Statement of the
U.S. Securities and Exchange Commission

A Global View: Examining Cross-Border Exchange Mergers

Before the Subcommittee on Securities, Insurance, and Investment of the
U.S. Senate Committee on Banking, Housing, and Urban Affairs

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Chairman Reed, Ranking Member Allard, and Members of the Subcommittee:

Thank you for inviting the Commission to testify today about the recent trend of cross-border exchange mergers, and their impact on the markets, on investors, and on regulation. These developments present both new challenges and opportunities for the U.S. securities markets and the Commission.

Current Trends in Capital Markets and Exchanges, Including Mergers and Acquisitions

Today, no one would dispute that the capital markets are becoming increasingly global. As the markets have evolved, innovations in technology have eliminated many physical barriers to market access, with the result that exchanges worldwide have pursued alliances and mergers in order to more effectively participate in the global exchange business.

For example, in February of this year, the NYSE Group and Euronext merged their businesses under a U.S. holding company – NYSE Euronext – to create the first trans-Atlantic equities market. Shares of NYSE Euronext are now listed on the NYSE trading in U.S. dollars, and on Euronext Paris trading in Euros. The U.S. headquarters of NYSE Euronext are in New York, and its international headquarters are in Paris and Amsterdam. The combined company comprises seven exchanges in six countries. Each of NYSE Euronext's markets, however, continues to be regulated in accordance with local requirements. Its European exchanges are overseen by the relevant European regulator, and the SEC continues to regulate NYSE and Arca, the U.S. exchanges.

In addition, Nasdaq has acquired a substantial minority interest in the London Stock Exchange, and recently announced an agreement to buy the Nordic stock-exchange operator, OMX. Further, Eurex – the European derivatives exchange – has agreed to acquire the U.S.-based International Securities Exchange.

I have no doubt that the trend of cross-border alliances and mergers will continue, and that these global exchange conglomerates will seek to further integrate their operations.

The Factors that Precipitated These Trends and Could Significantly Impact Them in the Future

I believe a number of factors have precipitated the recent trend of cross-border exchange combinations. In recent years, most of the U.S. exchanges have demutualized, usually by creating parent holding companies, and a number of those parent holding companies are now public companies. As a result, many U.S. exchanges have access to new sources of capital, and the means to consider mergers that would expand their businesses globally.

In addition, the demand for global exchanges has grown as more and more investors, both large and small, have begun to look beyond their own countries' borders for investment opportunities. Today, for example, nearly two-thirds of all U.S. equity investors hold foreign equities through ownership of individual stock in foreign companies or ownership of international or global mutual funds.

And finally, developments in technology and reduced communication costs have driven the markets to become largely electronic, with the result that geographic boundaries have become much less relevant. This, of course, has made it much easier and less expensive for investors to conduct cross-border securities activity.

The Role of Such Trends in the Changing Regulatory Environment

Globalization of the securities markets will clearly continue to present challenges for regulators in the U.S. and abroad. That said, to date, the regulatory issues faced by the Commission have been relatively modest, as the proposed transactions involving U.S. exchanges preserve their separate operation under a holding company structure. With NYSE Euronext, for example, the NYSE Group and Euronext markets continue to operate as separate liquidity pools in their respective jurisdictions. The creation of a single holding company for these markets, in and of itself, does not raise substantial U.S. regulatory issues. In essence, the Commission reviews the proposed governance and ownership structure of the new holding company to determine whether the SEC continues to have adequate tools to effectively oversee a U.S. exchange that is controlled by an entity not fully subject to its jurisdiction.

Over time, however, I expect the global exchange groups will seek to further integrate their markets, whether through a consolidation of technology platforms, the provision of trading screens in each other's jurisdictions, or linking their liquidity pools. Depending on the scope of the integration, a wide range of core U.S. regulatory issues could be implicated, including those surrounding exchange registration, broker-dealer registration, and listed company registration.

The Impact Such Changes Are Having and Could Have on Markets and Investors

Global exchange initiatives such as these may very well promote competition and the efficiency of cross-border capital flows, and thus have the potential to benefit the

markets and investors in the U.S. and abroad. A core SEC mission is to protect U.S. investors, so as we approach these difficult global regulatory issues, we must be vigilant in our efforts to ensure adequate disclosure and regulatory oversight for U.S. investors. At the same time, another core mission of the SEC is to foster capital formation, and we are mindful of the fact that today capital increasingly is being raised internationally, with securities trading on various exchanges.

Over the years, a number of foreign markets and jurisdictions have questioned whether registration of foreign exchanges and broker-dealers in the U.S. is essential to investor protection, if the foreign jurisdiction affords regulation comparable to that in the U.S. Some countries have complained that the U.S. "investor protection" mandate is used to protect the interests of domestic institutions and firms.

The SEC's response has generally been that our statutory mandate requires a high level of investor protection, while at the same time fostering capital formation, and that foreign exchanges and broker-dealers are welcome to do business here if – like their U.S. counterparts – they register, or for broker-dealers, if they comply with Rule 15a-6.

Unquestionably, however, there is more that we can do to reduce the costs and frictions of trading foreign securities in the U.S., without jeopardizing the protection of U.S. investors.

Opportunities and Challenges for the Exchanges, Regulators, and Investors Moving Forward

As you may know, the Commission has begun exploring the merits of a "mutual recognition" approach to facilitate global market access. Just last month, the Commission hosted a Roundtable on Mutual Recognition, where distinguished representatives of U.S. and foreign exchanges, global and regional broker-dealers, retail and institutional investors, and others shared their views on the possibility of mutual recognition.

Although the details of a viable mutual recognition approach are still in the early stages of development, in essence, it would permit foreign exchanges and broker-dealers to provide services and access to U.S. investors, subject to certain conditions, under an abbreviated registration system. This approach would depend on these entities being supervised in a foreign jurisdiction that provides substantially comparable oversight to that in the U.S.

For example, in the context of foreign exchanges, under the current U.S. regime, a foreign exchange that conducts business in the U.S. – for example, by placing its trading screens directly with U.S. broker-dealers – must register the exchange and the securities trading on the exchange with the SEC. In addition, in the context of foreign broker-dealers, under the current U.S. regime, foreign broker-dealers that induce or attempt to induce trades by investors in the U.S. generally must register with the SEC and at least one SRO. The SEC has, however, provided exemptions to foreign broker-dealers that

engage in a limited U.S. business, such as effecting transactions with U.S. institutional investors with the participation of a U.S.-registered broker or dealer. In addition, within the current regulatory framework a number of U.S.-registered broker-dealers today provide electronic access to foreign exchanges for their U.S. clients.

A mutual recognition regime would consider – for example, under what circumstances foreign exchanges could be permitted to place trading screens with U.S. brokers in the U.S. without full registration. Mutual recognition would also consider under what circumstances foreign broker-dealers that are subject to an applicable foreign jurisdiction's regulatory standards could be permitted to have increased access to U.S. investors without need for intermediation by a U.S.-registered broker-dealer. While this approach could reduce frictions associated with cross-border access, it would not address the significantly greater custodial and settlement costs that are incurred today when trading in foreign markets.

To satisfy the SEC's mission of investor protection and fostering capital formation, these exemptions from registration would depend on whether the foreign exchange and the foreign broker-dealer are subject to comprehensive and effective regulation in their home jurisdiction. To make this determination, the Commission would need to undertake a detailed examination of the foreign jurisdiction's regulatory regime, considering whether it adequately addresses such things as: investor protection, fair markets, fraud, manipulation, insider trading, registration qualifications, trading surveillance, sales practice standards, financial responsibility standards, and dispute resolution.

Other requirements or limitations may also be appropriate. For example, any exemptions permitting mutual recognition could be limited – at least to start – to trading in foreign securities, so as to address concerns about the impact of this approach on U.S. market activity. Similarly, exemptions could be limited to trading with market professionals and certain large sophisticated investors, who could be expected to more fully appreciate the risks of trading directly with foreign markets and intermediaries.

Finally, this approach could also require that the home jurisdiction of the foreign exchange and the foreign broker-dealer provide reciprocal treatment to U.S. exchanges and broker-dealers seeking to conduct business in that country.

At the direction of Chairman Cox, and drawing upon the valuable input received at the Roundtable on Mutual Recognition, Commission staff is developing a proposal regarding mutual recognition for Commission consideration. I expect the staff to have completed its initial work by the fall. In essence, the goal is to develop a regulatory approach that strikes a balance between securing the benefits of greater cross-border access to investment opportunities, while vigorously upholding the Commission's mandate to protect investors, foster capital formation, and maintain fair, orderly, and efficient markets.

Conclusion

The recent trend of cross-border exchange mergers, as well as the more general increased demand for worldwide financial services, challenges us to continue to view our markets, not in isolation, but rather as a part of the larger global marketplace. Globalization has the potential to provide great benefits for U.S. markets and investors. At the same time, the SEC must make sure that it has identified and appropriately addressed the risks of liberalized access by foreign markets and market participants to U.S. investors, so that our regulatory regime is not undermined, and our statutory responsibilities relating to U.S. investors and the U.S. markets are fulfilled.

I am grateful for the opportunity to provide you with this overview of the recent trend in cross-border exchange mergers and related regulatory issues. I am happy to take any questions you may have.