Plenary 1

Impact of the Internet on the Functioning and Regulation of Markets

4. Impact of the Internet on the Function and Regulation of Markets,  
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Introduction by Director General Claes Norgren

As a debarking point and in order to clarify the technological dimension of Internet on financial markets it might be appropriate to begin by clarifying a few definitions and terminological distinctions. First of all it might be worthwhile to look at a possible definition of the Internet. According to the Encyclopædia Britannica Internet is a common addressing system and communications protocol that enables computers to connect with each other and form different kinds of networks. In its everyday use the term Internet applies to this entire set of networks.

Secondly one must clarify the distinction between Internet and information technology. Internet, rather than being a technological invention among others, is today mainly an arena for technological applications – for information technology. Considering the relatively simple technology that binds the net together, the Internet is more like the wavelength for a radio transmission rather than the actual radio receiver. Today this is reflected in the technological development of the Internet, consisting on the one hand side of “broadening” the infrastructural capacity in order to transmit more information, and on the other hand by adding new kinds of technical applications to allow a more advanced use of the net.

A year ago, when we drafted the programme for the IOSCO conference, people where talking about Internet and the new economy and there was a feeling of euphoria in the air. Today the mood is quite different. Although some of us still might consider Internet as a novelty, Internet and its various effects on society and markets, is here to stay.

The logic of Internet has already today shaped markets and financial institutions for a while, and it is now high time to draw relevant regulatory conclusions from this development. This does not mean that the major changes in connection with the Internet are already behind us. On the contrary, it is obvious that most of the changes are still in front of us, although hard to foresee. In
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a way, financial regulators have the same problem as the rest of the financial markets, to foresee the future – a fact that ought to challenge our visionary skills.

The number of people that regularly uses the Internet grows. Just in Europe some 117 million people were using Internet in year 2000 – by the end of 2004 the corresponding figure might be as high as 233 millions.

Ranging through political, economic and ethical issues, the different Internet related issues appear to be infinite. Internet has for example been said to be the “death of distance”. Although this does seem drastic, it clearly shows in what way the Internet is capable of shedding new light on fundamental concepts. The concept of distance is, however, just one of many perspectives possible to apply on the Internet. ‘When’, ‘where’, ‘how’ and ‘whom’ are all key questions possible to relate to the growing use of Internet: “When” is an agreement met, “where” – under which jurisdiction – is a service provided, “how” do you sign an agreement in cyberspace and are you sure “who” you actually are doing business with, just to name a few.

Somehow all these different questions and perspectives make it quite impossible to simply pin down the significance of the Internet and move on to the next item on the agenda. This makes the development and use of the Internet a worthy subject to grasp for the participants of the financial markets, supervisors and regulators and not least the participants in this first panel.

It stands clear that the last few years have been intense. A lot has happened, been said and done throughout the markets and society in relation to Internet and the so called “information economy”. Still, the major changes lie in front of us. This alters the importance of exchanging ideas and thoughts in order to grasp the presence and the future.

The impact on markets

Despite the financial markets sudden change of mood in respect of Internet it is today clear - not to say obvious – that Internet and information technology have had, and still have, enormous effects on financial services. New technology is still at a rapid pace being implemented and
incorporated in the financial markets and institutions, and there are few parts of society where the impact of information technology has been so fundamental as in the financial sector.

This development implies an environment characterised by speed, transparency, knowledge and accessibility. An interesting development here is within electronic communications systems (ECNs), that make it possible to bypass traditional brokerage channels. This will have important structural effects on regulation of exchanges, dealers and other basic market structures.

New products and services have increased and changed the production economy of financial services. I would argue that we are only in the beginning of a period of rapid product development with important structural implications. Furthermore I would argue that we will experience a still higher speed in product development.

Technological development and automation of financial services have led to a number of new services such as Internet trading, direct/on-line IPOs, chat rooms and bulletin boards. With Internet as a driving force these new services offer the financial markets new possibilities for international trade in financial services. We can see how a more direct market accesses have important implications for risk management. One of those implications is the emergence of information turbulence with its effect on volatility and liquidity.

The use of Internet has enabled consumers to process information, find new investment opportunities and trade securities directly over the web. In a certain perspective one might say that the Internet is the ideal tool for the economic man. One question is, however, if that man is educated enough to use that tool. And if he is not, is there relevant and qualitative information accessible to him to compensate for this lack of knowledge? Or are the incentives among the participants of the financial markets well-calibrated enough to lend him sound advice?

For investors and consumers, Internet also offers new dimensions of access and interactivity through continuous trading. This can be said to professionalise the consumer by requiring new skills in order to be on equal footing with the professional investors. The value traded is increased, and retail customers can have convenient access to the financial markets.
The current regulatory discussion

One might contemplate in what way the possibilities Internet offers change social patterns and human behaviour? And in what way this affects the role for financial institutions, consumer, investors and regulators and supervisors of the financial markets? Important observations from market developments relate to the speed in decision making and anonymity that can be observed in the new financial geography. A broader freedom of choice and a more direct impact on the personal economy is clearly visible. At the same time investment choices based on knowledge seem to be developing.

Among financial regulators worldwide the issues that arise from the increased use of Internet has been on the agenda in more or less every grouping. This is a sign of strength but one must also show caution for a too fast and malplaced regulation of a technology that still is developing. In order to give an overview of activities one might consider the different groups on the global level working with Internet. The Basel Committee on Banking Supervision has mandated an E-banking group, the CGFS has a working group on e-trading, the CPSS a group on e-commerce and IOSCO has mandated an Internet task force. At the same time the OECD has appointed a Co-ordinator on e-finance. These groups are working on the issues from different perspectives but within the Financial Stability Forum a co-ordinating group constituted by the chairmen from the different groups is working.

Looking at the common denominator behind these developments in different fora one can see the following landscape opening up based on contributions from regulators in different fields of application. Regulation that is being considered to include the following headlines:

- Risk management principles
- Rules for investor and consumer protection
- Information requirements

A common denominator in all this work is that the Internet should not be considered as something unique that needs special regulation. Rather it is the common view that Internet is just
one channel in markets, that need to be considered on equal footing with others, but where we are on the learning curve to understand to get that right.

**Issues for consideration**

This panel session will focus on the impact of the Internet on the functioning and regulation of markets. More specifically we will approach the subject with the perspective that the Internet has become a major worldwide communication channel. Its increasing use and the continuing rapid development of the related technology are transforming the Internet into an important market place for goods and services, including financial information and securities trading. In the panel discussion after presentation by the invited panellists we will focus on where the Internet related technology is leading us and how this is likely to affect markets and market regulation.