Public Documents of the XXVIth Annual Conference of the International Organization of Securities Commissions (IOSCO)

23-29 June, 2001, Stockholm, Sweden

Opening Ceremony

2. Securities Markets in the Information Age, Speech by Mr. Claes Norgren

Chairman of the IOSCO Presidents' Committee
and
Director-General of the Finansinspektionen of Sweden

27 June 2001

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SECURITIES MARKETS IN THE INFORMATION AGE

The theme of the 26th Annual Conference of IOSCO is *Securities Markets in the Information Age.* The reason for choosing this topic is twofold. First of all information technology has profoundly changed financial markets and will have a continuos impact on market developments. Secondly, the word information age also captures the importance of information itself. The adequacy, treatment and use of information have become more and more important since structural change has made securities markets depend on more complex financial product and that an increased proportion of financial assets held by the public are equities.

Last year we were talking about the new economy. The perception of a new economic environment lead social science to analyse the issue of an information age. Manuel Castells has analysed the new economic and cultura1 environment in a work published under the name "The information age: economy, society and culture". The thesis is that new information technologies transforms the information process and inf1uences all domains of human activity. The result being the emergence of a deeply interdependent economy, increasingly able to apply its progress in technology , knowledge and management. This leading to a virtuous circle that increases productivity and efficiency.

A1though the discussion about the new economy seems to be left behind, the issue of the information age is not. The new environment based on increased processing capacity of information by the use of computers, communications systems and genetic decoding has important consequences. Since technology acts as an amplifier and extension of the human mind this fundamentally alters the way we learn, work, produce and consume.

Financial markets and trading of securities have been and will be affected profoundly. Some of these changes have been discussed and analysed by regulators, but a number of issues still need to be addressed. It is with this background that we will have the opportunity to discuss different items under the heading Securities Markets in the information age.

Fundamental changes in markets

The intensity of information in securities markets has increased due to structural reasons. The increased importance of information is due to the "equitisation" of financial flows. This can be seen in the amount of financial assets that today is held in the form of equities. As a percentage of world capitalization equity has grown considerably.

This is due to a number of factors.

- Inflation and interest rates have been reduced which has lead investors to seek higher yields on investments.
- Changes in savings patterns due to demographic reasons have increased the volume of savings. For investors and borrowers alike, equity markets, that are typically more information dependent, have become more and more important.
- On the supply side investments have to an increasing degree been financed by equities. During the last couple of years a wave of new enterprises have issued stock on securities markets which has raised questions about information management.

The importance of information depends on the fact that the value of a company depends on the judgment of its future economic performance. In order to assess this value a vast amount of information is processed and refined by the financial markets. How and on what criteria such a valuation is made is a cornerstone in the political economy.

In order for the investor to make the right decisions he must have the possibility and capacity to process more and more information. Information technology offers no doubt an important instrument to alleviate these problems. However, as the form and structure of the financial networks still in a rapid pace are developing, we can not to the full grasp *how* this instrument works and what questions it might raise.

What stands clear though, is that the consequence of a malfunctioning information process might be dramatic. In an era of mass-distribution of information and equity, even small biases or inconsistencies in the information structure may lead to surprisingly dramatic ends. Increased information turbulence might affect the movements of capital, which in a time when investments have become more decentralised directly effects the financial volatility.

The last years speculative IT -bubble highlighted the fact that information efficiency *still in this age of information and information technology* can be called in to question. The importance of information to reduce uncertainty has become a first order question.

The BIS, in its annual report, has pointed out evidence supporting the view that this was a global stock market bubble. This can be derived from the fact that several markets experienced an extended period of extraordinary price increase, followed by a nearly simultaneous reversal of those increases. This occurred despite somewhat divergent macroeconomic fundamentals.

These highly synchronised price movements cannot be fully explained by fundamental similarities between countries and markets. Rather, they are better understood as reflecting a high degree of uncertainty about valuations, which have led investors to seek quantative anchors in other stock markets. To efficiently use information to further reduce this kind of uncertainty is thus a challenge.

Information technology and globalisation of markets

During the end of the 20th century we have seen massive technological investments in the communications/information infrastructure worldwide. This has made possible the twin movements of deregulation of markets and globalisation of capital. What was labelled the new economy, accordingly first took shape in two key industries: information technology and finance.

New information systems and communication technologies allow capital to be transferred between economies in very short time. Thus, global financial flows have increased dramatically. The global interdependence of financial markets has been explained as the result of five main developments.

- Deregulation of financial markets

- The development of a technological infrastructure which includes advanced telecommunications, interactive information systems and powerful computers

- Financial innovation by the introduction of new instruments

- Financial cross-border flows

- Increased use of information creates a new/increased market for specialised information services

The outcome of the process is the concentration of value and of value making, in a global network of capital flows managed by networks of information systems.

Also for the individual information technology has changed the conditions for market access. For a large number of individual investors entry to the stock market today can be done on their own, using new technology. The so-called day-traders popularised electronic trading. In 1999 about 25 per cent of all transactions by individuals in the US were done via electronic trading.

Another major development has been the reinforced process of financial disintermediation. The development of new electronic transactions and information systems makes it possible to bypass traditional brokerage firms, on the basis of electronic communication networks (ECNs).

To open up new markets, linking in a global network valuable market segments of each country, capital require mobility , and firms need enhanced communication capabilities. Deregulation of markets and new information technologies provided such conditions. The global integration of financial markets has been made possible by new information technologies that had a dramatic impact on the growing disassociation of capital flows from national economies.

An interesting aspect of the infoIn1ation age is, what could be argued, the transfoIn1ation of time. The development of communication technology has enabled the economy and the financial market to work as one integrated unit in a real time world. At the same time, increased liquidity in financial assets press for more mark-to-market valuation which unifies the perception of time. Compressing time to the limit is tantamount to make time disappear. In financial markets, a unified global capital market, working in real time, is emerging.

Implications for markets and for regulation

Changes in communications and information technology combined with new financial instruments have integrated world financial markets and thereby made them more efficient. The new financial instruments would not have f1ourished without the technological advances.

In order to fully appreciate the importance of information technology we must consider the impact on information and how this might enhance efficiency in the markets. Information technology has caused what might be labelled as a revolution in the production of services; new investment opportunities and new markets have been created. For investors and intermediaries this has made information more accessible and the channels for investments more diversified.

The use of information technology has fundamentally changed the conditions for production of financial services. For securities markets this is a factor that has been made more and more clear, and we have over time adapted our behaviour to the new technology. Still, there are a number of areas where it is important to consider how technology has changed and will further change market conditions.

- The use of the Internet has enabled consumers to process information, find new investment opportunities and to trade securities over the Internet. For the investor this has lead to much greater opportunities at the same time as the demands on their expertise have been challenged. As regards information to investors the Internet opens up a new world of diversified information that clearly creates a much more informed investor thereby providing the technological infrastructure for the "economic man".

- For producers of financial services information technology -be it Internet or any other form of information technology -has created new economics of scale and scope. At the beginning of the 1990's the automation in production was still relatively modest but at the end of the decade a1most all services were automated.

- For risk management these new products and channels of distribution have many advantages. Due to the liquidity in the instruments and markets they have enabled investors and intermediaries to fine-tune their risk profile at a low transactions cost.

For regulation of securities markets, the increased demand for information and the new possibilities that come from the new supply of information technology create new challenges for regulation.

- The impact of information technology on consumers and investors raises questions about how they can handle and process their risks. First of all there is a need to make sure that information received comes from reliable sources. Secondly, as new layers of customers enters directly into the market the educational aspects of risk management becomes more and more acute. Thirdly, issues regarding personal integrity and resolution procedures comes into new light.

- Transparency and disclosure have been improved during the last decade. This has already proven good results. It can be argued that the new SEC rules requiring public companies to make materially relevant information available to the public at the same time that it is provided to analysts and investors, have served to quicken the response of markets to corporate-level information. It may also have reduced the effect of trading flows on prices. This shows the relevance of transparency and encourages further steps in this area.

- At the same time as the arguments seem valid for believing that market efficiency will be enhanced by the widespread use of information technology market developments show that volatility is a factor of concern. Last years rise and decline of share prices are far from indications about efficient markets. From a market stability perspective this raises questions about how the information structures in the market economy will be affected by developments in securities markets.

- For intermediaries the impact of information technology is considerable. Providing services via the Internet creates a new distribution channel that needs to operate 24 hours a day. Furthermore it creates a new contact with customers that needs to open and if disturbances occur, the impact on confidence will be considerable. In terms of risk management it increases the degree of operational risk in firms that needs to be properly addressed.

- An important aspect for regulation is how the market place is functioning. The development of information technology opens up new channels for trading in securities. One example is the Electronic Communication networks (ECNs) where trading can take place and reduce the volume of trades via the Stock Exchanges and the OTC markets.

An interesting observation is that national control is increasingly altered by global flows of capital, goods, services, technology, communication and infonI1ation. The national governments attempt to reassert its power in the global arena by developing supranational institutions. Co-operation in international policy institutions such as IOSCO will thus grow in importance in this age of information.

The panel sessions

The panel sessions of this conference have been designed in order to give a broad overview of Securities Markets in the Information Age. Altogether six panels will cover a variety of topics related to this broad theme.

Panel 1 has the theme: Impact of Internet of the Functioning and Regulation of Markets. Clearly the Internet will transform the market place not only for financial services but also for other products. The borderline between what is financial and non-financial products might be altered and new distribution channels will raise new issues. This panel session will discuss where information technology is heading and the implications for market regulation.

Panel 2 explores the implications for market stability of the increased globalisation that modem technology has made possible. Problems related to volatility in globalised securities markets are being discussed in conjunction with the challanges that poses to market stability .How this should affect market regulation will be considered.

Panel 3 covers the issue of market information and information accesses for the investor in the Internet age. Questions about how the information flow is changed both in terms of diversity and complexity are important in order to appreciate the impact on investors. This panel will consider the implications for market efficiency and quality of information.

Panel 4 raises the subject of auditor independence. This is a theme that has been widely discussed but where recent events on financial markets give a new perspective on the subject. The issue of conflicts of interest between accountant's responsibilities as auditors and as consultants will be discussed. The question of the reliability of audited financial statements will be considered.

Panel 5 discusses the issue of demutualisation and privatisation of Exchanges. During the last decade this is something that has gained momentum. At the same time growth in electronic trading systems (ECNs) have been changing the landscape and changed the environment for OTC-markets and exchanges. A new landscape in financial markets might be emerging. The implications for competition and the implications for regulation will be considered.

Panel 6 will take up for discussion the issue of Transparency in the Regulatory process. The debarking point of the discussion is the document *IOSCO Objectives and Principles of Securities Regulation.* This urges for consistent, comprehensible, transparent, fair and equitable regulation. In the context of more integrated, globalised and liquid markets this is a subject of new importance. Transparency in markets has for a long time been something that been promoted by regulators. Now there is also another aspect of transparency: transparency in the Regulatory process.