



## U.S. Securities and Exchange Commission

### **Speech by SEC Chairman: "Cross-Border Exchange Mergers in the Context of Global Trade"**

*by*

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*U.S. Securities and Exchange Commission*

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Thank you, Dean Light, for that kind introduction, and thank you for inviting me to speak to the Global Leadership Forum.

It's especially appropriate that we're meeting at the Ronald Reagan International Center — a Washington landmark dedicated to global commerce, and named for a president who above all else was a champion of free markets.

President Reagan liked to begin his speeches with a story. ("At my age," he used to say, "everything reminds me of a story.") And I have to say that seeing all of these Harvard alums gathered in the Ronald Reagan Building reminds *me* of a story.

On my very first day working for President Reagan in the White House, I met with the President in the Oval Office. And he said, "I understand you're a Harvard grad. Well, a very good friend of mine is a graduate of Harvard. And as a matter of fact, he recently asked me for some advice.

"This fellow had been partner in very prestigious firm, but then he fell on very hard times. He had a serious drinking problem, and it began to affect his work. Eventually, he was asked to leave the firm. Then, the financial and personal trauma from that broke up his marriage, and he lost touch with his family. Things got worse, and he ran into trouble with the law — he got picked up for shoplifting, and spent a brief time in jail.

"But recently he's come around — he's out of jail, he's completely sober, and best of all, he's found a wonderful woman he hopes to marry."

And it was on this point, the President said, that the man asked his advice.

"He said he hadn't told her anything about his past, because he was worried about what her reaction would be. So he asked, 'What do you think, Mr. President? Should I tell her I went to Harvard?'"

Right away, I knew where I stood.

But the truth is, President Reagan, like so many presidents of both parties, relied heavily on graduates of Harvard Business School to staff his administration and to fashion both domestic and international policy.

During the past two days, you've heard from several of them, including Secretary of Labor Elaine Chao, who I had the privilege of working with on the Reagan White House staff, and NASD Chairman Bob Glauber, with whom I worked when he served as Staff Director for President Reagan's Task Force on Market Mechanisms. (I should add that Bob was also my Department Chairman when I briefly served on the Harvard Business School faculty 25 years ago.) And of course, today, the President himself is a Harvard Business School alum.

I know that the business leaders gathered here today from so many different countries are well aware that Harvard is one of the leading business schools in the world — and that it has contributed enormously, in theory and in practice, to the development of the modern corporation. But did you also know that Harvard itself is the oldest private corporation in the western hemisphere? In 1650, the Great and General Court of Massachusetts approved Harvard President Henry Dunster's charter of incorporation, which established the Harvard corporation with a seven-member board.

That was more than 350 years ago. But a half century before that, Europeans not only had business corporations, but they were trading shares of stock on the Amsterdam Stock Exchange.

The innovation of joint ownership of business enterprises was as significant in the history of commerce as was the printing press to the spread of knowledge. The spread of stock markets eventually fueled all of Europe's economic growth following the Middle Ages.

Our focus at this Global Leadership Forum is on the increasingly international character of business — on issues such as the way that technology is shrinking the world, and integrating markets as never before.

But the truth is that our capital markets have always been global.

When the first company to go public issued its shares, Holland's modest population required the promoters to sell stock to foreigners and immigrants as well. So shares in the Dutch East India Company were taken up by,

among others, many Germans and residents of today's Belgium and Luxembourg.

And of course the mission of the world's first public company was global in every sense. It traded silver from Spanish mines in Peru, copper from Japan, textiles from China and India, and spices from throughout Asia and the Pacific. It established offices all over the world, in what today would be such far flung places as Iran, Thailand, Malaysia, Taiwan, and South Africa.

By the time Harvard got its corporate charter, this public company whose shares traded in Amsterdam employed more than 50,000 people, and paid a dividend of 40%.

This powerful idea — the pooling of capital from individual investors — not only financed the Dutch East India Company's shipbuilding, but also made the Netherlands a maritime superpower. It transformed a tiny, cramped place, most of which was below sea level, into a prosperous economy precisely because it traded with the world and welcomed all comers — whether they be Jews from Spain and Portugal, Puritans from England, or Huguenots from France.

So while it's true that today's technology has expanded our geographic horizons and is bringing the world closer together, it's also true that what we're seeing in the early 21st century is really just the continuation of a global imperative that has characterized the entire history of trade and markets.

It's in that perspective that we should view the proposed merger of the New York Stock Exchange and Euronext, and Nasdaq's initial acquisition of 25% of the London Stock Exchange.

These transactions are of course in a very immediate sense the logical consequence of the demutualization of our exchanges, and of the fact that we're finally moving away from the open-outcry pit system of the 1700s and toward the digital grid of the 21st century. But even more basically, they are the inexorable result of centuries of increasing interaction among nations and people the world over.

Think of what has happened in our own time. The 20th century saw the rise and fall of the three great totalitarian systems — Nazism, Fascism, and Communism. And in the wake of the last of these, Soviet Communism, we saw the blossoming of both democracy and free markets around the world, so that now we have some 159 securities exchanges in operation.

The question is not whether some of these exchanges will merge, but rather only when, and how.

Governments should welcome these cross-border affiliations, because they hold great potential. Already, we've seen the benefits to investors from lower

barriers to cross-border securities trading across Europe.

Until recently, each country in Europe had its own stock exchanges. The institutions and arrangements required to execute stock trades were therefore replicated many times. That led to low trading volumes and transactions conducted primarily among local investors — with the result that European markets had less liquidity for individual stocks and higher trade execution fees. Likewise, the redundancy in the systems for settling stock trades across Europe resulted in far higher settlement costs than exist in the U.S.

But Europe's gradual consolidation of some of its stock exchanges over the past decade has started to bring down trade execution costs. And if the current round of mergers of exchanges eventually facilitates mergers of the central securities depositories associated with the exchanges, they could have an even greater impact by significantly reducing settlement costs.

These same benefits could be available to American issuers and investors if U. S. exchanges are combined with those in other nations.

Inevitably, our parochial national market system will give way to the reality of a global market, because the only truly closed economy is the world economy. In the not-too-distant future, investors half a world away will be able to buy U.S. stocks during their own business hours, and in their local currency. And American investors will undoubtedly have cheaper access than today to stocks in foreign markets.

And there could be other, wider benefits. Global stock trading on a single computer platform would allow retail investors to more easily diversify away their risk, by adding global securities to their portfolios. As integrated global exchanges increase global liquidity, with more overseas investors being able to buy American stocks, and American investors getting greater access to foreign stocks, the price discovery for securities would work more efficiently. On a macroeconomic level, capital would be more efficiently allocated throughout the economy, to the benefit of firms, investors, and the world at large.

All of these benefits are achievable, but they are not free.

In order for America's citizen-investors to reap the advantages of easier trading technologies, increased liquidity, broader diversification, and a wider range of investment options — all at better prices and lower costs — we will have to navigate some difficult shoals.

National regulation will still be important. Indeed, it will be more important than ever, in order to protect investors from the new opportunities for fraud, unethical trading practices, and market manipulation that truly international markets could create. But equally important will be cooperation among national regulators. If national regulators don't cooperate with one another, and update their own rules and practices, the combination of global

exchanges could serve as a robust new means for the unscrupulous to circumvent laws and regulations and to hide illegal activities from surveillance.

So our genuine enthusiasm for the benefits of global markets should not mean that regulators will simply do nothing and let down our guard.

If we were to do that, questionable issuers who value U.S. liquidity — but not U.S. oversight — would soon realize that they could avoid our high standards, and still sell to U.S. clients, by using the foreign side of an affiliated exchange. That approach would, in very short order, undermine our disclosure and investor protection standards.

While the SEC applauds the benefits of global trading, we will never leave our investors open, and vulnerable, to an inadequate disclosure and oversight environment that puts them at needless risk.

The truth is, it is possible to coordinate oversight, so that each affected nation can maintain its standards. It won't be easy for each regulator, but it certainly isn't impossible either. We're already exploring ways to do just that, so that affiliated global exchanges are not unnecessarily burdened.

First, we should recognize that there are regulatory regimes around the world that provide home markets with high levels of investor protection. This is why, in many areas, U.S. regulations of foreign companies that are listed in the U.S. already permit those foreign companies to follow their home market practices. This is true for proxy statements, share solicitations, significant event reports, and even some corporate governance requirements.

This is only a beginning, of course. There are still many areas of significant difference between our standards and those of other countries. For example, we have different accounting and auditing standards, and, importantly, different liability standards.

But the key to success going forward is to recognize that harm to investors will be minimized if we agree to adhere to high quality securities regulation and there is a strong degree of cooperation and coordination among regulators.

Being open to the world and to progress is in our national interest. We will do everything within our power to help improve capital formation in this country, maintain fair markets, and protect investors.

There is no telling where the current round of bargaining for the world's major exchanges will lead us. But at the same time, there's no question that the way in which regulators respond to the changing competitive environment will have an enormous impact on the outcome.

In a world where not only companies but investors can choose where to

trade, every nation — including the U.S. — will discover that there are very real competitive limits to its ability to impose regulations.

But this doesn't mean that regulatory arbitrage will carry the day, or that every country will have to stand by and watch helplessly as its citizens' money is hijacked in a race to the bottom where no standards remain to protect investors.

Instead, it means that investors will be able to insist upon not only a regulatory framework that protects them against fraud and market manipulation, but also one that is modern, efficient, and affordable.

Just as companies in their own competitive markets are under constant pressure to provide better quality at lower prices, so too will regulators increasingly be required to give their customers — their nation's investors — better information in more useful ways, and at lower cost.

So as the SEC changes our regulatory focus from a mostly domestic U.S. equity market to a global market, we're starting by working with our counterpart regulators in other countries to minimize conflict and duplicative regulation.

Just recently, we finalized a memorandum of understanding between the SEC and the United Kingdom's Financial Services Authority that will enable us to work toward coordinated inspections and examinations, and to greatly enhance our sharing of information.

And here in Washington, I holed up for a day and half with my counterparts at the British FSA — Chairman Callum McCarthy, and Chief Executive John Tiner. We brainstormed about a variety of ways that we could collaborate in order to rationalize potential cross-border ownership of American and British exchanges.

And in Hong Kong just a few weeks ago, we met with the top regulators from France, Belgium, and the Netherlands for similar discussions about the potential NYSE-Euronext combination. I hope to host our counterpart regulators from these countries here in the U.S. very soon.

Beyond this kind of international collaboration, we've got to rigorously examine our own regulatory system from top to bottom, to exploit every opportunity for improvement. One of the most obvious ways to make the SEC's rules work better for investors is to eliminate the complexity that junks up disclosure, and runs up legal and accounting bills.

So we're mounting an all out war on needless complexity. Saying what you mean, and saying it clearly, will be every bit as important for the government as it is for companies and mutual funds. There is no room for language that makes things harder to understand in a global marketplace where fast moving information drives split-second decisions. This is especially true when

what a company is saying must be translated into several languages.

So our recently proposed proxy rules will require for the first time that the proxy statement be written in plain English. And that goes double for disclosure about executive compensation, where right now, the situation for investors is a mess.

We are working with the Financial Accounting Standards Board to get rid of unnecessary complexity in our accounting standards. Streamlining and simplifying our rules is vitally important if we're going to succeed in harmonizing global accounting standards.

Since the day I began, I've been focused on translating legal gobbledygook into plain English. I'm pretty sure that one of the formative experiences that led me to so strongly dislike legalese was my stint 20 years ago teaching federal income tax at Harvard Business School to second year MBA students.

As you well know, these are bright young men and women, eager to learn. My job was to get across to them the important concepts of federal taxation, without getting lost in the minutiae and the jargon. Mind you, that's pretty difficult to do when the Internal Revenue Code itself consists of nothing but minutiae and jargon — 3.4 million words of it. (And that doesn't even count another 1,800 pages of regulations in fine print that are just as confusingly written.)

I'll never forget my experience grading the students' final exams. There were two cases on the final — two business situations nefariously constructed to contain every tax problem known to man. And the exam lasted four hours. Naturally, each of the students filled up multiple blue books.

All, that is, except one. I can't tell you how excited I was when I picked up this student's single blue book. I was intrigued to find out what this model of concision could possibly look like.

And then, when I opened the cover, I discovered that he'd written on just the first page of the one blue book. Here is what he wrote:

"Dear Professor Cox: What I have learned in your course is that federal income is extraordinarily complicated. And when I go into business, I'll be sure to hire someone who knows what he's doing in this area."

I'm reasonably certain that this fellow ended up with a career in improv, rather than tax accounting. Either that, or he went to work for Enron. Much as I appreciated the wry humor, I didn't have too much remorse about flunking him.

But you have to admit, that student had a point. The arduous process of unraveling the man-made complexities that are the hallmark of government rules and regulations isn't just hard work. It's entirely unnecessary, and

vastly too expensive.

That's why even now, the SEC and the Public Company Accounting Oversight Board are also working to make Section 404 of the Sarbanes-Oxley Act more efficient and cost effective. The SEC is planning to issue guidance to help management in assessing their own internal control over financial reporting. And both the PCAOB and the SEC are working to propose revisions to Auditing Standard No. 2, which is the detailed roadmap for 404 implementation. The purpose of these changes will be to make sure that auditors concentrate on areas of higher risk, and to spell out clearly what role, if any, the auditor should play in evaluating a company's assessment of internal controls. We want to make sure we have an instinct for the jugular — not for the capillary.

Our overall aim is to significantly reduce the costs of 404 compliance, while improving protections for investors. This undertaking in itself will help conform our own rules to those of other high-standards countries.

As regulators, our jobs are by nature national — we generally claim jurisdiction only over companies whose shares trade on our markets. But companies, capital, and people live less and less within national limitations. Of Adam Smith's factors of production, only land remains immobile. That one will be difficult to change. But the rest will travel.

So we cannot let up on our job of investor protection. But we also have to be mindful of the fact that we now inhabit a world filled with new opportunities, and new challenges.

Which brings me back to the beginnings of the world's stock markets in Amsterdam, when our civilization took the first deliberate step toward privately financed commerce on a global scale.

The world has never looked back since.

Then, as now, investors came from a broad cross-section of society — because the genius of the stock market was that anyone could participate. Among the investors in the first IPO were hundreds of ordinary people with occupations such as spoon maker, seamstress, and servant maid. And while the individual contributions might be modest, the results were spectacular.

From the get go, the very idea of a stock market combined the two basic elements that still characterize stock markets today: ordinary people of modest means, often unsophisticated, investing in ventures that will, if they succeed, grow into significant business enterprises unlimited by national boundaries.

Governments and their citizens have learned, the hard way, that markets work best when individual investors can have confidence their money is safe from manipulation. And we have also learned that our economies work best



when healthy markets aggregate capital and allocate it to its most important uses. As we consider how public policy should approach the consolidation of exchanges across the world, we will be wise to heed both lessons.

Since it became the first market to formally begin trading in securities, the Amsterdam Stock Exchange has been in continuous operation for over 400 years. It was subsequently renamed the Amsterdam Bourse. And on September 22nd, six years ago, it merged with the Brussels Stock Exchange and the Paris Stock Exchange to form Euronext.

It's possible that the proposed combinations involving the Nasdaq and the London Stock Exchange, or the NYSE and Euronext, represent a dramatic new development in the history of free enterprise.

Or it may simply be, four centuries after the first florins changed hands on the banks of the Amstel River, that we're just getting back to our roots.

Thank you for inviting me. And thanks for all that each of you does to make the world a better place.

*<http://www.sec.gov/news/speech/2006/spch062206cc.htm>*

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