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On

"America's Capital Markets: Maintaining Our Lead in the 21st Century"

Financials Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

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Chairman Baker, Ranking Member Kanjorski, Chairman Oxley, Ranking Member Frank and members of the Committee. I am Marsh Carter, Chairman of the NYSE Group, Inc.

Thank you for inviting me to testify before your committee today.

I am grateful for this opportunity to discuss an issue of rising national importance, which is the loss of U.S. competitiveness in the capital formation process. Chairman Baker, your leadership on this issue could not come at a more significant time to our markets and our economy. Thank you for taking the initiative of holding this hearing to preserve the preeminence of the U.S. markets.

Today I am going to divide my testimony into four parts:

First, I will present evidence detailing this loss of competitiveness.
Second, I will offer some explanations as to why it is occurring.
Third, I will discuss some ideas for improving our competitive position.
Finally, I will conclude with the implications of losing our leadership position for American investors, our capital markets and the broader economy

Let me begin with the good news. That is, our economy is strong, and the U.S. market remains the market of choice. In 2005, the U.S. again achieved the highest amount of capital raised in IPOs by any single country in the world. The U.S. provides unrivaled access to a very deep and broad pool of investors and enables companies to extend their own visibility on a global stage. At the NYSE, we had record trading volumes in 2005.

But there is a very troubling trend emerging among foreign companies seeking access to capital, particularly the largest foreign companies. From every vantage point, evidence of the loss of U.S. competitiveness in the capital formation process in the increasingly global marketplace is real and growing. In 2000, nearly half, 46.8%, of the global IPO equity was raised on U.S. exchanges. However, in 2005 only 5.7% of the dollars raised by non-U.S. company IPOs was raised through shares listed on U.S. stock markets subject to U.S. regulatory rules and oversight. Unfortunately, we do not believe this is a one-year phenomenon.

In terms of sheer numbers, global foreign IPOs that are SEC-registered and listed on a U.S. exchange declined from 100 in 2000 to 35 in 2005.

In addition, of the top 24 global IPOs in 2005:

- Only one was registered in the U.S.
- All of the top 10 were outside the U.S. public markets.
- Eight of the top 10 raised capital in the U.S. via private placements and therefore not accessible to the average investor.
- Vivendi, one of the five most active French stocks on U.S. exchanges, has announced its intention to delist.
- Coles Myer Ltd., Australia’s leading retailer, will also delist.

- Cable & Wireless Plc., Britain's second leading telephone company, delisted last December.
- The number of companies with American depositary receipts on U.S. exchanges has declined 8.8 percent since 2002.
- Twelve companies from China qualified to list on the New York Stock Exchange listed in Hong Kong instead. One of these companies, China Construction Bank, was the world's biggest IPO in five years – nearly $10 billion – and elected to go to market in Hong Kong rather than the U.S.

These statistics are in stark contrast to the situation in 2000, when 9 of the top ten worldwide IPOs registered on U.S. markets. All told, there were fewer IPOs in 2005 than in the peak year 2000. However, the proportion of the value of all IPOs that were global – i.e. that were raised in markets outside their home country – actually increased from 48.1% to 55.8%. More IPOs are global -- and fewer are listed in the U.S. This highlights quite dramatically the U.S. loss of global market share.

In 2005, $86 billion was raised through 224 IPOs for non-U.S. companies in the U.S. capital markets. This illustrates that non-U.S. companies still want to access the unparallelled depth and liquidity of the U.S. capital markets.

However, they are no longer doing so through the public markets, to the degree that they once did. Of the 224 IPOs for non-U.S. companies that came to the U.S. in 2005, 94% of those offerings, 189 of them representing $80.5 billion, were not registered in the U.S. or listed on any U.S. exchange. Instead, they were offered privately, to qualified institutional investors, under Regulation 144A. These 144A IPOs are less liquid, and are not subject to the rigorous regulatory oversight and disclosure that apply to registered offerings. Individual investors, for the most part, cannot participate directly, but can only access these 144A offerings through pension funds, mutual funds, and other institutional investment vehicles. These 144A offerings completely circumvent the corporate governance and transparency requirements that are the hallmarks of the registration process. This means less investment opportunity, and less protection by corporate governance and other rules, for the nation's individual investors.

Let me turn to the possible explanations for this disturbing trend. We see at least four.

First, the U.S. is losing listings because of the persistent concerns surrounding the U.S. trial bar and the litigious environment in the U.S. We need to recognize that the United States today has the reputation, both at home and globally, as an increasingly difficult place to do business. The possibility of being sued for huge sums, while also bearing high costs of legal defense has brought many companies to a moment of reckoning that mitigates against registering their securities in the United States. The total value of settlements in securities litigation class action lawsuits has continued to increase from $150 million in 1997 to $9.6 billion in 2005. Given the risks and threats to their bottom line, regrettably, foreign companies are simply concluding that it's not worth it to come to our market.

A second reason for the loss of listings on U.S. financial markets is the lack of convergence in international accounting standards. This divergence becomes all the more important in this period when European companies and countries are moving toward a common standard. When companies today are required to reconcile their accounts with U.S. GAAP when they list in the U.S., many balk at what they consider needless and costly redundancies in reporting.

While the FASB and IASB have made significant progress towards reconciling U.S. GAAP with international accounting standards, to date, the progress has been mostly incremental and failed to reduce costs significantly. While the SEC, IASB and FASB have established a goal to eliminate burdensome reconciliation requirements for the financial statements of non-U.S. issuers by 2009, there is no target date yet for true convergence of U.S. and international accounting standards.

A third explanation to which we can point is the improving quality and depth of equities markets abroad. European markets in particular are being helped by the success of the Euro, their relatively new, single European currency. Broad acceptance of the Euro makes it now possible, for example, for a Spanish investor to purchase a German security easily and with no foreign currency risk exposure.

Europe has also developed robust homegrown sources of capital. Europe today is served by three principal exchange operators, the Deutsche Borse, Euronext and the London Stock Exchange. Each of these exchanges is a well–capitalized, publicly-held entity that offers broad product mixes, that can absorb significant offerings, and all are competing aggressively to expand globally and to take away U.S. market share.

The London Stock Exchange's small-cap growth market, known as AIM, saw a tripling of the number of overseas listings in the past two years, with more than 220 foreign companies listing. They saw increasing interest in 2005 not only from companies in Australia, Israel and China, but also from companies here in North America.

Other markets, especially in Asia, the Hong Kong and Tokyo Stock Markets representing two excellent examples, are stepping up the pace to compete for listings and global capital, usually at the expense of the U.S. As reported in the April 6, 2006 edition of The Wall Street Journal, the Tokyo Stock Exchange is in the middle of a campaign to become the exchange of choice for Asian companies. As part of their effort, "the TSE is trying to persuade Japanese regulators to accept (financial) statements that follow international standards."

Finally, foreign companies are unquestionably concerned about the costs and added regulatory burdens associated with the U.S. regulation, including Sarbanes-Oxley.

U.S. regulatory costs in general are high because of the overlapping, multiple regulatory enforcement bodies to which public companies are subject. The Securities and Exchange Commission and the 50 states (and U.S. territories), in particular New York and California, in the wake of the scandals that began with Enron and Worldcom, have been outdoing each other in their efforts to demonstrate that they are tough cops. This regulatory zeal is a real concern for international companies.

With respect to Sarbanes-Oxley, we have stated and we believe that the law as a whole strengthened investor confidence by reforming corporate governance and financial disclosure. As noted in a recent opinion piece in The Wall Street Journal, Sarbanes-Oxley did two important things: it established the PCAOB to provide private-sector regulation of the accounting profession, and it mandated that public companies and their outside auditors attest to the quality of their internal controls. Sarbanes-Oxley has changed the tone at the top of organizations, revitalized the engagement of boards, provided for better disclosure, and is largely responsible for the compliance culture that now exists at companies.

Indeed, one of the underlying motivations for companies listing in the U.S. is the increase in value – which averages about 30 percent -- that accrues as a result of adhering to the high standards of governance that the U.S. markets demand. But companies are increasingly viewing the costs associated with these regulatory requirements, as well as their impact on the speed with which they can reach the market, as outweighing the valuation premium they offer. The way that the requirements of Section 404 were implemented is perceived to have resulted in substantial cost and duplication of effort that has caused international companies to conclude that the additional costs of our regulatory structure outweigh the benefits.

While we are heartened by the recent report that Section 404 compliance costs are decreasing, the costs continue to be a significant factor in international companies' decision to list, or not to list, on a U.S. market.

When the London Stock Exchange surveyed 80 international companies that conduced IPOs on its market, it reported that 90 percent of the companies that had listed on the LSE felt that the demands of U.S. corporate governance rules made listing in London more attractive. The Wall Street Journal recently reported that small U.S. companies are turning to London's small-cap market, AIM, for a variety of reasons, including the regulatory costs of going public. The article noted that "one of the reasons most commonly cited is the strain of Sarbanes-Oxley regulations in the [United S]tates."

These added costs and regulatory risk are seen as disincentives that are dissuading more and more non-U.S. companies and even U.S. companies from listing on U.S. exchanges. According to the National Venture Capital Association, the venture-backed IPO market declined from $11 billion in 2004 to $4.4 billion in 2005. While this cannot be entirely attributed to the added costs of regulation, it is a real factor.

With that said, let me turn now to possible ideas for improving our competitive position. We are encouraged that your hearing today, Chairman Baker and Ranking Member Kanjorski, signals a recognition on the part of our Congressional leaders of these realities and a demonstration of the leadership needed to find solutions. We also recognize the work of the SEC, PCAOB, accounting firms and others to address these issues.

For our part, the New York Stock Exchange has worked over the last two years, both nationally and internationally, to bring together interested parties – regulators, accountants, CEOs and others – to discuss the issues facing the U.S. capital markets. The purpose of these efforts has been to find common ground and strive for a better balance between regulatory costs and benefits, as well as to accelerate convergence of international accounting standards.

We believe that these efforts are bearing fruit, and we applaud the willingness of U.S. regulators to demonstrate greater flexibility. At the same time we strongly believe that more needs to be done. Understanding that there will be no shortage of proposed solutions, permit me to suggest three possible areas of focus for strengthening competitiveness of U.S. markets:

First, continue to work to reduce the risks and costs of meritless litigation;
Second, seek to accelerate harmonization of accounting standards; and
Third, work with the SEC and PCAOB to streamline the regulatory requirements attendant to securities registration**,** including the requirements under Section 404, and ensure that these regulators have adequate flexibility to implement the law's requirements in a cost-effective manner.

With respect to the costs of meritless litigation: tort reform is a difficult objective that many have worked hard for many years to achieve. Some of you here today, as well as

SEC Chairman Cox are owed a great debt of gratitude for the success ten years ago of the Private Securities Litigation Reform Act, which has helped to curb meritless securities lawsuits against public companies. But more needs to be done to control the costs of the country's appetite for litigation, so I urge the Congress to continue to press for meaningful tort reform.

With respect to harmonization of accounting standards, we applaud the efforts of SEC Chairman Cox to achieve this goal. Just this February, he welcomed the announcement by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) of a memorandum of understanding about their plans for measurable progress on improved and converged standards in a number of areas. Chairman Cox has endorsed the "roadmap" for elimination of the requirement that foreign private issuers reconcile financial statements prepared using international financial reporting standards to the U.S. system of Generally Accepted Accounting Principles (GAAP).

As I noted above, while the FASB and IASB have made significant progress towards reconciling U.S. GAAP with international accounting standards, we need to accelerate efforts to achieve true convergence of accounting standards for U.S.and non-U.S. issuers. Every year we delay it will become more difficult for us to regain market share that is lost to other countries.

With respect to reducing the regulatory costs of U.S. registration, we believe that much of what needs to be done can be done within the current system via the SEC and the PCAOB. We suggest that those organizations consider emphasizing and supporting risk-based reviews under Section 404. For example, each year, a company and its auditors review the internal controls surrounding the most material, significant income statement and the balance sheet assertions where the risk of material misstatement would prove harmful to investors. This approach ties into the current SEC focus on "materiality" aspects of risk. Such reviews would catch the most egregious risks to the organization without the costs associated with some of the reviews currently being conducted. Of course, in order to provide some comfort to auditors and companies, explicit guidelines and criteria for such risk-based reviews would need to be provided by the PCAOB.

Within a risk-based review framework established by the SEC and PCAOB, they could use their rulemaking authority to reduce the frequency of annual baseline Section 404 reviews to every third year. Once the controls are in place, it is more a matter of maintaining and updating them, especially with respect to low materiality, low risk areas. For the intervening two years, auditors would still review all of the high materiality, high risk areas while performing high level testing on the areas of low risk and low materiality, working from a baseline Section 404 audit. Every third year, the audit firm would conduct another baseline Section 404 review. This would preserve the investor protections provided under Section 404 without the unnecessary burden of annual baseline reviews.

Let me be clear: we advocate that the SEC and PCAOB establish specific risk-based materiality criteria.   A company must pass the annual audit of these materiality criteria. Only then would consideration be given to permitting the company to undergo a full baseline audit every third year.

Just this week, The Economist recommended a risk-based approach under Section 404, suggesting that the SEC "narrow the scope of the internal-control review carried out by auditors so that they examine only the larger risks, not the size of people's lunch expenses."[1]

It is worth considering the approaches to periodic review that are taken in another industry where risks to consumers are considerable. For example, the Joint Council on the Accreditation of Hospitals (JCAHO) audits hospitals every three years. The work of the JCAHO is vitally important to the protection of U.S. citizens and yet it does not conduct audits on an annual basis**.**

Now let me turn to the consequences of losing global listings – for U.S. investors, our financial markets and the broader economy. Let me be clear that the NYSE Group believes in competition, in free and open markets, and in the right of investors to manage their risks and invest wherever they choose. In fact, it is our commitment to these core principles that led to our historic decision to become a public, for-profit company, merging with Archipelago and transforming the New York Stock Exchange into a far

[1] "In search of better SOX," The Economist (April 22nd-28th, 2006) at 11.

more competitive and innovative marketplace offering a broader portfolio of products and platforms.

At the same time, we understand that investing outside the U.S. is an important, and growing, means for American investors to manage risks and potentially to increase returns, as well. Therefore, even when companies do not list in the United States, American households can own their stock indirectly through mutual funds, pensions or savings plans, insurance contracts, or other institutionally managed accounts.

However, when U.S. investors send their capital to overseas markets in this manner, they risk losing the protection of strong, well-established and designed U.S. standards including the federal and state securities laws and the rules and oversight of SROs like the NYSE. These protections are the highest in the world. Ironically, the factors that are causing more non-U.S. companies to raise capital overseas instead of in the U.S. are denying U.S. investors the benefits of transparency and investor protection that are the hallmarks of U.S. registered offerings.

While robust private placement and overseas listings markets are important to both local and international markets, we do not believe that reducing transparency, limiting access, and leaving U.S. investors more exposed and more vulnerable is a good thing. And this is unfortunately the impact of companies being less willing to participate in the U.S. public markets.

In addition, independent research also shows that when non-U.S. companies meet the high bar of U.S. listing standards, the global value of their brand is enhanced, and they can sell their stock at a higher price. These gains are also increasingly at risk.

As for the impact of the forces that are causing foreign issuers not to list on U.S. markets on our economy, the financial services industry has long been one of the most dynamic in the U.S. and, as such, a vital U.S. export, and a strong and reliable engine for growth and prosperity. Capital is the lifeblood of our economy, however, nothing is written in stone that decrees American capital will stay here or that global capital will continue to come here. If the volume of the listings business continues to trade away from U.S. exchanges, the ability of the U.S. to remain the leading financial center in a world of rapid globalization will be in doubt. And, should the United States no longer be viewed as the investment capital of the world, we will risk losing our leadership in innovation, job-creation and growth as well.

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In conclusion, despite a welcome resurgence in global equity financing, the United States is losing the competition for these new listings. While capital markets abroad become steadily more developed, liquid and open, the United States has created barriers to our own success in the form of our propensity for litigation and the costs of our own regulatory system.

We stand at the fork in the road. One road continues along the direction that we are headed today. It leads, unfortunately, to a further weakening of U.S. competitiveness, an increasing loss of global capital, and the flight of U.S. investors toward the possibility of uncertain, regulatory regimes.

There is another road that we believe is a better road. It is the road that builds on the beneficial effects of Sarbanes-Oxley with a risk-management based approach and common-sense regulation, so that we can meet the competitive challenge; maintain the leadership of U.S. financial markets, and America's position as the investment capital of the world.

For the sake of our markets and the good of our country, we believe that this is the road upon which we can and, hopefully, will make our journey together.

Thank you again Mr. Chairman for holding this hearing today and for giving me the opportunity to testify before your committee.