

2005 Equity Markets Conference: Keynote Address

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Keynote Address by Paul Schott Stevens President, ICI

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Good morning. I am Paul Stevens, President of the Investment Company Institute. Welcome to the ICI's Equity Markets Conference. The past year has been highly eventful for the nation's securities markets, and there are a host of important regulatory and business developments to consider. In addition to Regulation NMS and the NYSE's hybrid market proposal, the conference will examine new compliance challenges facing the buy-side, the evolving role of the broker in our securities markets, and the implications of proposed exchange mergers, among other matters.

We have been very fortunate once again to recruit an all-star lineup of speakers to address these issues, and we are grateful to one and all for their participation. Let me thank in particular Annette Nazareth, now an esteemed member of the Securities and Exchange Commission; Robert Greifeld, President and CEO of the Nasdaq Stock Market; and John Thain, CEO of the New York Stock Exchange, for taking part in this year's conference. Let me also acknowledge and thank Ari Burstein of the ICI staff, who has played a critically important role in planning and organizing this year's conference.

This is the seventh year that the Institute has held this conference. We launched it in 1999 to address some of the regulatory and structural developments in the securities markets affecting mutual funds. Over time the conference has become a unique forum for the exchange of ideas and views on a broad range of issues – and this dialogue has attracted a large and knowledgeable group of participants. It is a forum – and a process – to which we are strongly committed.

Why, you might ask, do the Investment Company Institute and its members care about market structure issues? In my time this morning, I want to answer that question – and I also want to share our views briefly on some other key issues:

- on the most efficient and effective market structure;
- on keeping investor trading information confidential; and
- on creating a strong and effective system of oversight for the securities markets.

Why ICI Cares About Market Structure Issues

First, why do we care about market structure and functioning: The answer is simple. It is because of the dual role that mutual funds play in our financial marketplace – first, as the intermediary of choice for individual investors; and second, as investors ourselves on behalf of our shareholders. Some basic numbers tell the story.

Since 1999, the ICI and the Securities Industry Association (SIA) have studied [U.S. ownership of equity securities](#), and our latest study will be released shortly. The results of our studies make clear how much America has become a society of equity investors. Since the early 1980s, the number of households owning equities has increased more than threefold, with more than half of all US households now owning stocks directly or through mutual funds.

Of these equity-investing households, about 50 percent own individual equities – but far more, about 90 percent, own stock mutual funds. The growth in equity ownership is even more striking when you consider that, just since 1999, the number of households owning equities has increased by 7.1 million.

Ownership of equities also has become central to Americans' retirement nest eggs. The ICI/SIA studies show that the growth of equity ownership among America's individual investors has been fueled largely by the expansion of defined contribution retirement plans, which widely use stock mutual funds as investment options. ICI estimates that at the end of 2004, about half of defined contribution plan assets (some \$1.6 trillion) and about forty percent of IRA assets (\$1.5 trillion) were invested in mutual funds. Of this \$3.1 trillion of retirement assets, 70 percent were invested in equity funds, with another 12 percent invested in hybrid funds holding a mixture of stocks and bonds.

Events of the past two years serve to remind us all of the bedrock propositions upon which every successful fund manager bases its business: loyalty and care – loyalty to the interests of the fund's investors, and care in fulfilling its responsibilities to them. These fiduciary duties require fund advisers to conduct securities transactions in a way that maximizes the benefits to their funds and fund shareholders. More broadly for our industry, the same fiduciary principles also strongly commend our attention to the integrity, functioning and structure of the markets in which we participate. Here, there is an alignment of interests: the more efficiently the markets work for funds as investors, the more benefit funds are likely to be able to return to their shareholders. And this necessitates that we, as the national association of mutual funds, engage at the level of national policy – raising our voice to advance the interests of millions of average investors who participate in the equity markets through mutual funds.

On the Most Efficient and Effective Market Structure

That is why the Institute has been working with many of you on the sellside to make changes to the securities markets to facilitate the efficient trading of securities by funds. Market structure reforms have a significant impact on funds and other institutional investors: greater efficiencies in the markets result in lower costs and better execution for funds and hence for their shareholders. Our goal is to ensure that our markets are highly competitive while facilitating the efficient execution of investor orders.

Developments in the securities markets over the past year have produced measurable progress towards achieving this goal. Arguably, the most significant regulatory development was the adoption of [Regulation NMS](#) and the “trade-through” rule, or the “order protection” rule, as it is now known. You will hear a lot about Regulation NMS and its implementation over the course of the day. I just want to make a few points about the new rules and the process by which they were adopted.

The intense debate over Regulation NMS illustrates the fact there is no consensus among market participants – and even within the SEC – about how best to structure our markets. The Institute supported the adoption of the trade-through rule – we called it as we saw it, but our position was not popular in many circles. The issues are complex, and there is a delicate balance that must be achieved between the often-competing interests of market participants. The SEC deserves credit for working hard to strike that balance. It adopted Regulation NMS and the trade-through rule because it regarded these to be in the interests of investors.

Adoption of this rule represents an important step. It moves the securities markets in the right direction by advancing some of the key goals of institutional investors in market structure reform – goals such as increased automation of order execution and increased interaction of investor orders.

Regardless of where you stood in the Regulation NMS debate, today it is in the interest of us all to stand together. All market participants must work together to ensure that the new rules are implemented effectively, to promote the smooth functioning of our markets and protect the interests of investors.

Without question, we convene the conference this year in the midst of remarkable changes. Another case in point: the continued restructuring of the New York Stock Exchange – in particular, its plans to become a “hybrid” market, incorporating elements of a traditional auction market with those of an electronic market. The NYSE's proposal is an important step in implementing much needed automation on the Exchange and facilitating more efficient trading of listed securities.

We commend the NYSE for the bold steps it has in view. We hope it will continue to devise ways to increase automatic execution of orders and to improve the ability of investors to interact efficiently with those orders. The Institute will monitor developments at the Exchange closely, with these two objectives in mind. One thing that the Exchange can rely upon us for is candid, constructive commentary – we have provided that concerning the hybrid proposal, and we hope our recommendations receive serious consideration.

On Keeping Investor Trading Information Confidential

The structure of our securities markets is obviously important. Nevertheless, the full potential of our markets will not be realized unless investors are confident that the markets present a fair and level playing field. It is important that we all work together to create an environment in which investors have confidence that their interests take precedence over the interests of intermediaries.

One key ingredient here is preserving the confidentiality of the information that investors entrust to their intermediaries. This is a

matter of enormous consequence for mutual funds, who hold about one out of every five dollars of US equities and are responsible for about 10 percent of average daily trading volume.

Unfortunately, confidentiality and anonymity are not conditions we can take for granted. As several recent cases brought by the SEC illustrate, there are individuals and firms quite prepared to profit unlawfully by obtaining information about mutual fund and other institutional orders and trades and then “trading ahead” of those orders. We owe it to fund shareholders and the market at large to root out such abuses, where they exist.

We are pleased that the SEC, in particular the Office of Compliance Inspections and Examinations and the Division of Market Regulation, is alert to this problem. In a recent letter to SEC Chairman Cox, I outlined further steps the Commission might take to protect the confidentiality of investor trading information and eliminate “leakage.”

In particular, we believe the SEC should:

- continue vigorous enforcement of existing regulations prohibiting the disclosure of confidential information in the possession of market participants involved in the trading process;
- continue to focus on issues relating to the leakage of confidential information during its examinations of market participants, and insist upon proper policies and procedures to safeguard such information;
- assess more broadly the implications of its examination findings and report on the adequacy of market participants’ policies and procedures; and
- finally, firmly reiterate in its public guidance to market participants their responsibilities to guard against disclosure and improper use of investor trading information.

We appreciate the continuing vigilance of the Commission – and that of the many intermediary partners with whom we work daily – to guard against abuses of this kind and protect the interests of funds and their shareholders.

Ensuring a Strong and Effective System of Regulatory Oversight

The evolution of our markets also makes it important to re-examine current arrangements for oversight and regulation – to determine whether, and how well, the current system meets the needs of investors. There is much at stake, and we commend the Commission’s timely consideration of the operation and structure of the SROs.

As the Commission noted in its recent proposals in this area, SROs are charged with an important public trust to carry out their self-regulatory responsibilities effectively and fairly while, among other things, protecting investors. The Institute supports the Commission in its objective of more effectively managing the potential conflicts of interest of SROs and increasing the transparency of their governance structure. We also support efforts in this area to eliminate duplicative regulatory requirements and promote uniform rules.

In general, we believe markets and investors would benefit from establishment of a single set of standards for market participants to follow – especially standards that implicate core investor protections and that are designed to prevent violations of the securities laws. If a lack of uniformity in these areas hinders the detection of securities laws violations, the Commission clearly must conduct a careful review and take necessary remedial action.

At the same time, the Commission should be cautious to avoid establishing rules that are unnecessarily burdensome. Such an outcome could impede market participants in fulfilling their regulatory and administrative responsibilities. Who would that hurt? The very people whom regulation is intended to help – investors.

Conclusion

As you can see, we’ve got a full agenda at this year’s conference – with serious issues to command our attention, and serious thinkers to participate in the debate. Now and in the future, the Institute welcomes the opportunity to engage on these and other important issues affecting our securities markets. We also look forward to working with all parties concerned to achieve the full potential and preserve the integrity of these markets, and thereby advance the interests of our shareholders.

Thank you for your attention. I hope you enjoy the conference.

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