Subcommittee on Securities, Insurance and Investment
"A Global View: Examining Cross-Border Exchange Mergers"
Subcommittee Chairman Jack Reed, RI
July 12, 2007

This morning we are holding a hearing on "A Global View: Examining Cross-Border Exchange Mergers."

Globalization has led us to a crossroads. The world economy is developing and a variety of factors, including increased liquidity and improved regulatory structures, are drawing both firms and investors to emerging markets. Furthermore, as technological obstacles to cross-border trading disappear and markets are increasingly dominated by hedge funds and institutional investors with appetites for international investments, exchanges seek a global presence to remain viable.

In an effort to preserve and improve their positions, exchanges are engaging in increased cross-border transactions through mergers and acquisitions of other exchanges. In light of this growing trend, we are here to examine the impact on market participants, investors, and regulation.

The New York Stock Exchange, for example, has merged with Paris-based Euronext, formed a strategic alliance with the Tokyo Stock Exchange, and invested in a 5% stake in India's National Stock Exchange. Nasdaq acquired an increased stake in the London Stock Exchange (LSE) before announcing it would merge with the Nordic exchange, OMX. These trends are not only confined to domestic markets, as the Germany-based Deutsche Börse has announced its intent to buy the U.S.-based International Securities Exchange.

The increased alliance between exchanges has led to increased interaction amongst regulators. In the United States, both the SEC and CFTC are engaged in cross-border conversations with regulators in Europe, China, Japan, and Australia, among others. Additionally, the International Organization of Securities Commission (IOSCO), has announced that by 2010, its 108 members must sign on to a Memorandum of Understanding (MOU) that seeks to enable regulators to cooperate on enforcement in a timely, seamless manner.

In recent months, the SEC has been prioritizing a number of regulatory reforms focused on providing foreign entities greater access to the U.S. securities markets. For example, the SEC is considering eliminating the need for non-U.S. companies to reconcile to U.S. generally accepted accounting principles. While this effort might ease the filing requirements on non-U.S. companies, some argue that the integrity of the International Financial Reporting Standards, the alternative filing, is not on par with and may in fact be dependent on reconciliation to U.S. GAAP.

Additionally, the SEC is looking at a move to mutual recognition with foreign regulators with substantially comparable regulatory regimes; and is examining whether foreign exchanges could place their screens with U.S. brokers in the U.S. without multiple registrations. However, it is important that these efforts provide comparable safeguards for investors; and in considering such approaches we must ensure that, while the rulebooks may be similar on paper, their interpretation and enforcement by other regulators must be equally comparable.

The globalization of markets—across product lines as well as geographic boundaries—through increasingly sophisticated trading in multiple markets and multiple currencies and other complex transactions, significantly raises the potential to obscure illegal activities and avoid timely detection. In an effort to move forward with the times, the integrity and trust in the regulation of the U.S. exchanges, which has contributed so greatly to their success, can not be compromised.

Today, it is necessary to ensure that investors are sufficiently informed and protected in the new global marketplace. Regulators have historically focused on protecting domestic investors. In a global economy, regulators must take a broader view; for example, the U.S. regulatory regime is designed to protect retail investors while many foreign regulatory regimes focus largely on wholesale and institutional investors. Thus, the ability of the regulators to meet their mandates of protecting investors while ensuring vibrant capital markets cannot be secured in the same manner across borders.

The role exchanges play in economic development, capital formation, job creation, and innovation cannot be ignored and we have a national interest in ensuring their continued vitality.

It is noteworthy that as local stock markets grow more liquid and well-regulated, 90% of the world's companies chose to list in their primary markets. For example, in 2006, 18 of the global Top 20 IPO's went public on domestic exchanges.

In this regard, U.S. markets remain competitive as the most liquid, transparent, and capitalized in the world with the deepest retail base and solid institutions that protect investors. In 2006, the U.S. launched the highest number of IPO's (187) in the world and U.S. companies raised $34.1 billion in capital, second only to Chinese firms.

A study by Professors Craig Doidge, Andrew Karolyi, and Rene Stulz found that, "Cross-listing in the U.S. leads firms to increase their capital-raising activity at home and abroad…" Moreover, they stated that, "an exchange listing in New York has unique governance benefits for foreign firms. These benefits have not been seriously eroded by SOX."

The hearing today is an opportunity to evaluate the current situation and get a full picture of the implications of these actions on the future of exchanges as well as for market participants, investors, and regulators alike.