presentations.html>.
- <sup>7</sup> Peter Borish of OneChicago, SIA-FIA presentation.
- <sup>8</sup> "Amex and One Chicago Debate Futures Fungibility," *Wall Street Letter*, March 4, 2002, p. 2.
- <sup>9</sup> See "Memorandum: Issues Raised Under Federal Securities Laws By The Introduction of Single Stock Futures," June 12, 2001. See [http://www.sia.com/ssf/html/sia\\_resources.html](http://www.sia.com/ssf/html/sia_resources.html).
- <sup>10</sup> See <http://www.fif.com/ssf.asp>.
- <sup>11</sup> The Honorable Tom Ewing, Opening Statement, Hearings to Review reform of the Commodity Exchange Act and provisions of H.R. 467, the Commodity Exchange Act Amendments of 1997, Tuesday, April 16, 1997, p.1. See <http://agriculture.house.gov/105/h70415o1.htm>.
- <sup>12</sup> Elizabeth L. Ritter of the CFTC and Onnig H. Dombalagian of the SEC, "Overview of Rules and Regulations Governing Security Futures," presented at the SIA-FIA Security Futures Conference, February 25, 2002, New York City. See <http://www.sia.com/siafia/html/presentations.html>.
- <sup>13</sup> See Section 3(a)(57)(A) of the Securities Exchange Act of 1934, as amended by the CFMA of 2000.
- <sup>14</sup> Kenneth M. Rosenzweig, "Margin Rules Come Into Focus," *Futures Industry Magazine*, December 2001.
- <sup>15</sup> See Erika W. Nijenhuis of Cleary, Gottlieb, Steen & Hamilton, "Summary of Taxation of Securities Futures Contracts," presented at the SIA-FIA Security Futures Conference, February 25, 2002, New York City. See <http://www.sia.com/siafia/html/presentations.html>.



## ACRONYMS

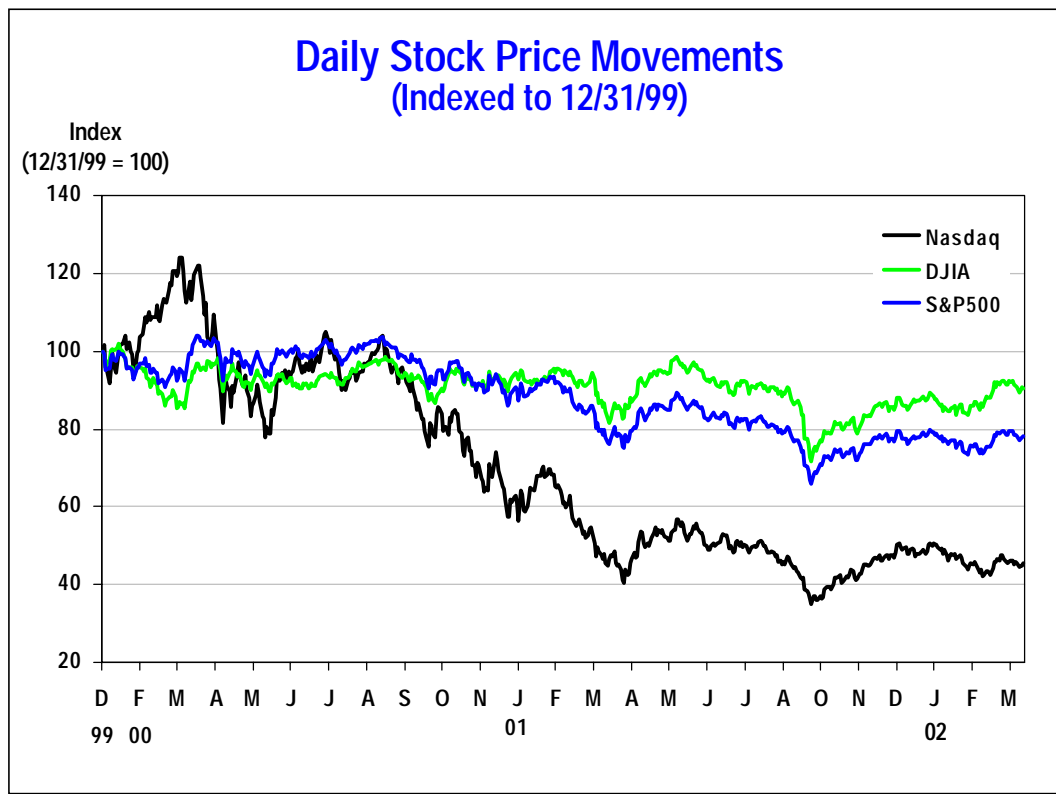
<b>AMEX</b> .....	American Stock Exchange
<b>AODB AMEX</b> .....	Options Display Book system
<b>ATS</b> .....	alternative trading system
<b>CBOE</b> .....	Chicago Board Options Exchange
<b>CBT</b> .....	Chicago Board of Trade
<b>CEA</b> .....	Commodity Exchange Act
<b>CFMA</b> .....	Commodity Futures Modernization Act
<b>CFTC</b> .....	Commodity Futures Trading Commission
<b>CME</b> .....	Chicago Mercantile Exchange
<b>ECN</b> .....	electronic communications network
<b>FCM</b> .....	futures commission merchant
<b>IB</b> .....	introducing broker
<b>IRS</b> .....	Internal Revenue Service
<b>NASD</b> .....	National Association of Securities Dealers
<b>NFA</b> .....	National Futures Association
<b>NQLX</b> .....	Nasdaq-Liffe Exchange
<b>NSCC</b> .....	National Securities Clearing Corporation
<b>OCC</b> .....	Options Clearing Corporation
<b>SEC</b> .....	Securities and Exchange Commission
<b>SIA</b> .....	Securities Industry Association
<b>SSF</b> .....	single stock future

## MONTHLY STATISTICAL REVIEW

### U.S. Equity Market Activity

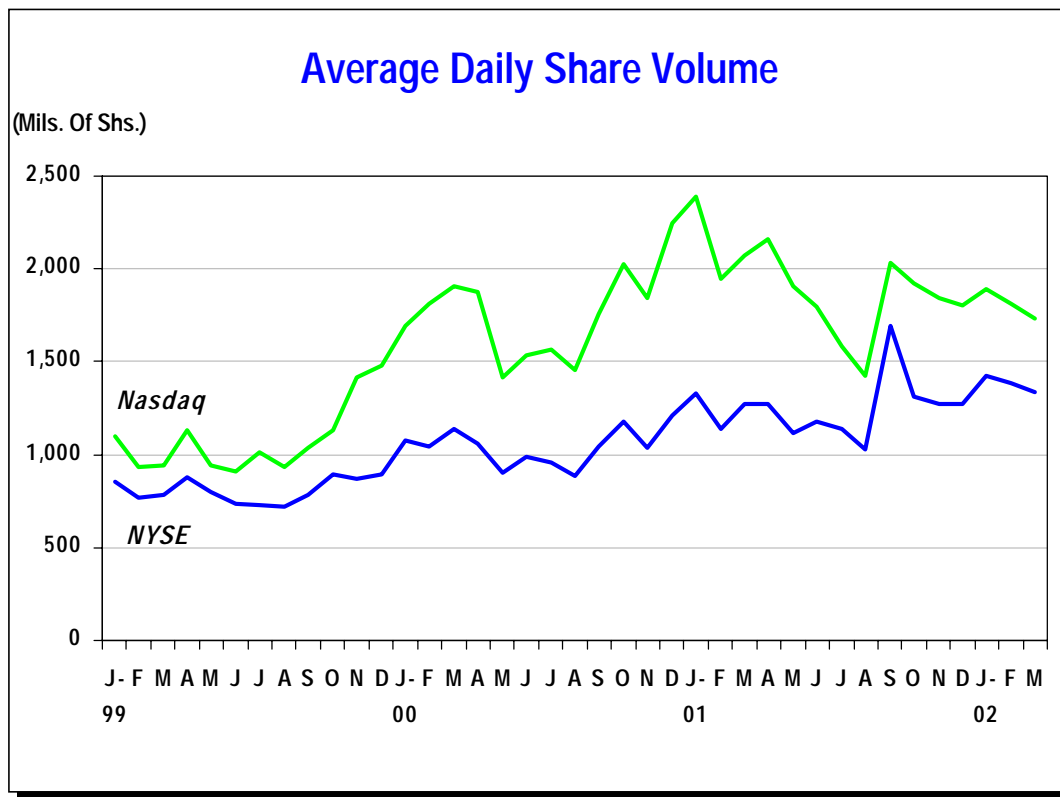
**Stock Prices** – The year began on a down note, as questionable corporate accounting practices, mixed signals on the economy, and weak corporate earnings all weighed on the market. Conditions improved as the quarter progressed, helped by a series of encouraging economic indicators which fueled hopes for a quick rebound in profits. One such market boost was the revision upward of fourth quarter GDP to 1.7% (annualized growth), which confirmed a stronger-than-expected economic recovery. Finally in March, each of the major market indices posted gains and their best monthly showing since November. The Nasdaq Composite Index rose 6.6% after sinking 10.5% the prior month. Meanwhile, the DJIA was up 2.9%, its second straight monthly increase, and the S&P 500 rose 3.7% following two consecutive monthly declines.

For the entire first quarter, the DJIA gained 3.8%, propelled by strength in economically sensitive stocks. The S&P 500 was essentially flat, inching down a meager 0.06%. In contrast, the Nasdaq Composite retreated 5.4% in 1Q'02 mainly due to continued weakness in the tech sector.

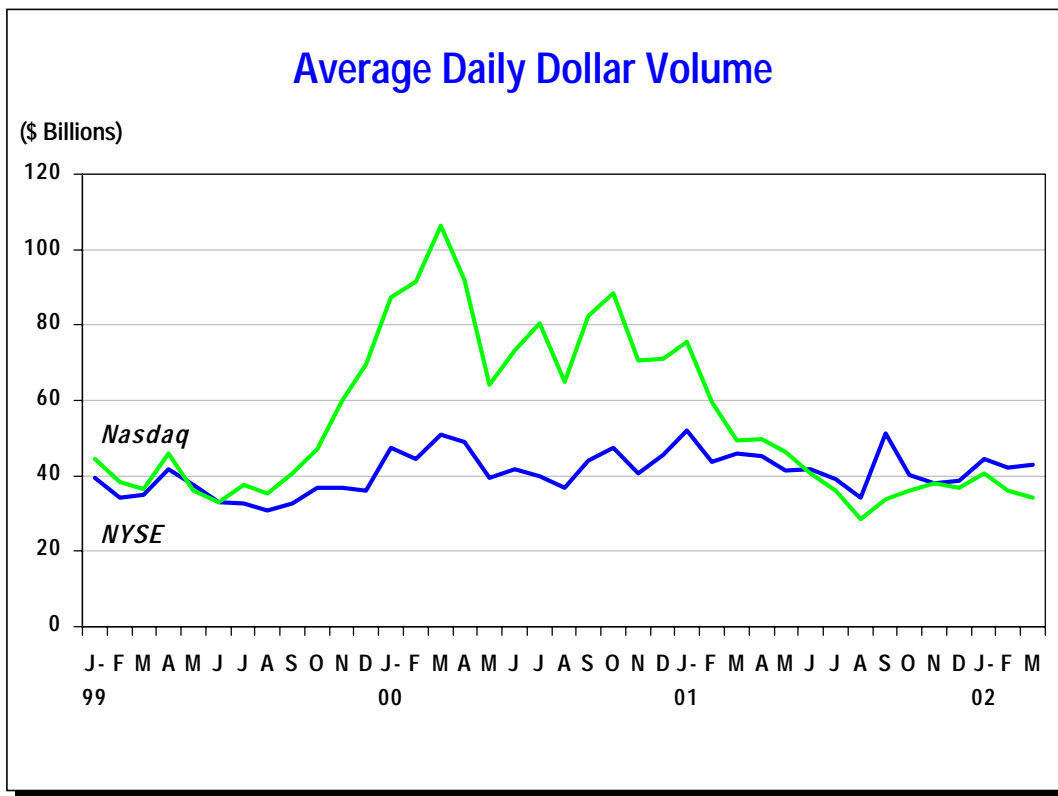


**Share Volume** – After a brief bounce in January from the usual New Year portfolio shifting by institutions, volume steadily declined over the next two months. Nasdaq's average daily volume slipped 4.6% from February's level to 1.73 billion shares daily in March, a seven-month low. Year-to-date, Nasdaq volume of 1.81 billion daily trails last year's average by 4.7%.

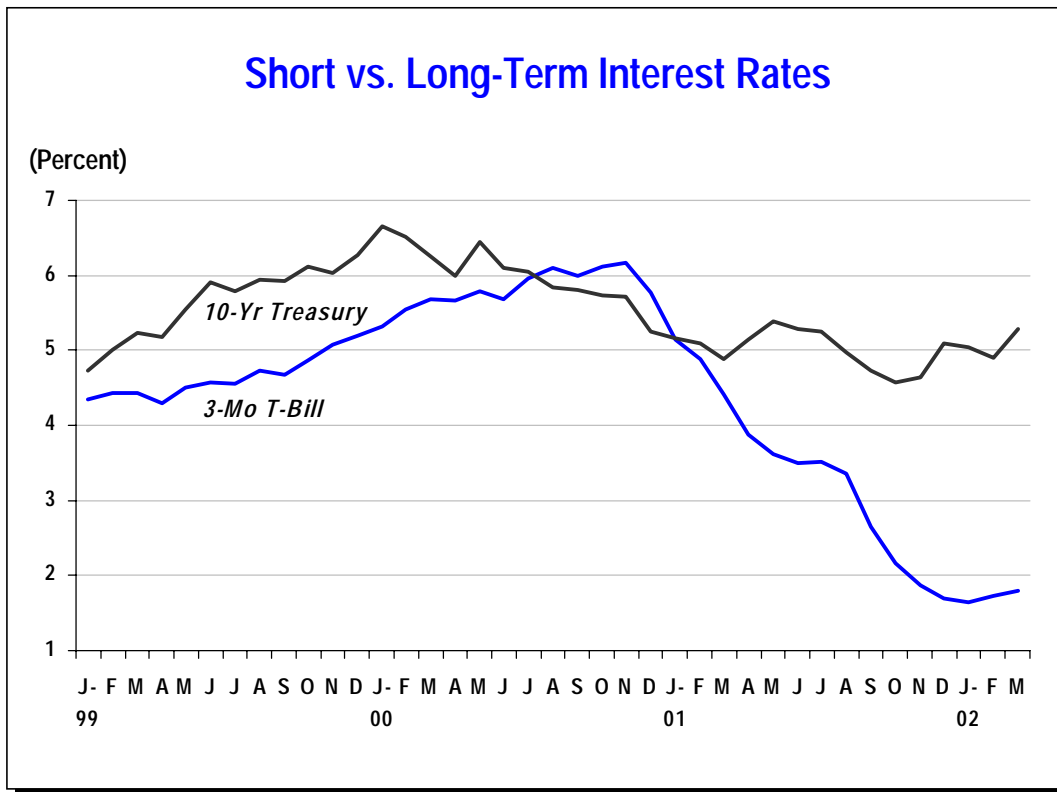
On the NYSE, volume slipped to a three-month low of 1.34 billion shares daily in March, 3.2% short of February's average. Despite the slowdown in trading, the NYSE's average daily volume of 1.38 billion daily during 1Q'02 was 11.5% higher than last year's annual record pace of 1.24 billion per day.



**Dollar Volume** – So far this year, both share and dollar volumes have been stronger on the NYSE than on Nasdaq. Average daily dollar volume on Nasdaq sank monthly in 1Q'02 from \$40.8 billion daily in January to \$34.1 billion in March. To put that figure in perspective, March's level was less than one-third the record \$106.4 billion daily average reached in March 2000. For the first three months of 2002, the daily value of trading in Nasdaq stocks, at \$37.0 billion daily, was 16.1% below 2001's full-year average of \$44.1 billion daily and less than half 2000's annual record of \$80.9 billion per day. On the NYSE, the dollar value of shares traded edged up 1.9% in March due to increased trading activity and higher share prices. That brought the year-to-date value to \$43.2 billion daily, up 2.1% from last year's average and just shy of the \$43.9 billion daily record set in 2000.

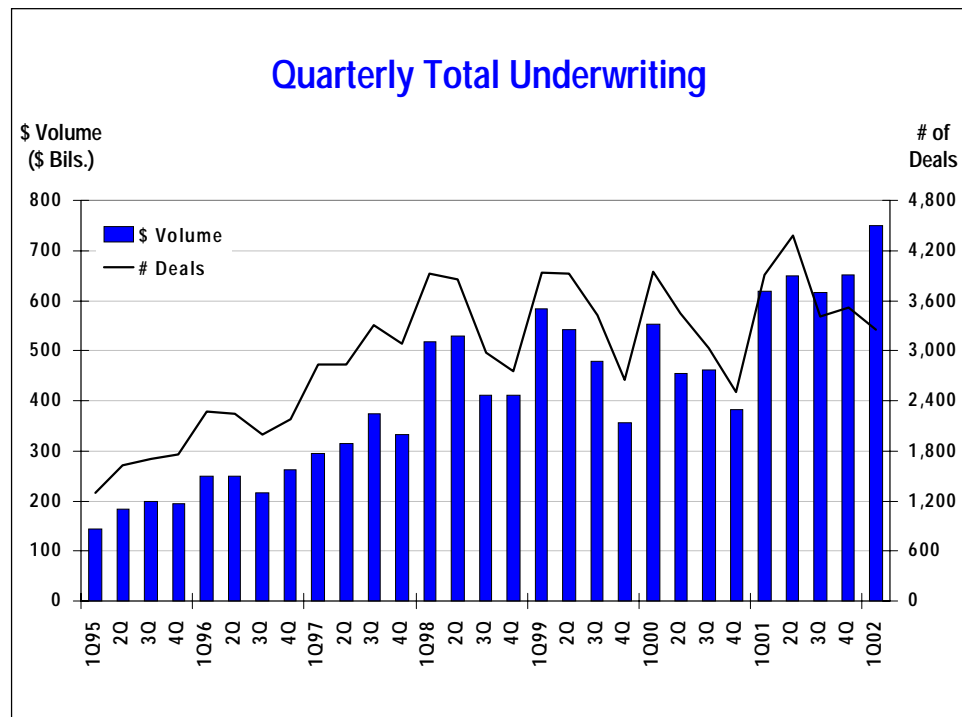
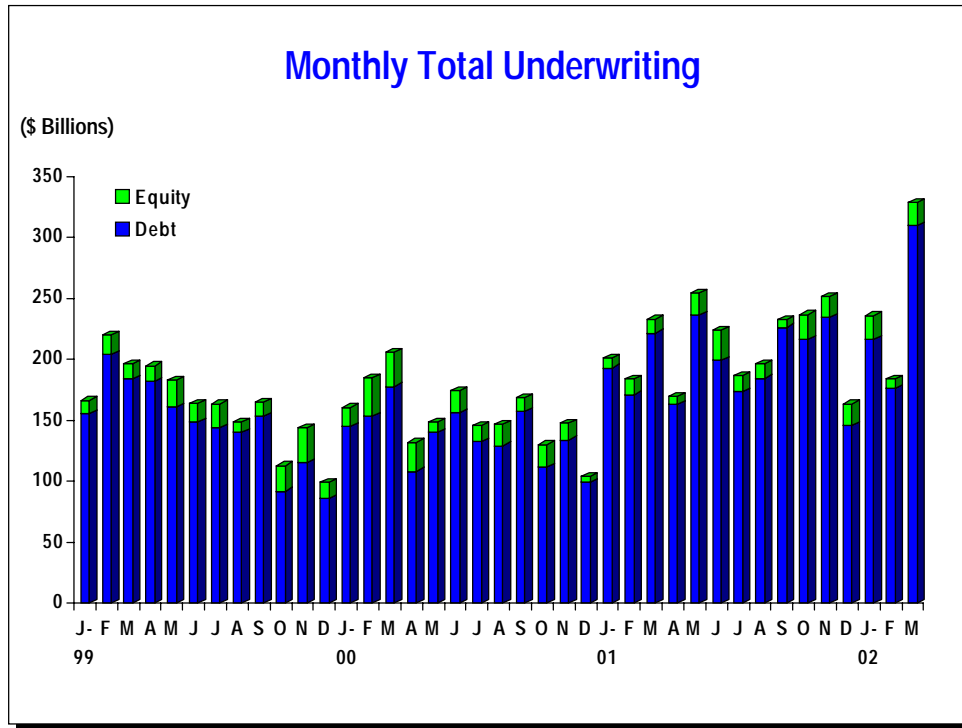


**Interest Rates** – Long-term Treasury yields, which have been moving higher since early November, rose sharply in March amid rising expectations that the Fed would shift to a tightening stance this year. The yield on the benchmark 10-year Treasury bond climbed to a nine-month high of 5.28% in March, up 37 basis points (bps) from February and 39 bps above its year-earlier level. On the short-end, 3-month T-bills averaged 1.79% in March, up 6 bps from February's average but 263 bps below where it stood a year ago. Thus, the yield spread between the 10-year Treasury and the 3-month T bill gapped to 349 bps in March, its widest margin since January 1993. In stark contrast, just 15 months earlier the yield curve was inverted and averaged -53 bps.

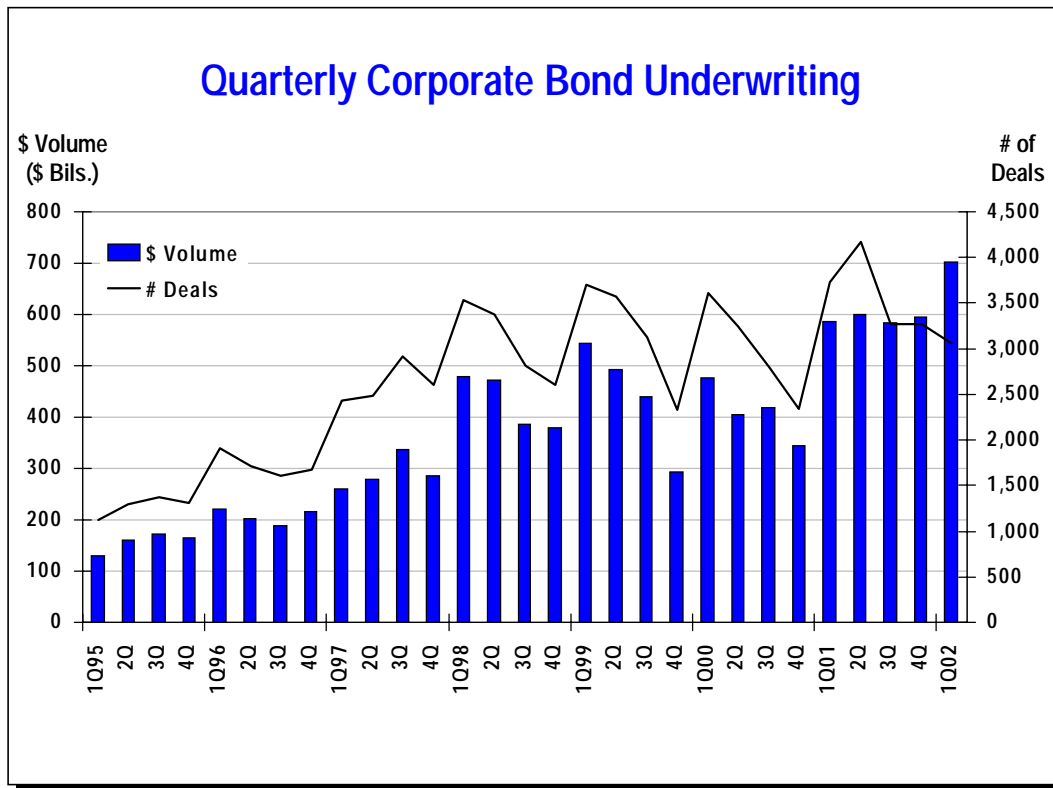


## U.S. Underwriting Activity

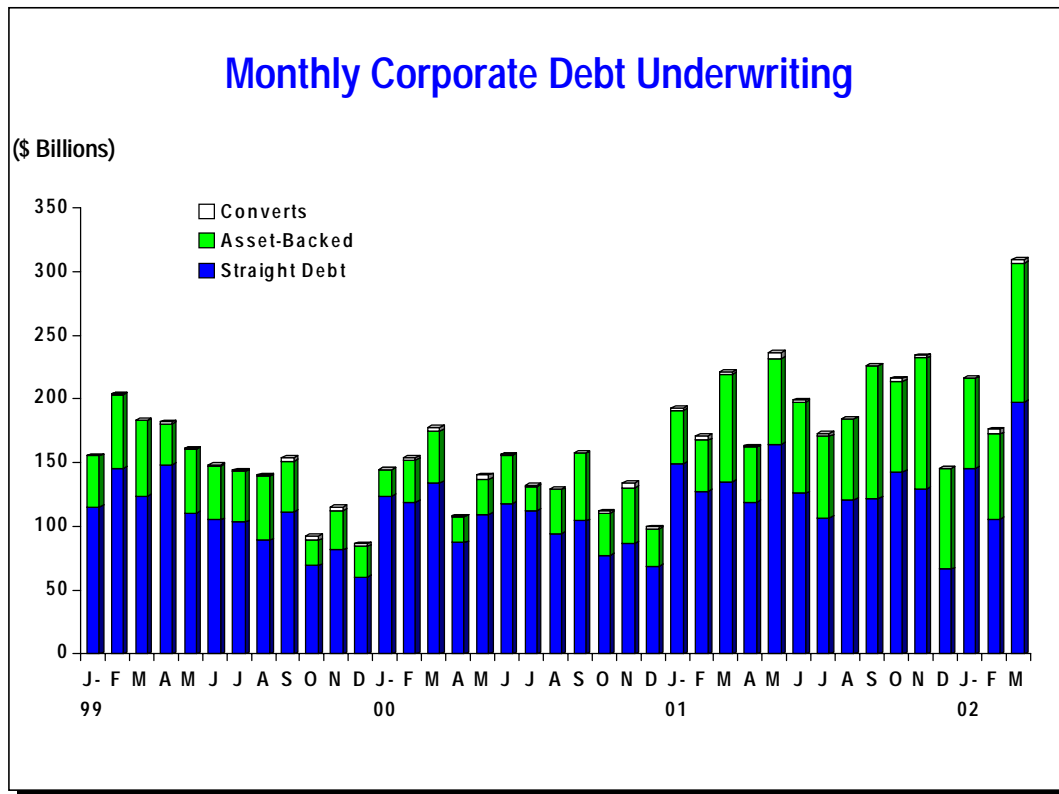
Record corporate bond issuance, combined with a revival in equity activity, propelled the total amount underwritten in March to a record \$329.0 billion. This shattered the previous monthly mark of \$254.4 billion set last May. The strong showing in March drove the 1Q'02 total to a record \$748.7 billion, smashing the previous record of \$652.0 billion set in last year's fourth quarter.



**Corporate Bond Underwriting** – Record bond offerings in March led to a record 1Q'02, as issuers sought to lock in lower interest rates ahead of an anticipated hike in rates later this year. In addition, with the commercial paper market now under water due to credit deterioration and balance sheet scrutiny in the wake of the Enron scandal, issuers have turned to SEC registered bond offerings for financing. Domestic underwriting of straight corporate debt surged 86.7% from February's level to a monthly record \$197.7 billion in March, eclipsing the previous record of \$164.8 billion set in May 2001 by 20%. This brought the first quarter 2002 total to \$449.1 billion, up 8.8% from the year-earlier period and 32.7% higher than the \$338.5 billion raised in the fourth quarter of last year.

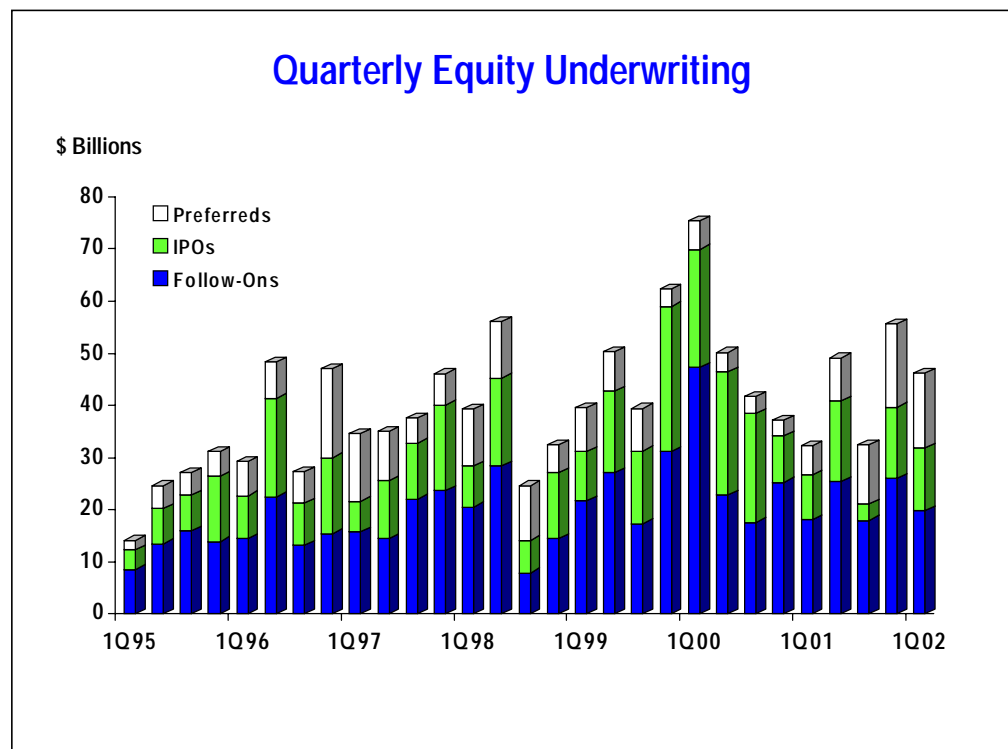
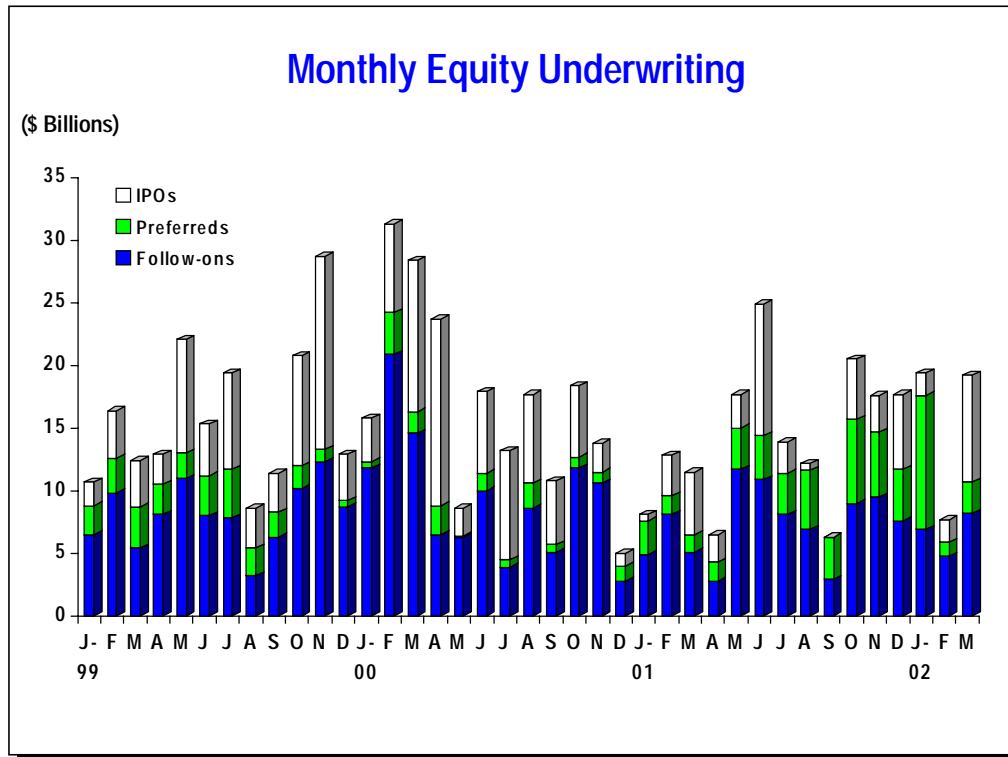


Asset-backed bond issuance climbed 63.5% from \$66.6 billion in February to \$108.9 billion in March, eclipsing the record \$104.6 billion previously set in September 2001. That lifted the 1Q'02 total to \$246.3 billion, up 48.4% from the same period a year-ago and just shy of 4Q'01's record \$253.2 billion. Underwritten convertible bonds totaled \$7.1 billion in 1Q'02, the third best quarterly showing ever behind the \$7.3 billion raised in last year's comparable period, and the record \$7.8 billion set in 4Q'99.

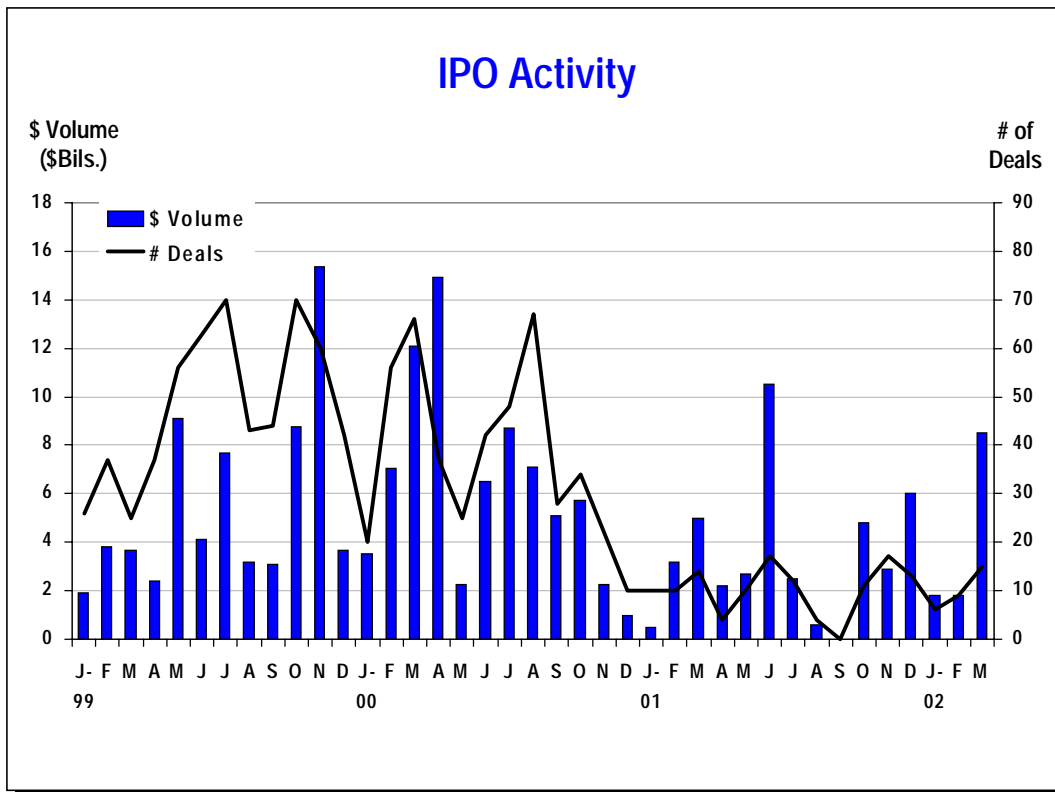




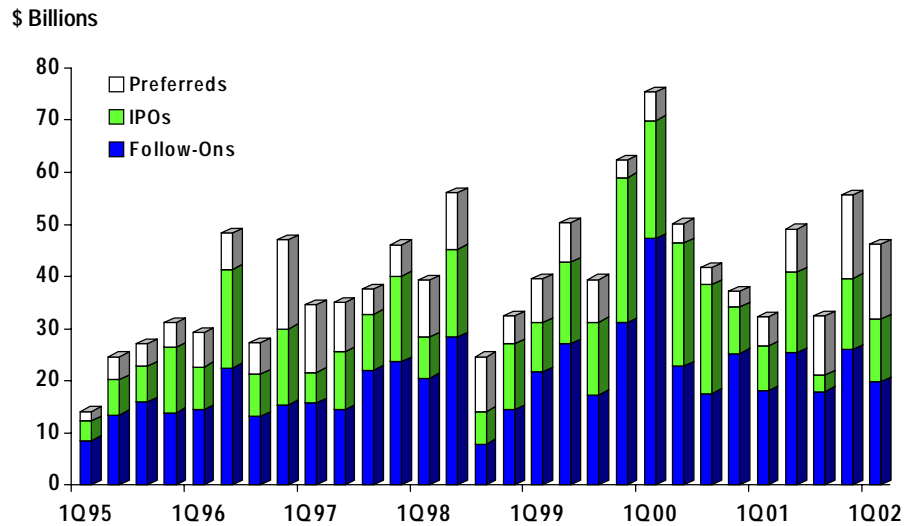
**Equity Underwriting** – New issuance of common and preferred stock rebounded sharply from \$7.7 billion in February to \$19.2 billion in March, bringing this year's first quarter total to \$46.3 billion. While 43.1% above last year's first-quarter level, 1Q'01 volume was 16.9% short of 4Q'01's tally and well below the record \$75.4 billion set in 1Q'00 during the dot-com mania.



Dollar proceeds from IPOs (including closed-end funds) totaled \$12.1 billion in 1Q'02, up 40.7% from the sparse \$8.6 billion raised in last year's first quarter, yet below the \$13.6 billion raised in 4Q'01. Activity surged in March to \$8.5 billion from a paltry \$1.8 billion the previous two months. However, March's volume was misleadingly high, as two jumbo spin-off deals alone accounted for nearly three-quarters of the volume: the \$3.9 billion Travelers Property Casualty Corp. issue from Citigroup and the \$2.3 billion Alcon offering from Nestle. (The Travelers deal represented the largest IPO of the year and the biggest U.S. insurance IPO ever.) These mega-deals masked the still sluggish deal volume, however. In 1Q'02, there were just 30 deals completed, down from 41 deals in 4Q'01 and the sixth consecutive quarter with fewer than 100 IPOs. Hopefully, the pickup in IPO filings during March will lead to a more active IPO market going forward.

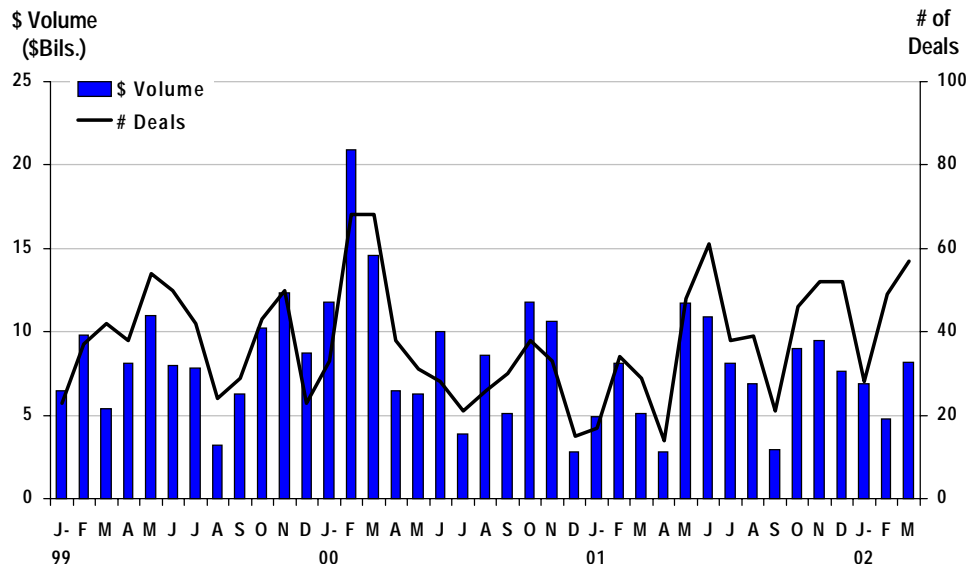


## Quarterly Equity Underwriting



Follow-on dollar volume was also up in this year's first quarter relative to a year ago, yet below 4Q'01's level. Follow-on offerings of \$19.8 billion in 1Q'02 were up 9.1% from the year-earlier period, but 23.8% below the \$26.0 billion offered in 4Q'01.

## Common Stock Follow-On Deals



**Grace Toto**  
Assistant Vice President and Director, Statistics

## U.S. CORPORATE UNDERWRITING ACTIVITY

(In \$ Billions)

	Straight Corporate Debt	Con- vertible Debt	Asset- Backed Debt	TOTAL DEBT	High- Yield Bonds	Common Stock	Preferred Stock	TOTAL EQUITY	All IPOs	Follow-Ons	TOTAL UNDER- WRITINGS
1985	76.4	7.5	20.8	104.7	14.2	24.7	8.6	33.3	8.5	16.2	138.0
1986	149.8	10.1	67.8	227.7	31.9	43.2	13.9	57.1	22.3	20.9	284.8
1987	117.8	9.9	91.7	219.4	28.1	41.5	11.4	52.9	24.0	17.5	272.3
1988	120.3	3.1	113.8	237.2	27.7	29.7	7.6	37.3	23.6	6.1	274.5
1989	134.1	5.5	135.3	274.9	25.3	22.9	7.7	30.6	13.7	9.2	305.5
1990	107.7	4.7	176.1	288.4	1.4	19.2	4.7	23.9	10.1	9.0	312.3
1991	203.6	7.8	300.0	511.5	10.0	56.0	19.9	75.9	25.1	30.9	587.4
1992	319.8	7.1	427.0	753.8	37.8	72.5	29.3	101.8	39.6	32.9	855.7
1993	448.4	9.3	474.8	932.5	55.2	102.4	28.4	130.8	57.4	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	33.3	61.4	15.5	76.9	33.7	27.7	716.4
1995	466.0	6.9	152.4	625.3	28.9	82.0	15.1	97.1	30.2	51.8	722.4
1996	564.8	9.3	252.9	827.0	37.2	115.5	36.5	151.9	50.0	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	31.4	120.2	33.3	153.4	44.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	42.9	115.0	37.8	152.7	43.7	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	36.6	164.3	27.5	191.7	66.8	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	25.2	189.1	15.4	204.5	76.1	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	30.6	128.4	41.3	169.7	40.8	87.6	2,535.1
<u>2001</u>											
Jan	149.6	1.7	41.7	193.0	5.9	5.4	2.7	8.1	0.5	4.9	201.1
Feb	127.5	3.3	40.5	171.3	4.1	11.3	1.5	12.8	3.2	8.1	184.1
Mar	135.5	2.3	83.8	221.6	1.3	10.1	1.4	11.5	5.0	5.1	233.1
Apr	119.3	1.1	42.9	163.4	3.1	5.0	1.5	6.5	2.2	2.8	169.9
May	164.8	4.8	67.0	236.6	3.1	14.4	3.3	17.8	2.7	11.7	254.4
June	126.1	1.0	71.9	199.0	3.6	21.4	3.5	24.9	10.5	10.9	223.8
July	106.8	2.6	63.9	173.3	0.2	10.6	3.3	13.9	2.5	8.1	187.2
Aug	121.2	0.2	63.0	184.4	2.7	7.6	4.7	12.3	0.6	6.9	196.7
Sept	121.8	0.0	104.6	226.5	0.2	2.9	3.4	6.3	0.0	2.9	232.8
Oct	142.8	2.7	70.8	216.4	1.9	13.7	6.7	20.4	4.8	9.0	236.8
Nov	129.3	1.9	102.9	234.2	3.1	12.4	5.2	17.6	2.9	9.5	251.8
Dec	66.4	0.0	79.4	145.8	1.4	13.6	4.1	17.7	6.0	7.6	163.4
<u>2002</u>											
Jan	145.5	0.2	70.7	216.4	4.8	8.6	10.7	19.4	1.8	6.9	235.8
Feb	105.9	3.8	66.6	176.2	1.2	6.6	1.1	7.7	1.8	4.8	183.9
Mar	197.7	3.2	108.9	309.8	4.5	16.7	2.5	19.2	8.5	8.2	329.0
Apr											
May											
June											
July											
Aug											
Sept											
Oct											
Nov											
Dec											
YTD '01	412.6	7.3	166.0	585.9	11.2	26.7	5.6	32.3	8.6	18.2	618.3
YTD '02	449.1	7.1	246.3	702.5	10.5	31.9	14.4	46.3	12.1	19.8	748.7
% Change	8.8%	-2.3%	48.4%	19.9%	-6.7%	19.2%	157.3%	43.1%	40.7%	9.1%	21.1%

Note: High-yield bonds is a subset of straight corporate debt. IPOs and follow-ons are subsets of common stock.

Source: Thomson Financial Securities Data

## MUNICIPAL BOND UNDERWRITINGS

(In \$ Billions)

## INTEREST RATES

(Averages)

	Compet. Rev. Bonds	Nego. Rev. Bonds	TOTAL REVENUE BONDS	Compet. G.O.s	Nego. G.O.s	TOTAL G.O.s	TOTAL MUNICIPAL BONDS	3-Mo. T Bills	10-Year Treasuries	SPREAD
1985	10.2	150.8	161.0	17.6	22.8	40.4	201.4	7.47	10.62	3.15
1986	10.0	92.6	102.6	23.1	22.6	45.7	148.3	5.97	7.68	1.71
1987	7.1	64.4	71.5	16.3	14.2	30.5	102.0	5.78	8.39	2.61
1988	7.6	78.1	85.7	19.2	12.7	31.9	117.6	6.67	8.85	2.18
1989	9.2	75.8	85.0	20.7	17.2	37.9	122.9	8.11	8.49	0.38
1990	7.6	78.4	86.0	22.7	17.5	40.2	126.2	7.50	8.55	1.05
1991	11.0	102.1	113.1	29.8	28.1	57.9	171.0	5.38	7.86	2.48
1992	12.5	139.0	151.6	32.5	49.0	81.5	233.1	3.43	7.01	3.58
1993	20.0	175.6	195.6	35.6	56.7	92.4	287.9	3.00	5.87	2.87
1994	15.0	89.2	104.2	34.5	23.2	57.7	161.9	4.25	7.09	2.84
1995	13.5	81.7	95.2	27.6	32.2	59.8	155.0	5.49	6.57	1.08
1996	15.6	100.1	115.7	31.3	33.2	64.5	180.2	5.01	6.44	1.43
1997	12.3	130.2	142.6	35.5	36.5	72.0	214.6	5.06	6.35	1.29
1998	21.4	165.6	187.0	43.7	49.0	92.8	279.8	4.78	5.26	0.48
1999	14.3	134.9	149.2	38.5	31.3	69.8	219.0	4.64	5.65	1.01
2000	13.6	116.2	129.7	35.0	29.3	64.3	194.0	5.82	6.03	0.21
2001	17.6	164.2	181.8	45.5	56.3	101.8	283.5	3.39	5.02	1.63
<u>2001</u>										
Jan	1.2	4.9	6.1	4.4	1.9	6.3	12.4	5.15	5.16	0.01
Feb	0.9	10.3	11.2	4.7	5.1	9.8	21.0	4.88	5.10	0.22
Mar	1.2	16.2	17.4	2.7	5.1	7.8	25.1	4.42	4.89	0.47
Apr	1.0	10.5	11.5	3.6	3.5	7.1	18.6	3.87	5.14	1.27
May	1.2	18.5	19.7	4.4	4.5	8.9	28.6	3.62	5.39	1.77
June	1.8	18.1	19.9	5.1	4.8	9.9	29.9	3.49	5.28	1.79
July	1.5	13.1	14.7	3.8	2.3	6.1	20.8	3.51	5.24	1.73
Aug	1.6	12.6	14.2	3.9	5.8	9.7	23.9	3.36	4.97	1.61
Sept	0.9	9.1	10.0	2.2	2.0	4.2	14.1	2.64	4.73	2.09
Oct	3.1	15.1	18.2	4.8	9.0	13.8	32.0	2.16	4.57	2.41
Nov	2.0	18.2	20.2	3.4	5.8	9.2	29.4	1.87	4.65	2.78
Dec	1.1	17.6	18.8	2.5	6.5	9.0	27.8	1.69	5.09	3.40
<u>2002</u>										
Jan	1.1	12.2	13.3	4.3	3.8	8.1	21.4	1.65	5.04	3.39
Feb	1.5	10.4	11.8	4.9	3.9	8.8	20.6	1.73	4.91	3.18
Mar	1.6	11.5	13.1	5.0	5.1	10.1	23.2	1.79	5.28	3.49
Apr										
May										
June										
July										
Aug										
Sept										
Oct										
Nov										
Dec										
YTD '01	3.3	31.4	34.7	11.7	12.1	23.8	58.5	4.82	5.05	0.23
YTD '02	4.2	34.1	38.2	14.2	12.8	27.0	65.2	1.72	5.08	3.35
% Change	27.4%	8.5%	10.3%	20.9%	5.8%	13.2%	11.5%	-64.2%	0.5%	1337.1%

Sources: Thomson Financial Securities Data; Federal Reserve

**STOCK MARKET PERFORMANCE INDICES**

(End of Period)

**STOCK MARKET VOLUME**

(Daily Avg., Mils. of Shs.)

**VALUE TRADED**

(Daily Avg., \$ Bils.)

	Dow Jones Industrial Average	S&P 500	NYSE Composite	Nasdaq Composite	NYSE	AMEX	Nasdaq	NYSE	Nasdaq
1985	1,546.67	211.28	121.58	324.93	109.2	8.3	82.1	3.9	0.9
1986	1,895.95	242.17	138.58	348.83	141.0	11.8	113.6	5.4	1.5
1987	1,938.83	247.08	138.23	330.47	188.9	13.9	149.8	7.4	2.0
1988	2,168.57	277.72	156.26	381.38	161.5	9.9	122.8	5.4	1.4
1989	2,753.20	353.40	195.04	454.82	165.5	12.4	133.1	6.1	1.7
1990	2,633.66	330.22	180.49	373.84	156.8	13.2	131.9	5.2	1.8
1991	3,168.83	417.09	229.44	586.34	178.9	13.3	163.3	6.0	2.7
1992	3,301.11	435.71	240.21	676.95	202.3	14.2	190.8	6.9	3.5
1993	3,754.09	466.45	259.08	776.80	264.5	18.1	263.0	9.0	5.3
1994	3,834.44	459.27	250.94	751.96	291.4	17.9	295.1	9.7	5.8
1995	5,117.12	615.93	329.51	1,052.13	346.1	20.1	401.4	12.2	9.5
1996	6,448.27	740.74	392.30	1,291.03	412.0	22.1	543.7	16.0	13.0
1997	7,908.25	970.43	511.19	1,570.35	526.9	24.4	647.8	22.8	17.7
1998	9,181.43	1,229.23	595.81	2,192.69	673.6	28.9	801.7	29.0	22.9
1999	11,497.12	1,469.25	650.30	4,069.31	808.9	32.7	1,081.8	35.5	43.7
2000	10,786.85	1,320.28	656.87	2,470.52	1,041.6	52.9	1,757.0	43.9	80.9
2001R	10,021.50	1,148.08	589.80	1,950.40	1,240.0	65.8	1,900.1	42.3	44.1
<u>2001</u>									
Jan	10,887.36	1,366.01	663.64	2,772.73	1,325.9	72.5	2,387.3	52.0	75.6
Feb	10,495.28	1,239.94	626.94	2,151.83	1,138.5	70.9	1,947.6	43.8	59.7
Mar	9,878.78	1,160.33	595.66	1,840.26	1,271.4	82.5	2,071.4	45.9	49.2
Apr	10,734.97	1,249.46	634.83	2,116.24	1,276.5	78.4	2,162.8	45.1	49.6
May	10,911.94	1,255.82	641.67	2,110.49	1,116.7	66.7	1,909.1	41.4	46.4
June	10,502.40	1,224.42	621.76	2,160.54	1,175.0	63.8	1,793.9	41.6	40.6
July	10,522.81	1,211.23	616.94	2,027.13	1,137.1	56.0	1,580.7	39.0	36.0
Aug	9,949.75	1,133.58	587.84	1,805.43	1,025.7	49.1	1,426.4	34.0	28.4
Sept	8,847.56	1,040.94	543.84	1,498.80	1,694.4	72.8	2,033.0	51.2	33.9
Oct	9,075.14	1,059.78	546.34	1,690.20	1,314.3	67.8	1,926.0	40.1	36.1
Nov	9,851.56	1,139.45	579.27	1,930.58	1,270.1	57.8	1,840.3	38.1	37.8
Dec	10,021.50	1,148.08	589.80	1,950.40	1,275.3	54.1	1,807.0	38.8	36.2
<u>2002</u>									
Jan	9,920.00	1,130.20	578.50	1,934.03	1,425.9	56.1	1,888.7	44.5	40.8
Feb	10,106.13	1,106.73	578.60	1,731.49	1,381.8	56.3	1,812.8	42.1	35.9
Mar	10,403.94	1,147.39	600.43	1,845.35	1,337.1	56.5	1,729.7	42.9	34.1
Apr									
May									
June									
July									
Aug									
Sept									
Oct									
Nov									
Dec									
YTD '01	9,878.78	1,160.33	595.66	1,840.26	1,249.1	75.6	2,140.4	47.3	61.4
YTD '02	10,403.94	1,147.39	600.43	1,845.35	1,382.3	56.3	1,811.7	43.2	37.0
% Change	5.3%	-1.1%	0.8%	0.3%	10.7%	-25.5%	-15.4%	-8.8%	-39.7%

# MUTUAL FUND ASSETS

(\$ Billions)

# MUTUAL FUND NET NEW CASH FLOW\*

(\$ Billions)

	Equity	Hybrid	Bond	Money Market	TOTAL ASSETS	Equity	Hybrid	Bond	Money Market	TOTAL	Total Long- Term Funds
1985	116.9	12.0	122.6	243.8	495.4	8.5	1.9	63.2	-5.4	68.2	73.6
1986	161.4	18.8	243.3	292.2	715.7	21.7	5.6	102.6	33.9	163.8	129.9
1987	180.5	24.2	248.4	316.1	769.2	19.0	4.0	6.8	10.2	40.0	29.8
1988	194.7	21.1	255.7	338.0	809.4	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	248.8	31.8	271.9	428.1	980.7	5.8	4.2	-1.2	64.1	72.8	8.8
1990	239.5	36.1	291.3	498.3	1,065.2	12.8	2.2	6.2	23.2	44.4	21.2
1991	404.7	52.2	393.8	542.5	1,393.2	39.4	8.0	58.9	5.5	111.8	106.3
1992	514.1	78.0	504.2	546.2	1,642.5	78.9	21.8	71.0	-16.3	155.4	171.7
1993	740.7	144.5	619.5	565.3	2,070.0	129.4	39.4	73.3	-14.1	228.0	242.1
1994	852.8	164.5	527.1	611.0	2,155.4	118.9	20.9	-64.6	8.8	84.1	75.2
1995	1,249.1	210.5	598.9	753.0	2,811.5	127.6	5.3	-10.5	89.4	211.8	122.4
1996	1,726.1	252.9	645.4	901.8	3,526.3	216.9	12.3	2.8	89.4	321.3	232.0
1997	2,368.0	317.1	724.2	1,058.9	4,468.2	227.1	16.5	28.4	102.1	374.1	272.0
1998	2,978.2	364.7	830.6	1,351.7	5,525.2	157.0	10.2	74.6	235.3	477.1	241.8
1999	4,041.9	383.2	808.1	1,613.1	6,846.3	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	3,962.0	346.3	811.1	1,845.2	6,964.7	309.4	-30.7	-49.8	159.6	388.6	228.9
2001R	3,418.2	346.3	925.1	2,285.3	6,975.0	32.2	9.5	87.8	375.3	504.8	129.6
<u>2001</u>											
Jan	4,093.5	354.9	833.3	1,954.8	7,236.5	24.9	2.5	9.0	103.5	139.9	36.4
Feb	3,688.9	344.9	844.5	2,018.7	6,897.0	-3.3	1.3	8.9	58.2	65.1	6.8
Mar	3,402.9	333.7	852.1	2,035.5	6,624.2	-20.7	-0.4	7.7	13.7	0.4	-13.3
Apr	3,715.7	348.0	846.0	2,031.5	6,941.2	19.1	1.3	1.4	-10.3	11.6	21.8
May	3,744.6	352.6	858.4	2,070.9	7,026.5	18.4	0.9	6.3	34.3	59.8	25.6
June	3,677.2	349.9	860.8	2,052.5	6,940.4	10.9	1.2	2.3	-24.2	-9.8	14.3
July	3,589.3	351.7	882.3	2,069.8	6,893.1	-1.3	1.3	9.3	12.2	21.5	9.3
Aug	3,382.7	342.6	908.3	2,104.3	6,737.9	-5.0	-0.7	16.7	26.1	37.2	11.0
Sept	3,018.9	324.1	909.6	2,161.7	6,414.3	-30.0	-1.3	7.7	52.9	29.3	-23.6
Oct	3,111.2	330.3	935.2	2,239.7	6,616.4	0.9	1.6	13.6	74.2	90.2	16.0
Nov	3,348.6	343.0	934.1	2,306.5	6,932.2	15.3	1.0	6.9	60.3	83.5	23.2
Dec	3,418.2	346.3	925.1	2,285.3	6,975.0	2.9	1.0	-1.9	-25.4	-23.3	2.1
<u>2002</u>											
Jan	3,373.5	347.2	947.0	2,303.5	6,971.2	20.0	2.2	10.5	14.0	46.7	32.7
Feb	3,308.3	348.4	962.3	2,301.3	6,920.3	4.7	2.3	10.6	-5.5	12.2	17.6
Mar											
Apr											
May											
June											
July											
Aug											
Sept											
Oct											
Nov											
Dec											
YTD '01	3,688.9	344.9	844.5	2,018.7	6,897.0	21.7	3.8	17.8	161.7	204.9	43.3
YTD '02	3,308.3	348.4	962.3	2,301.3	6,920.3	24.7	4.5	21.1	8.5	58.8	50.3
% Change	-10.3%	1.0%	13.9%	14.0%	0.3%	14.1%	20.4%	18.2%	-94.7%	-71.3%	16.3%

\* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges

Source: Investment Company Institute



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