IDC Independent Directors Council
Promoting Excellence in Fund Governance

2006 Equity Markets Conference: Keynote Address

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Keynote Address by
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Good morning, I'm Paul Stevens, President of the Investment Company Institute. Welcome to this eighth annual ICI Equity Markets Conference.

This conference has earned its place on our industry's calendar as a valuable forum for exchanging views and ideas on a wide range of issues relating to the structure of the financial markets. Again this year, we certainly have no shortage of topics to discuss. Today's panels will examine the implications for investors of the globalization of the securities markets; important developments relating to soft dollars; concerns about preserving the confidentiality of mutual fund trading information; and compliance challenges for the buy-side of the markets.

We have an outstanding group of speakers, and I thank all of them for taking time out of their busy schedules to join us. Thanks also to Ari Burstein of the Institute's staff, who played a key role in organizing the conference.

As I emphasized in my remarks last year, ICI's record in holding this annual conference underscores the importance of trading and market structure issues to mutual funds and fund investors. For a considerable number of Americans – more than 92 million, in fact – mutual funds are a gateway to the securities markets. And Institute members hold about 25 percent of the value of publicly traded equity securities in the United States.

The Institute and its members accordingly have a keen interest in the competitiveness and efficiency of the securities markets – and in a regulatory structure that promotes these objectives. That is why the Institute has been, and will continue to be, an active participant in regulatory initiatives to improve the way securities are traded.

With this perspective in mind, I would like to touch briefly on three issues this morning:

- First, the impact on investors, and on the marketplace, of technological advancements in trading.
- Second, the new competitive landscape that has emerged – in America and around the world.
- And, finally, the challenges that regulators face promoting competition among markets and market participants – while preserving critical investor protections.

Impact of Technology and Competition

Thinking back on some key developments that have shaped today's equity markets, it is worth noting that this year marks the tenth anniversary of the SEC's Order Handling Rules, which addressed abusive trading practices in the Nasdaq market. As you know, the Order Handling Rules required fair treatment of customer limit orders and improved transparency for orders submitted to brokers. The rules also launched an era of rapid innovation that continues today, opening the door for ECNs and other electronic trading venues to introduce new technology into trading and to compete with the "traditional" securities exchanges.

Close on the heels of the Order Handling Rules were other important regulatory initiatives, such as Regulation ATS, the advent of decimalization, and most recently Regulation NMS. Whether you believe that these and other innovations spurred the unprecedented level of competition and the technological advancements we are witnessing today, or simply responded to them, there is no doubt that they worked dramatic changes in our markets.

Are investors better off than they were 10 years ago? The answer, I believe, is a resounding “yes.” They have more access to choices when trading, through more efficient markets, with more useful technology at their fingertips. Consider developments just since last year’s conference. As we will certainly hear in a few minutes from our first panel, competition and technology have introduced new ways of trading at the New York Stock Exchange and Nasdaq. And for the first time, we are witnessing not only fierce domestic competition, but also competition among markets around the globe.

Challenges of the New Competitive Environment

Clearly, we are moving rapidly toward true international investing – with the proposed mergers of the NYSE Group and Euronext, Nasdaq’s acquisition of a significant amount of the stock of the London Stock Exchange, and talk of numerous other global stock exchange mergers and acquisitions. While these developments undoubtedly are good for the markets and fundamental to their ability to grow and thrive, we can ill afford to lose sight of the importance of maintaining strong and vibrant securities markets here at home. We have long enjoyed the most dynamic markets in the world. But we cannot simply assume they will remain so.

In fact, there is evidence of a disturbing trend among foreign companies to avoid listing in the United States – reducing the relative size and liquidity of U.S. markets. A recent study by PricewaterhouseCoopers showed that the number of IPOs on U.S. exchanges was down by 15 percent in 2005 over the previous year. At the same time, European exchanges showed a 40 percent jump, and there is a similar trend reported in Asia. Just yesterday, the Wall Street Journal reported that New York received only four of the top 25 global IPO’s in each of the past two years, fewer than Hong Kong and far fewer than London.

It is important to ask: Are we outsourcing America’s long-time predominant role in capital formation? What impact will this trend have on mutual funds and other investors? Will the U.S. markets continue to offer them access to the widest possible range of listings?

The apparent downturn of listings on U.S. exchanges has prompted new concerns about how our rules and regulations affect the markets. One example that many continue to raise is the impact of certain provisions of the Sarbanes-Oxley Act. Treasury Secretary Henry Paulson has said the law is hurting U.S. capital markets. And while SEC Chairman Christopher Cox points out the benefits of SOX, he also says the effort to revise SOX is underway.

It seems to me altogether fair to ask whether current U.S. requirements encourage a kind of regulatory arbitrage, favoring lower-cost, less-regulated markets. At the same time, we must be careful not to compromise protections that are essential to maintaining investor confidence. Striking this delicate balance poses significant challenges for our regulatory community and the financial services industry. Chairman Cox has already opened discussions with his European counterparts on how to coordinate oversight if the NYSE and Euronext combine. But as globalization of the securities markets continues, we must consider how best to ensure that our regulations keep pace with innovation and competition.

Mutual funds, in particular, will have to wrestle with changes in how we transact in securities and meet our obligations to our shareholders in this new environment. How, for example, should industry practices and regulatory requirements evolve in light of a longer – or even a non-stop – trading day? With the multiplication of trading venues, what issues arise for funds seeking to make sure they get “best execution” of their stock trades?

In the broadest sense, how can we assure that globalization leads to better markets – markets that provide investors with the opportunities and efficiencies that they need?

Conclusion

All these are difficult and complex questions. They will occupy our industry and fill the agenda of this conference for years to come. Answers to them likely will emerge only over time. But one thing is already clear: Continuing to focus on how markets serve investors is critically important.

Chairman Arthur Levitt made the point well 10 years ago, when the SEC adopted the Order Handling Rules. “We must not forget that the true strength of our markets is investors,” the Chairman said. “It is investors who provide the capital, the liquidity, and the trust which fuel our markets.”

Thank you, and do enjoy the conference.
