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Plenary 3

Market and Information Access for the Investor in the Internet Age

12. Market and Information Access for the Investor in the Internet Age, Speech by Mr. Richard Lambert

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Panel Three
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My message this afternoon is resolutely upbeat.

- It is that the impact of the internet on market and information access for the investor is almost entirely for the good.
- And although it may create more work for the regulators, this new age offers great opportunities for them as well.

Of course, the internet also creates new opportunities for market abuse. But I' d argue that most of these are only different in terms of degree: they don 't usually represent completely new threats for the investor.

After all, the boiler room operators in Amsterdam during the 1970s and 1980s managed to do their dirty work quite successfully by way of the telephone. No doubt their successors today can do a better job of deceiving their customers by using the internet - but at least they are likely to be leaving a clearer audit trail. I'd like to present my remarks under four headings.

- The first is how the internet is changing the character and quality of financial journalism, which is my field of expertise.
- The second will describe the enormous opportunities that the internet offers investors and regu1ators.
- The third will be the issues I don't think you should spend too much time worrying about -internet chat rooms being one example.
- And finally, I'll high light what seem to me to be some of the key issues that you as regulators are going to have to tackle.

Financial journalism first.

The enormous difference, which the internet is making to the personality of financial journalism, is that it is changing the relationship between reporters and their sources.

Just as financial intermediaries face the threat of disintermediation in this new world, so do financial correspondents and editors.

Two minutes of history.

The world's first financial editor appears to be have been Thomas Massa A1sager, who got the job on the London Times in 1817. Incredibly well connected, he had the ear and the friendship of the entire City establishment. He kept an elegant house in B1oomsbury, where his guests were royally entertained. Some of Beethoven ' s chamber music was given its British premiers in his music room.

Alas, he came to a bad end. When the scale of his corruption became apparent, he cut his throat.

One hundred and fifty years later, access was still the key to success in British financial journalism. A handfu1 of City editors did their best work in the Savoy Grill or at Royal Ascot racecourse, where they were fed titbits by the captains of industry who were their friends and confidants.

Today, that form of journalism is dead and - I would say - a good thing too.

It's been killed by a more rigorous approach to corporate governance; by the growing power of institutional investors, which companies want to address directly rather than through the press; by tougher regulation on disclosure and insider dea1ing.

Above all, it's been killed by what you might ca1l the industria1isation of access. It's goodbye to the discrete lunch at the Savoy Grill, and hello to the morning conference call.

These days, many big companies don 't even have press conference any more. Instead, they'll broadcast their results by web cast and conference calls to almost anyone who wants to hook up.

There is, it must be admitted, a downside to this increased transparency. If journa1ists can no longer differentiate their work by exclusive access, they will seek other ways of making their name.

Some will do it by their reputation for accuracy, their judgment and their analytica1 insights.

Others will be tempted to push the edge of the envelope. To see if two and two can be made to add up to something more interesting than four .T o be the first to say that this or that chief executive is obviously incompetent and has to be fired, or to suggest that a take-over of X by Y is only a matter of time.

It's no coincidence that the tone of the financial press has become more aggressive in recent years. You don't bite the hand that feeds you, but if you are not going to get fed - wel1, it may be a different matter.

The good news, though, is that serious financiljourna1ism has been vastly enhanced by free and instant access to vast amounts of data and original material. The complete text of Mr. Greenspan's speech, as he is delivering it. The full financial statements, and the CEO's results presentation. More monetary data than you can handle. It's a1l there.

I'd like to make a specia1 mention here of the SEC's fair disclosure regulations, which have been ofrea1 va1ue in this respect. It's been almost as controversia1 amongjourna1ists as it has among investment bankers. But I agree with Floyd Norris, chief financia1 correspondent of the New York Times, who says that “Reg. FD has enabled me to do a better job of writing about investments, markets and the economy. Web casts are inva1uable when I have to learn about a company fast.”

He compares this with the old days. “I've been kicked out of conferences, lied to by companies, and refused access to conference calls, which has meant that I've had to rely on third-party information from ana1ysts.”

How about the ethics and regulation of financial journalists? Taken as a whole, I would a1so suggest that the internet is likely to raise rather than lower standards, at least among the established business news organizations.

There are two reasons for this possibly counter-intuitive thought.

The first is that in a much more open and transparent market for corporate information, journalists will very rarely have access to price sensitive information, and will be less subject to manipulation.

When I worked on the Lex column twenty five years ago, a large pharmaceutica1 company which I knew wel1 would regularly give me its profit figures a couple of days before publication, to give me time to think about them.

It didn't seem to me to be especially unusual at the time. But I can't imagine such a thing happening today.

The second reason to hope for improving standards of conduct - again at the top end of the trade -comes from the fact that the advent of online publishing has greatly increased the level of competition in financial journalism.

Although the number of business internet sites is bound to decline, there are still a lot more voices out there clamouring for attention.

The most important ingredients for success in this noisy world will be trust and integrity, sustained over time. Investors will become increasingly confused and even misled by the astonishing range of information -some of highly dubious quality -which will be available to them. Increasingly, they will turn to a name they recognize and trust.

These days, we think of the Financial Times as a brand rather than just the title of a newspaper. I'm sure the same is true of our rivals at Reuters or the Wall Street Journal. We believe that we will succeed in this very competitive environment only if people believe what we publish, and trust our integrity.

It would be a disaster for our brand if one of our journalists were exposed in dishonest activity. For this reason, the 1evel of regulation and codes of conduct that we impose on ourselves has been transformed out of all recognition.

I remember the first editor of the Financial Times I worked for 30 years ago firrn1y dismissed any idea of a code of ethics. “If you need such a thing, you shouldn’t 't be working here,” he would say.

Today, we have a rulebook - not 1east to protect ourse1ves.

Of course estab1ished pub1ications have an enormous vested interest in their own integrity.

It should be up to the marketp1ace -not the regu1ator- to decide which have integrity and which do not.

The same considerations may not app1y to peop1e running a one-person share tipping web site - and they definitely won 't be re1evant to peop1e posting anonymous messages in market related chat rooms.

This, I know, makes regu1ators very uneasy. And of course it' s important that they should be ready to deal with fraudsters who use the internet to cheat innocent investors- applying the same standards as they do to peop1e who use the te1ephone, the post, or the house call.

A famous example: last August a 23-year old student in the US named Mark Jakob pub1ished a bogus press re1ease c1aiming that the CEO of Emulex Corp was about to step down. This was picked up by a smal1 tech news site, Internet Wire and then pub1ished on B1oombergs, with a devastating impact on the share price.

The point to emphasize, of course, is that the internet was a convenient way of pulling off this fraud -but there were many examp1es of similar scams in preinternet days.

I would council caution against any general attempt at cracking down on internet pub1ishing, for three reasons.

The first is that it is important to distinguish between the impact of a stock market bubble and some 1onger 1asting regu1atory fai1ure.

Given the dotcom mania in 1999 and 2000, it wou1d have been tru1y amazing if gullible investors had not been parted from their savings in many creative ways in the past year or two.

It seems to me that the number of scanda1s that have been revealed so far, at least, has been quite modest.

And the way things are heading on Wall Street, most chat rooms are going to be rather lonely places for the next year or five.

The second reason for not seeking to regulate potentially spurious information is more philosophical than practical.

It's this. Free markets depend on freedom of information. The more diverse, varied and frequent the sources of information, the more efficient the market is likely to be. Attempts to control or regulate in this area almost invariably have adverse consequences which are quite unforeseen at the time.

In the 17th Century, Amsterdam was the world's most important capita1 market.

And it is no coincidence that it was a1so the first great center of international business information.

The Dutch East India Company built very sophisticated reporting systems to control its far-flung empire, and around its information hub in the Netherlands clustered other merchants, consular agents, newspaper publishers and conmen.

But that nerve center was gradually crushed over the next century by increasingly repressive politics, fina1ly by the French occupation.

Meanwhile, London was moving in the opposite direction, and gaining the upper hand as a financia1 center. In 1679, Cromwell's repressive licensing act was eliminated, and large numbers of newspapers and other periodica1s began to appear.

One of London's earliest financia1 papers started in 1691, with an editoria1 which has really been the justification of my trade ever since: I quote:

"Without doubt, if these transactions were better known, 'twould be a great advantage to the Kingdom. Only I must caution beginners o be wary, for there are many cunning artists among them."

Rather than seeking to control uncontrollable websites, regulators should be starting at the other end: they shou1d be "cautioning beginners to be wary."

And that' s the third reason for regulators to be careful about cracking down in this area. It's very difficult to do, and they risk making fools of themselves in the process

Earlier this year, Michael Lewis wrote a wonderful piece in the New York Times magazine about the SEC's recent case against a 15-year old high school student named Jonathan Lebed. The first minor ever to face proceedings for stock market fraud,

Jonathan had used the internet to promote stocks from his bedroom in the Northern New Jersey suburb of Cedar Grove.

It's a great piece of journalism -no doubt completely unfair- which should be compulsory reading for a11 stock market regulators, and it poses the question:

What exactly was young Jonathan doing that was so very different from the behaviour of all those sell side ana1ysts who just 15 months ago were saying that their latest hot IPO would be cheap at twice the price?

Rather than dwelling on the negatives, I' d like to turn now to the enormous opportunities that the on-line world offers to investors and regulators.

Above a1l, it presents a real opportunity for creating a level playing field on which the individua1 investor can compete on a more even basis with the big institutions, in areas like information access, market access, costs of dealing, and investment tools.

I come back to Regulation FD. As Arthur Levitt put it recently:

"If important financial information continued to travel only to a privileged few, if information stil1 came by way of favoured access rather than by acumen or insight, and if it continued to be used to profit at the expense of the investing public, more and more investors could only ask: 'Whose interest is rea11y being served?'"

The internet offers the opportunity of simultaneous access to wide ranging information by an unlimited audience. To that extent, it dis-intermediates ana1ysts and reporters - and makes them look for other ways of adding va1ue.

Its critics say it will lead companies to be less willing to disclose information, and that it will make prices more volatile. But competition will surely deal with both those issues in time. And transparent disclosure should make prices less volatile, rather than the opposite.

This equa1ity of market access should be a prime target for regulators, a1ong with increasing efforts to encourage the competition that wil1 drive down transaction costs, and eliminate old restrictive practices and privileges, such as selective briefings and soft commissions.

The other great benefit of the online world for investors and customers is that it leaves a clearer audit trail. Confusion, mistakes, and fraud should all be much easier to track down and resolve in a digital world than in one which depends on telephone ca11s and paper.

These are the things that matter.

The things that don't matter include

- As I have a1ready suggested, the proliferation of online rumour mills. If they are to retain their sanity and their jobs in this new digita1 age, regulators are just going to have to work harder at explaining to politicians and the public the meaning of the phrase *caveat emptor*. They can 't waste too much time on what in preinternet days was known as locker room chat.
- The loss of convenient regulation which depended on geography. A good example of what I mean here is the SEC rules governing access to offshore press conferences held by US companies raising capital in the intemationa1 securities markets. In the mid 1990s, over zea1ous US lawyers would regularly exclude FT reporters from such briefings because our newspaper was printed in the US. They said that made us a US publications, which meant we were to be treated differently from the Times or Le Monde.
- This used to drive us completely mad with frustration - and was obviously in no - one's interest, since we would invariably find ways of getting the information at second hand. To its credit and our gratitude, the SEC created a safe harbour to get us round this problem.

A digital world simply does not allow for the kind of geographic segmentation that was possible when everything came on newsprint.

- They shouldn't worry too much about the way business television, especially in the US, has turned stock markets into a spectator sport. Again, this is what happens in bull markets. We saw the same on a bigger sca1e in London during the South Sea bubble of 1720, and everyone knows how the shoeshine boys were caught up by the boom on Wall Street in 1929. The cold 1ight of day wil1 sort out these excesses.

Other things that don't matter include the loss of cozy professional monopolies - such as the privileged relationship between companies and analysts - and threats to traditional professional rents, including those of financial journalists. So what *does* matter?

Let me suggest three key issues, in no order of priority.

1) There needs to be equality of treatment between digital and print publications.

Two examples:

Analysts are usually obliged to disclose when they make a recommendation in print whether their firm might have a position in the stock. The same ru1es shou1d probably apply when they are making tips on television - and indeed I understand that the Nasd is very close to announcing a ruling on these lines. This is likely to be one of the issues discussed by congressman Richard Baker, whose subcommittee on capital markets is holding a series of hearings on Wall Street and alleged conflicts of interest later this summer.

Again, there are well-understood ru1es in the established media, setting out the boundaries between journalism, share tipping, and advertising. Regulators are right to express concern when these distinctions get blurred on line, for instance when financial web sites carry advertising that lets investors trade stocks directly from the same page, which is also carrying share recommendations.

At what point do journalists become broker dealers?

Investors need to be clear about the distinctions. So do journalists. They need clearly defined and understood ru1es to establish their status. The matter should not be left to the discretion of individual regulators, as was proposed in Australia. Such uncertainty would be damaging for everyone.

2) A second big issue is about cross border share dealing. Regulators can and do impose tough conditions on securities that are listed in their own jurisdiction. But how can they protect investors from exposure to on-line trading in the shares of companies that meet none of these requirements?

The long-term answer must be to promote international accounting standards, and to augment the quality of international audits. Regu1ators and professional bodies shou1d put more pressure on the big accounting firms to ensure that the same resources and quality controls are being brought to bear on audits everywhere. But all that will take years to accomplish.

In the short term, I can 't come up with anything better than increased investor education, and careful regulatory scrutiny.

3) Finally, it's important to avoid the fragmentation of market liquidity. This seemed more of a threat a year or two ago, when the growth of various electronic trading systems seemed to be threatening the fabric of centralized market places. You would know better than I whether this is something that will be resolved in a more austere phase of the business cycle.

4) About one thing I am certain. As trading in securities becomes more dispersed, and the sources of liquidity more diverse, the free flow of news, analysis and comment will become all the more important to the sound workings of the financial markets.

The regu1ators' job is to protect the public. It is not to differentiate between the kinds of information which the public should be allowed to see. Freedom of speech does NOT provide a license to commit fraud, as the SEC has often demonstrated. But without freedom of information--- good and bad--- free markets don't flourish.

Remember Amsterdam.

My overall conclusion is that market and information access for the investor - especially for the individual investor- will be greatly enhanced in the Internet age.

There are regulatory risks, mainly arising from a vast increase in the number of potential news sources and the ease with which national boundaries can now be ignored.

But the main task for regulators is to explain these risks, and to do what they can to break down the barriers of professional monopolies that prevent investors from enjoying the benefits of much greater transparency and much lower transaction costs.