PLENARY 1
Global Market, Global Regulation

17th May 2000

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Today, all markets face fundamental challenges that implicate both the evolving structure of capital markets, and the financial information that binds these markets together.

The forces of competition and centrality are the defining propositions at the heart of the debate on market structure today. Central markets have always had an allure. Basic economics tells us that the greater the supply and demand that congregate in one place, the more efficient the price-setting mechanism. This means the more customer orders that interact with one another, the better the prices will be. Questions about best execution begin to fade. Spreads may narrow, liquidity may increase, and markets become more orderly. But there is another side to centralization. As centrality tends towards monopoly, it also becomes more immune to innovation and the benefits of competition.

In the United States, electronic communications networks have introduced new competition driving traditional markets to innovate like never before. Many Asian and European exchanges are fully electronic trading venues. Across Europe, exchanges are consolidating, heading, possibly, towards a Pan-European platform. In fact, centralized, electronic national markets are not a new development for these exchanges. If one surveys the construct of exchanges around the world it’s safe to say that the open outcry has been replaced, to a great extent, by the silent screen.

U.S. markets, however, have not moved as fast towards order-driven electronic systems with central order books. The reasons are as much historically rooted as they are economically rooted. For the last twenty-five years, America's capital markets have been characterized by a system of competing market centers. In the Nasdaq market, you have a system of competing dealers with large numbers of connected pools of liquidity. Our listed market, in contrast, consists of a largely central pool of liquidity, governed by auction principles. But, it too faces competition, for example, from the third market which trades listed securities in the Nasdaq dealer market. And, with the recent repeal of certain anti-competitive rules, it remains to be seen whether the powerful force of a central market will mean the continuation of the New York Stock Exchange as the dominant exchange, in light of competition from electronic communication networks.

As one compares U.S. markets to those around the world, you can easily be struck by the vast structural differences. Many Asian and European exchanges, for example, have for years automated their trading and altered their ownership structures. And with economic and monetary union in Europe, exchanges are under greater pressure to meld diverse operations or develop common settlement systems.

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In Asia, Europe and the United States today, traditional markets, whether they are auction-based or screen-based, are increasingly under fire from new, innovative trading systems and platforms.

It could be a dealer with automatic execution and liquidity guarantees or an Electronic Crossing Network. In both cases, the promise of disintermediation, or greater anonymity, or lower costs, is pushing traditional markets to cut costs and to become more efficient.

What strikes me most about the current environment is the salient pressure markets around the world are experiencing in the tension between competition and centrality. This tension is, by no means, new. But it is more pronounced today than ever before.

The question we all are wrestling with is “How do you couple vibrant competition and the innovation it produces with efficiency of centralizing orders?” Put another way: “How do you ensure that a market is central enough to maximize the possibility that buyers and sellers will meet on terms that serve them best, and at the same time competitive enough to spur enduring innovation?”

It is not good enough to have a brilliantly designed trading platform that solely produces efficient prices. There is a big difference between an efficient trading system and an efficient national market system.
I view our role at the Commission as maintaining and upholding a framework that fosters vibrant systemic competition. In this framework, multiple market centers - traditional exchanges, electronic markets, and dealers - compete with one another for business, spurring a race towards faster, cheaper execution of transactions.

Prices across these markets are visible - or transparent - to market participants. Brokers are legally obligated to obtain the best prices reasonably available for their customers. And multiple market centers are linked, ensuring that brokers have access to the best prices in the overall markets.

**Selective Disclosure**

As more countries embrace a true equity culture, and investors respond by allocating capital globally, a transparent and trustworthy global financial reporting framework has also become more important than ever. Nothing erodes investor confidence more quickly than when the financial reporting process is guided by anything but fairness and integrity.

The all-too-common practice of selectively disseminating material information is a disservice to investors and undermines the fundamental principle of fairness. This practice leads to potential conflicts of interest for analysts and undermines investor confidence in our markets. In a time when instantaneous and free-flowing information is the norm, "whispered" information is an insult to the principles of free and open disclosure upon which the success of our capital markets is based.

In the United States, we are in the midst of a lively debate on the issue of selective disclosure. Some argue that stricter rules will "chill" the flow of information as companies respond by providing less disclosure altogether. I disagree. The Commission's proposed rules on this issue exemplify the "best practices" standards of analyst and investor relations groups. They will provide issuers with a great degree of flexibility in the way they distribute information - including the use of new technologies over the Internet to offer extraordinarily broad access at minimal cost.

**Auditor Independence**

Integrity, transparency and fairness also serve as the bedrock of a strong and trustworthy financial reporting framework. Independence is at the core of the accounting and auditing profession, the very essence that gives an auditor's work its value.

But as the largest accounting firms expand their product lines, consulting and other services may shorten the distance between the auditor and management. Independence - if not in fact, then certainly in appearance - becomes a more elusive proposition.

The audit is sometimes priced lower to attract clients willing to pay for higher-margin consulting services. But, the audit foothold as a distribution channel for consulting services is at the very root of the inherent tension that these interdependent relationships foster.

When performing an audit, auditors are accountable to one master - the audited company's shareholders. But when auditors engage in extensive services for an audit client truly unrelated to the audit, they must also serve another master - management. In this dual role, the auditor, who guards the integrity of the numbers, now both oversees and answers to management.

Assuming the role of "relationship" manager, the auditor helps develop and coordinate extensive cross-selling and marketing strategies with, for example, his firm's information technology consulting group. And while it may never be quite so explicit, some auditors know, and other suspect, that their compensation is influenced by how well they "manage" that relationship in its entirety. As the firm's business objectives drive them into broader alliances, it's becoming more difficult to ascertain where one relationship ends and another begins.

In my view, any regulatory action must address a few fundamental public policy questions: Should there be more appropriate limits on the types of services that an audit firm can render to a public company client? How should audit firms be structured to assure independence? What are the consequences, if any, of public ownership? Should firms be permitted to affiliate with entities who provide services to the firms' audit clients that the firms themselves would not be allowed to provide?

In the coming months, our Commission will consider how to address the long-term ramifications of today's firm structure on both auditor independence and investor confidence.

**Conclusion**

We are living in a time when investors are increasingly able to shift their capital in and out of markets cheaply and easily; it may not always happen overnight, but the history of markets teaches us it can happen quickly.

If investors lose faith in the integrity of a market's prices, they will go elsewhere. If investors believe that they are not receiving high quality financial information, they will go elsewhere. If they believe that their interests are being placed secondary for any reasons whatsoever, they will go elsewhere. And the road to restoring lost confidence is a long one indeed.

This is the challenge, I believe, for all financial regulators regardless of how or where their markets operate.

Thank you.