Press release

News from the International Securities Market Association (ISMA)

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Transatlantic securities trading costs could be cut by up to 60%

New report urges US-EU accord on transatlantic exchange access

(LONDON, UK) An expert report published today urges a US-EU accord on transatlantic exchange access to jumpstart integration of the two mammoth securities markets. Such an accord would significantly cut transatlantic trading costs as well as the cost of capital for American and European companies.

Published by the International Securities Market Association (ISMA) in cooperation with the independent New York-based research centre, the Council on Foreign Relations, *Building a Transatlantic Securities Market* argues that unnecessary regulation inflates trading costs for US investors in Europe and vice versa. The report proposes an innovative regulatory regime based on mutual recognition, allowing exchanges authorised on one side of the Atlantic to give direct trading access to professional investors on the other side.

The author of the report, Dr. Benn Steil, Director of International Economics at the Council on Foreign Relations, is widely regarded as one of the world's leading authorities on exchanges and market regulation.

Benefits of a Transatlantic Trading Market

The Transatlantic Business Dialogue has highlighted the removal of impediments to capital flow and coordination of financial architecture as their priority issues for 2002. This report takes up the challenge head on, crafting a highly practical mechanism for achieving these aims swiftly and effectively.

The report analyses the economic impact of the recent expansion of automated trading networks, and concludes that the benefits of US-EU market integration far outweigh those of the current EU initiative to liberalize intra-European market access.

In particular:

- Combining less costly US institutional brokerage with more efficient EU exchange trading systems would lower trading costs on each side of the Atlantic by about 60%.
- A trading cost decline of this magnitude would reduce the cost of capital for the most widely traded American and European companies by about 9%.

The increase in investment thereby stimulated would promote higher growth and living standards on both sides of the Atlantic.

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The Status Quo

Current regulatory barriers to transatlantic securities trading, particularly those in the United States, impose major inefficiencies in the investment process without any corresponding benefit in terms of investor protection.

For example, the 300 EU companies listed on US exchanges must issue American Depositary Receipts (ADRs), which frequently costs them millions of dollars in legal, accounting, and exchange fees. Trading in the ADRs is also more costly than trading in the underlying shares would be if US investors could trade the underlying shares without the layers of redundant intermediaries necessitated by outdated regulation.

One result of these inefficiencies is that American investors are far less diversified in terms of their European shareholdings than standard financial market models would identify as optimal.

The Proposal

The report proposes to eliminate those regulatory barriers to transatlantic trading which have no useful role in terms of investor protection. This would be accomplished through a highly innovative mutual recognition regime that would allow exchanges authorized on one side of the Atlantic to offer direct trading access to professional investors based on the other.

Under this scheme, US exchanges operating in the EU would be regulated by the SEC and EU exchanges operating in the US would be regulated by their respective home market authorities. Direct electronic trading access to the exchanges would be limited to broker-dealers and so-called “qualified institutional buyers”, although individual investors would be able to place orders through registered local brokers in accordance with current retail investment law in the investor’s jurisdiction.

Such an agreement would provide huge benefits to European companies looking to attract US investor interest. Previous liberalization proposals have sought only to make it easier for such companies to list on US exchanges. Steil’s plan, however, would eliminate the necessity of a redundant US exchange listing, thereby allowing them to access US investor capital without having to suffer the costs imposed by extraterritorial US legal initiatives, such as the recent, highly controversial Sarbanes-Oxley Act.

The report’s recommendations are carefully crafted to ensure legal simplicity and to minimize political resistance. All the components of Steil’s detailed proposal for US liberalization have already been implemented by the SEC as parts of previous initiatives, and therefore involve no major legal or political innovations.

The most important component of his blueprint, permitting US trading of EU-listed securities meeting International Accounting Standards (IAS) rather than US Generally Accepted Accounting Principles (GAAP) disclosure requirements, is now less controversial than it has ever been. Steil argues persuasively that GAAP disclosure by EU companies not only fails to protect US investors, but in many cases serves to *mislead* them as to the true financial position of these companies.

On the European side, Steil’s plan involves EU finance ministers, through the ECOFIN Council, pledging to allow US exchanges to acquire “Regulated Market” status in any EU national jurisdiction without the imposition of new regulatory requirements. The ministers would further pledge to permit such exchanges to operate freely throughout the EU under the “single passport” provisions of Article 15.4 of the Investment Services Directive.

The simplicity of the proposal, which avoids any need for prior harmonization of securities laws and regulations across the Atlantic, means that it could easily be made operational within a year.

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EU Internal Market Commissioner Frits Bolkestein commented: "Dr Steil has produced an excellent piece of work that deserves to be thoroughly considered. I welcome his clear and compelling medium-term policy blueprint for an integrated transatlantic securities market."

American Century Ventures President Harold S. Bradley commented: "Dr.Steil's work shines a bright light on structural inefficiencies and regulatory barriers that unnecessarily raise our costs of doing business in European markets. Increasingly, an investment manager must evaluate true global companies and make investment decisions that slice through traditional political boundaries. Trading technology offers the potential for instantaneously interconnected markets. I think that many existing barriers represent protectionist policies which are maintained for the benefit of traditional exchange venues, and this is certainly the case in the debate over GAAP versus IAS disclosure. Regulatory reciprocity is an idea whose time has come, and this report provides a compelling vision for how intelligent public policy can help enhance investment returns for our investors. At a time when our own SEC is terribly overburdened, why wouldn't we share responsibility and cost in today's global economy? This is important thinking."

ISMA Chief Executive and Secretary-General John Langton commented: "Amidst the frenzy of regulatory activity accompanying the creation of the European single capital market, the issue of regulatory barriers to transatlantic business has been somewhat neglected. This timely report redresses the balance. Dr Steil presents us with a pragmatic, market based solution to the regulation of transatlantic securities trading, which will undoubtedly raise the level of the debate on this topic of global concern."

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Notes for editors

1 To obtain a copy of the report

Building a Transatlantic Securities Market is available free of charge as a downloadable file from ISMA's web site at the following address: www.isma.org/surveys/latest.

2 International Securities Market Association

The International Securities Market Association (ISMA) is the self-regulatory organisation and trade association for the international securities market. For some 500 member firms in almost 50 countries world wide, ISMA oversees the efficient functioning of the market through the implementation and enforcement of a self-regulatory code covering trading, settlement and good market practice. The Association also provides its member firms - and other users - with a range of services, products and support.

3 Council on Foreign Relations

The Council on Foreign Relations is dedicated to increasing America's understanding of the world and contributing ideas to U.S. foreign policy. The Council accomplishes this mainly by promoting constructive debates and discussions, clarifying world issues, and publishing *Foreign Affairs,* the leading journal on global issues. The Council is host to the widest possible range of views, but an advocate of none, though its research fellows and Independent Task Forces do take policy positions. www.cfr.org

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4 Dr Benn Steil

Dr. Benn Steil is Director of International Economics and André Meyer Senior Fellow in International Economics at the Council on Foreign Relations in New York. He is also the Editor of *International Finance* (Blackwell Publishers); a co-founder and director of Efficient Frontiers Ltd, a markets consultancy; a non-executive director of the virt-x stock exchange in London; a member of the European Shadow Financial Regulatory Committee; and a member of the Advisory Board of the European Capital Markets Institute. Until November 1998, he was Director of the International Economics Programme at the Royal Institute of International Affairs in London. Prior to his appointment at the Institute in 1992, he held a Lloyd's of London Tercentenary Research Fellowship at Nuffield College, Oxford, where he received his PhD in Economics.

Dr. Steil has written and spoken widely on securities trading and market regulation. Among his books are a critically acclaimed study of *The European Equity Markets* and a major text on *Institutional Investors*, as well as edited volumes on cross-border antitrust (*Antitrust Goes Global*) and the economics of innovation (*Technological Innovation and Economic Performance*).

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