SIA RESEARCH

REPORTS

Volume VI, No. 5 May 27, 2005

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UPDATE ON RESEARCH ANALYST RELATED ISSUES

Summary

Since the commencement of the research analyst scandals that emerged in the aftermath of the bursting of the high tech investment bubble, *SIA Research Reports* has provided regular updates on research analyst related issues. The last update followed the October 2004 SIA Research Management Conference[1] and it seems timely to review where we have been[2] and where we are going. The timeline in the box below gives a brief summary of the highlights of research analyst-related regulatory developments. The earlier items are described briefly in Appendices 1 through 3 and the more recent items, in italics, are discussed in greater depth below. While much has happened since then in terms of U.S. Securities and Exchange Commission (SEC), New York Stock Exchange (NYSE) and National Association of Securities Dealers (NASD) releases, it is still unclear as to how the new rules will work in the long run. Questions remain concerning what kind of business models the new and evolving rules will permit for the provision of research by sell-side firms.

Research Analyst Regulatory Timeline[3]

July 2002	NASD Notice 02-39: SEC Approves Rule Governing Research Analysts' Conflicts of Interest
Dec. 2002	Securities and Exchange Commission (SEC), New York Attorney General (NYAG), NASD, North American of Securities Administrators Association (NASAA), New York Stock Exchange (NYSE) and State Regulators Announce Research Analyst Global Settlement
Feb. 2003	SEC Adopts Regulation Analyst Certification (AC)
Apr. 2003	Global Settlement of Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking
Aug. 2003	NASD Notice to Members 03-44 SEC Approves Amendments to Rules Governing Research Analysts' Conflicts of Interest
Mar. 2004	NASD And NYSE Provide Further Guidance On Rules Governing Research Analysts' Conflicts Of Interest
Mar. 2004	SEC Approves NASD Research Analyst Qualification and Examination Requirements (Series 86/87)
Nov. 2004	SEC Staff Interpretive Responses Relating to the Global Research Analyst Settlement (Q&As)
Nov. 2004	NASD Notice 04-81: SEC Approves New NASD Qualification Requirements for Supervisors of Research Analysts
Feb. 2005	*NASD and NYSE Extend Exemption from Analyst Qualification Exam to Technical Analysts That Have Passed the CMT Level II.*
Apr. 2005	*SEC Release Regarding the NYSE Definition of Research Analyst*
Apr. 2005	*NASD and NYSE Exemptions from 86/87 for Certain Employees of Foreign Affiliates*

[1] See "Update On Research Management Issues: SIA Research Management Conference," *SIA Research Reports*, Vol. 5, No. 11, Oct 27, 2004, www.sia.com/research/pdf/RsrchRprtVol5-11.pdf.

[2] Review of history of research analyst regulation is largely drawn from a presentation made by Frank Fernandez to the Toronto CFA Society, February 15, 2005, in Toronto, Ontario.

[3] The timeline is drawn from the SIA and SEC websites (www.sia.com and www.sec.gov).

Research Analyst Qualifications

Much of the regulation and guidance which has emerged over the last six or seven months has revolved around research analyst and research analyst supervisor qualification exams. The majority of these changes were responses to industry questions or suggestions to help make the rules fit with actual practices – and to also clarify how some practices needed to be altered to fit the new regulatory regime. As an example of a rule being altered to conform to practice, the NASD and NYSE in February 2005 exempted technical analysts who have passed the CMT Level II exam from taking the Series 86 exam, which tests knowledge of financial analysis that is irrelevant to the provision of technical analysis.[4]

Another area of great concern to globally active firms is how to reconcile the many and often conflicting rules concerning the provision of research in the myriad jurisdictions in which they do business. Although the harmonization or convergence of research analyst regulation is not yet on the horizon, the NASD and NYSE took steps in April 2005 to ease the burden on firms with employees in certain approved jurisdictions.[5] While the release is not perfect – it omits several major jurisdictions and adds some confusion in terminology – industry participants are hopeful that with a little work the exemption will provide much needed relief from duplicative regulation.

An emerging opinion among some research managers and related legal and compliance managers is that since the NYSE and NASD have established standards for research analysts, it is time to reconsider whether it is truly necessary or appropriate to require research analysts to pass the Series 7 exam. The Series 7 is, after all, the examination designed for sales people, and tests many areas that are irrelevant for the provision of equity analysis. Any questions from the Series 7 deemed necessary could be added to the Series 87, and thereby save much time and money for both firms and individuals, without any loss of rigor in qualification standards. The SIA is examining this issue, and if an industry consensus is reached, will make the suggestion.

Other Research Analyst-Related Regulatory Developments

The SEC recently issued a release concerning the NYSE's proposal to harmonize its definition of "research analyst" with that of the NASD.[6] The proposal is broadly supported by the industry and SIA issued a comment letter on May 11, 2005 echoing that support.[7] While supporting the amendment for bringing the NYSE definition closer to the NASD definition, the comment letter points out that the NYSE proposal includes a proposed definition of "associated person" as including any person who is engaged in a "kindred business" to investment banking or securities. Since the term "kindred business" does not appear in the NASD definition of "associated person" and is vague, the SIA letter suggests that it be removed from the NYSE definition.

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4 NASD Notice to Members 05-14, www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_013390.pdf.

5 NASD Notice to Members 05-24, www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_013741.pdf. These jurisdictions include, for example, the United Kingdom, China, Singapore and Japan, but currently do not include Canada, Germany, France and Spain.

6 SEC Release No. 34-51545, www.sec.gov/rules/sro/nyse/34-51545.pdf.

7 See www.sia.com/2005_comment_letters/6374.pdf.

Also raised in the SIA letter is the subject of issuer retaliation against research analysts. SEC Chairman Donaldson recently commented on the topic[8], and SIA took the opportunity to state its concern about the threat that retaliation presents to research independence. Analysts have reported that some issuers may take "steps to punish analysts or their employers for research coverage that an issuer found too negative for its liking." The letter, while expressing appreciation for Chairman Donaldson's remarks, requests that the SEC and/or self-regulatory organizations (SROs) consider adopting rules to address this issue.[9]

Another topic being discussed among industry participants is the interpretation of the NASD's rules concerning a publishing quiet period surrounding stock issuance[10]. The publishing prohibition has the perverse effect of restricting rather than increasing the amount of information available to investors. At its simplest, research analysts who work for firms that participate in an issuer's underwriting syndicate are forbidden to publish research, or even discuss the issuer with clients, during a fixed period before and after the issuance takes place unless there is public material information that can justify a change in view. The only action such an analyst can take if they have a negative view during that period is to pull their rating without an explanation, which could be viewed as contradictory to the rule requiring publishing a final research piece when dropping coverage. While institutional investors may understand silence or the pulling of a rating, it is unlikely that the average retail investor is as sophisticated. This interpretation of the rule, which effectively shuts down analysts when they want to publish and forbids them from speaking with clients who have questions, is surely an unintended consequence. Several approaches to remedying this situation have been discussed, including requesting an improved interpretation or requesting a reexamination of the rule in its entirety.

Litigation Update

The most notable recent research-related decision was the April 19, 2005 Supreme Court decision in *Dura Pharmaceuticals, Inc., et al v. Michael Broudo, et al*. In an *amicus curiae* brief[11], SIA and The Bond Market Association (TBMA) argued that the Ninth Circuit's ruling opened the door to frivolous litigation by permitting plaintiffs to move forward with securities class action lawsuits even if any alleged wrongdoing did not result in a decline in the security's price. The SIA-TBMA brief points out that the decision disregards the requirement imposed by the federal securities laws that an alleged misrepresentation caused a security's price to decline.

In the unanimous Dura decision the Supreme Court reiterated the principle of loss causation, "that the plaintiff is required to prove that there is a direct causal connection between a specific false statement and the subsequent decline in the value of the security once the truth was revealed."[12] This decision reinforces and clarifies the standard that potential plaintiffs must

[8] Remarks by SEC Chairman William H. Donaldson to The Bond Market Association, April 20, 2005, www.sec.gov/news/speech/spch042005whd.htm.

[9] SIA has made its own efforts to educate issuers on the terms of the new research analyst regulations, see www.sia.com/analyst_integrity/pdf/AnalystsSettlement.pdf.

[10] NASD Notice to Members 02-39, www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003620.pdf.

[11] For the press release on amicus brief, see www.sia.com/press/2004_press_releases/02790460.html.

[12] Brad Hintz, "U.S. Securities Industry: A Legal Win for the Industry," *Bernstein Research Call*, April 21, 2005.

pass to be able to bring suit thereby lessening the likelihood of frivolous lawsuits, but it should not prohibit legitimate cases from going forward.[13]

Independent Research Providers

One of the terms of the April 2003 Global Research Settlement[14] is the requirement that the settling firms provide independent third-party research from no fewer than three third-party research providers to retail customers for all stocks covered by their own in-house research analysts. This provision requires that the firms spend over $430 million on third-party research over a five-year period and retain an SEC-approved independent consultant to choose the research providers. Hailed as a boon for the development of third-party research, the results of this requirement have yet to be fully evaluated, although preliminary reports have been mixed.

The first official reports by the SEC-mandated research consultants are not due until October, but it seems clear that the settlement was not the outright bonanza to independent research providers that some had touted. While there was an explosion in the number of third-party research firms applying for settlement business, it appears that established research houses with very broad offerings and the research aggregator business model have benefited most.[15] Research aggregators allow subscribers to choose among a wide range of independent research providers and to switch among them. According to one estimate, out of the 350 to 400 independent research providers in the market (up from 40 only five years ago), 65 won settlement firm contracts.[16] The vast majority of independent research providers receive no direct benefit from the global settlement, leaving some struggling to find a workable business model.

Although the global settlement mandates the 10 firms spend over $85 million per year on independent research, the research providers are finding them tough customers. Some reports stress the difficulty the small independent boutique research firms have had meeting the settlement consultants' time deadlines, which are stringent.[17] Some research providers have reportedly been unable to meet such deadlines and have lost contracts. To combat the workload and to broaden their offerings, smaller providers are forming consortiums.

Another issue is the attempt to determine whether independent research is actually better than in-house research. This is a very tricky judgment and it is difficult to define what 'better' means. Important metrics include whether buy-side clients are actually reading research, whether they are using it to make investment decisions, and the relative performance of investment recommendations. Independent consultants or evaluation services often provide such evaluations, although some firms are bringing these capabilities in-house and even offering them as services to third parties.[18]

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[13] Josh Freidlander, "Supreme Court Eases Research Burden," *IDD*, May 2, 2005, p. 11.

[14] See www.sec.gov/spotlight/globalsettlement.htm.

[15] Liz Moyer, "Research's Report Card," Forbes.com, April 14, 2005.

[16] Amy Stone, "Still Outside Looking In," BusinessWeek Online, May 5, 2005.

[17] New research reports must be provided whenever a news event happens or every 90 days, whichever comes first, according to "Indies Struggle to Keep Up With Stringent Specs," *Wall Street Letter*, April 25, 2005, pp. 1, 7.

[18] For example, see: "Investars Launches New Research Performance Measurement Tool," *Wall Street Letter*, January 17, 2005, pp. 1, 10-11; "Citigroup Plans New Indie Research, Consultancy Business," *Wall Street Letter*, February 14, 2005, pp. 1, 11; and, "Deutsche Bank's Monitor Develops Own Performance Measurement System," *Wall Street Letter*, February 28, 2005, pp. 1, 10-11.

One of the many wild cards that make predicting the future of independent research so difficult is the ongoing debate over soft dollars.[19] While it seems unlikely that regulators will ban the use of commission dollars to pay for legitimate research product and services, the fact that such a decision is still pending may have had a chilling effect on the development of new business models. Although market participants believe that regulators are much more likely to narrow the scope of products and services that may be paid for with soft dollars, rather than an outright ban, some buy-side clients have already shrunk their use of soft dollar arrangements.

One market observer estimated that soft dollar arrangements are used to pay for 80% of independent research[20], but that percentage has been, and continues to, decline. Continuation of the trend towards using fewer soft dollars, not to mention the impact of any future restrictions on the use of soft dollars, would have serious, negative repercussions for the market for third-party research. As one commenter noted "The decision [on soft dollars] could make or break independent research as a viable business."[21]

Sell-Side Research

Decisions on the future use of soft dollar arrangements are of no less importance to the provision of in-house research. Currently, payment for in-house research is bundled into the commission paid by customers. Among the discussions regarding soft dollars is the potential 'un-bundling' of the price of in-house research from the price of execution-related services. Even if clients are allowed to continue to pay for in-house research with commissions, calculations of how much to charge a customer for such research are likely to be required. There have been predictions that unbundling will hurt the large sell-side research effort as clients decline to pay for it once the costs are known and will actually help third-party providers who often provide a less expensive service.

In-house research departments are expensive to maintain, and firms that want to continue to offer a full-service product are getting creative about how to develop a viable business model. Some firms have stressed lowering their costs by cutting staff, replacing senior research analysts with more junior analysts, and outsourcing routine number crunching tasks to services located in India and other, lower cost locales.[22] Regulatory and compliance requirements, however, create a very high fixed cost for broker-dealer research departments that cannot be overcome by creative cost shifting. If research is a service that sell-side firms want and need to provide to their clients, greater consideration of the cost of regulation – and the cost of continually evolving regulation – will have to be taken into account, and mitigated.

Since the global settlement and the separation of research from the investment banking business, settlement firms have been severely challenged to bring the cost of providing in-house research in line with post-settlement realities. Research department budgets have been severely cut – down by over 40% in line with the general reduction in expenses and in response to the withdrawal of the investment banking contribution and the slow down in corporate issuance

[19] "Soft dollars" is a term that refers to the market practice of paying for research, both sell-side and third party, using commissions from securities transactions.

[20] Op. Cit. 17.

[21] Op. Cit. 16.

[22] "Outsourcing Firm Boosts Research," *Wall Street Letter*, April 18, 2005, p. 4.

over the past several years.[23] There is a limit to how much firms can cut compensation – and a limit to how much work their greatly reduced research staffs can do. Firms are covering fewer companies, but with even greater cuts in staffing levels that translates into research analysts covering a greater number of companies.

So far, sell-side firms have not come up with an answer to the question "what is the new business model after the global settlement?" but they continue to reach for an answer. The commitment of firms to maintain a significant in-house research product appears to remain firm. However, in the competitive and rapidly evolving market for investment ideas, the nature of that product and how it is provided will likely continue to change.

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[23] See, for example: Will Leach, "Indie Research (A Non-Event So Far)," *Registered Rep*, April 2005, pp. 57-58, 60 and Adrian Cox, "Wall Street Analysts' Pay Tumbles After Settlement," Bloomberg.com, January 10, 2005.

Appendix 1

Summary of Global Settlement Terms

Structural Reforms

— Separate research and investment banking: physical location, reporting lines, legal and compliance staff, and budgeting processes.

— Research analysts' compensation cannot be based directly or indirectly on investment banking revenues or input from investment banking personnel.

— A research analyst's compensation will be based in significant part on the quality and accuracy of analyst's research and decisions about compensation will be documented.

— Investment banking will have no role in determining which companies research analysts cover.

— Research analysts will not solicit investment banking business, including pitches and roadshows.

— Firms will implement policies and procedures reasonably designed to assure that investment banking does not influence the content of research reports.

— Firms will create and enforce firewalls between research and investment banking to prohibit improper communications.

— Each firm will retain an Independent Monitor to conduct a review to provide reasonable assurance that firm is complying with the structural reforms.

Enhanced Disclosures

— Required conflicts of interest disclosure on the first page of research reports.

— When a firm terminates coverage of a company it will issue a final report discussing the reasons for termination.

— Each quarter, the firm will publish on its website a chart of its research analysts' performance, as well as an explanation of the firm's rating system.

Independent Research

— For a five-year period, each firm will be required to contract with no fewer than three independent research firms and make the independent research available to the firm's customers.

— An independent consultant for each firm will have the final authority to procure independent research.

Investor Education

— Firms will make a payment, part of which will be put into an Investor Education Fund and the rest to be paid to state securities regulators.

Appendix 2

Summary of Regulation AC Requirements

— Clear and prominent certifications in research reports by the research analyst that the views expressed in the report accurately reflect his or her personal views, and disclosure whether or not the analyst received compensation or other payments in connection with his or her specific recommendations or views; and

— Periodic certifications by research analysts in connection with the analyst's public appearances.

Appendix 3

Summary of SRO Rules

Analyst Qualification Examinations

— Series 86 (Analytical) and Series 87 (Regulatory).

— Prerequisite of Series 7, 17, 37 or 38 required.

— Exemption from Series 86 for certain persons who have passed CFA Level II and for technical analysts that have passed CMT Level II.

— April 4, 2005 deadline.

Supervisor Qualification Examinations

— Dual NASD/NYSE members must have a principal who has passed either (1) Series 24 and Series 87 or (2) Series 16 to supervise the content of research.

— If a Series 16 approves the content of research, then a Series 24 principal who has passed either Series 87 or Series 16 must supervise the conduct of the Series 16 Supervisory Analyst and the research analyst.

— August 2, 2005 deadline.

SRO Rules Similar to those in Global Settlement

— Prohibition on analysts participating in pitches and solicitation efforts.

— Separate reporting lines for research and investment banking.

— Compensation restrictions and annual review.

— No promises of favorable coverage.

— Termination of coverage.

SRO Rules Not Addressed in Global Settlement

— Personal trading.

— Lock-up Rules.

— Retaliation.

THE EFFECTS OF MARKET TECHNOLOGY, GLOBALIZATION AND COMPETITION ON DOMESTIC MARKET DEVELOPMENT AND REGULATION[1]

The combination of rapid and profound technological change; glacial, but ongoing globalization; and intense competition is driving revolutionary and evolutionary change in domestic capital markets in both developed and developing countries, leading to increased vertical and horizontal integration globally. Demutualization, mergers and acquisitions, and regulatory changes in market structure are just some of the manifestations of these drivers that are transforming increasingly integrated, complex, fast, efficient and transparent global financial markets. These trends raise a number of questions, some of which we will consider today, including:

1) What should be the role of government in attempting to address potentially conflicting economic goals, which is consistent with sound securities regulation objectives?

2) How should market regulation adapt to address competing markets or automated trading systems with a view to assuring optimal price discovery, best execution and market liquidity?

3) Are restrictions on accessing foreign markets or trading in foreign securities necessary or desirable to foster domestic economic development policies?

4) What additional regulatory issues arise when markets demutualize?

5) Does every country need its own securities market? Would it be preferable to encourage regional or integrated markets?

A Question of Balance and Understanding

Q: **What should be the role of government in attempting to address potentially conflicting economic goals, which is consistent with sound securities regulation objectives?**

A: Potentially conflicting economic goals are inevitable in markets that accommodate the interests of multiple issuers and investors, buyer and sellers, and the financial services providers that facilitate these activities by executing and processing transactions. Managing these conflicts and balancing the interest of all market participants – issuers, investors (retail and institutional) and financial intermediaries – are integral components of the roles governments take on in pursuing sound securities regulation.

Regulators must also ensure orderly primary and secondary markets. Primary markets ought to facilitate capital formation that is fair, orderly and efficient. Secondary market stability also requires that adequate liquidity and continuity are always present. Market efficiency has many dimensions, and the bar is constantly rising in response to the pressures of vigorous competition, globalization and rapid technological innovation. Market

[1] Remarks prepared by Frank A. Fernandez for a panel discussion at the U.S. Securities and Exchange Commission's International Institute for Securities Market Development, April 25, 2005.

participants demand and receive increasingly faster, cheaper, better performance. Improved price discovery, more rapid order entry and execution, and increasingly seamless trade processing are dictated by both regulation and by intense competition.

Regulation must be efficient and balanced, weighing the need for flexibility in the face of rapidly evolving and increasingly interdependent global financial markets with recognition of the value of permanence, predictability and coherence. Regulation should be responsive to market structure evolution and keep pace with the rapidly adaptive and innovative financial services industry offerings of increasingly diverse and often complex products and services.

But this need for change should be tempered by recognition of the costs, how these costs are distributed (which may favor one group of market participants at the expense of another) and their potentially disruptive effects. Take for example regulations that carry a high fixed-cost component. These tend to place a disproportionate share of the costs of compliance on small- and medium-sized firms, imposing significant competitive restraints in an industry that already has high barriers to entry and significant and growing economies of scale that encourage increased concentration and vertical and horizontal integration. Fortunately, regulators are generally sensitive to this issue, granting safe harbors and exemptions for small firms.

Although regulators must be agile, flexible and swiftly responsive to shifting market and industry conditions, they need also be cognizant that changing legal and compliance standards is a costly and disruptive affair, particularly to an industry characterized by narrowing margins, high capital investment requirements and relatively rapid obsolescence. Market stability and efficiency are fostered by a level playing field that does not shift frequently and that is governed by rules and regulations that are reasonably durable.

Regulators must carefully weigh the costs and benefits of each new rule to ensure that markets are fair, efficient and orderly, and that public trust and confidence is maintained without being unduly restrictive (to avoid stifling innovation) or unduly burdensome (to avoid stifling competition). This is not an easy task. Often times the benefits are "soft" or intangible and hence not easily quantifiable. But it is neither helpful nor amusing to say they are "priceless" and so undermine a balanced appraisal of costs and benefits.

To achieve this difficult goal of balanced and efficient regulation requires a thorough understanding of market dynamics and of what fosters and what represses market growth and development. For example, as Lee[2] points out the "success of a stock exchange depends on many factors beyond the control of the exchange itself." Some of the factors are subject to the vagaries of the global or local economies, or the arrival of the "perfect" or "hundred year" storm which seems to come several times every decade. But many of the factors are within the control of regulators. These include:

— Ensuring the provision and continuity of issuance and trading infrastructures – so-called market structure and trading issues. Depth of understanding of technological and operations (tech/ops) issues can be enhanced by working with private sector market

[2] Ruben Lee, "Changing Market Structures, Demutualization and the Future of Securities Trading," pp. 283-303, in *The Future of Domestic Capital Markets in Developing Countries* (Robert E. Litan, Michael Pomerleano and V. Sundararajan eds.) Brookings (2003).

participants. The progress toward straight-through processing and business continuity planning efforts are two examples of the success of this type of public/private partnership;

— Fostering breadth, depth and heterogeneity of market participants so as to minimize market and liquidity risk and ensure orderly and equitable market conditions – and acting forcefully and expeditiously when market failures inevitably occur. For developing countries, this may include affirmative efforts to foster the development of both domestic retail and institutional investors; and,

— Establishing legal and compliance standards and maintaining effective enforcement of these standards in order to ensure protection of shareholder and investor rights and orderly market operation. Coherent and effective corporate governance, accounting, listing, issuance, trading and transparency standards are also part of an effective regulatory regime.

Focus on Float and Flow

Q: **How should market regulation adapt to address competing markets or automated trading systems with a view to assuring optimal price discovery, best execution and market liquidity?**

A: The recent discussions on Regulation NMS have provided adequate airing of views on what constitutes optimal price discovery and best execution, and what is required to attain it, so we need not retrace this well-trod ground. Other issues posed by competing markets and automated trading systems are rapidly being resolved as excess capacity is absorbed through mergers and acquisitions, while the need for greater connectivity to ensure optimal order interaction and best execution is being addressed with the establishment of effective market linkages. Increased transparency, harmonization of divergent market rules and cross-border standards would go a long way towards advancing these goals.

Ensuring adequate market liquidity in terms of breadth, depth and immediacy of order flow requires active, efficient market centers. Ensuring balanced, deep and continuous order flow and adequate trading float in individual securities best minimizes liquidity risk. This might appear to be increasingly problematic given the rapid growth and increasing integration of global capital markets, the accelerating speed with which financial transactions occur and the increasing use of leverage employed in the marketplace. However, improved risk management practices, increasingly efficient and sophisticated operational systems, harmonization of cross-market and cross-border standards and improved supervisory and regulatory practices are all helping to meet this challenge. However, ensuring adequate market liquidity may be one of those factors outside the reach of the regulatory authorities, other than to ensure market access and enhance public trust and confidence in fair, orderly and efficient market operation in the manner outlined above. Order flow attracts order flow and liquidity begets liquidity, generally in a manner impervious to regulatory actions.

Controlling Contagion, Cascade Effects and the Migration of Domestic Savings

Q: **Are restrictions on accessing foreign markets or trading in foreign securities necessary or desirable to foster domestic economic development policies?**

A: No. Restrictions on accessing foreign markets or trading in foreign securities are not necessary to foster most domestic economic development policies. This assumes the goal of such policies is not autarky or complete self-sufficiency in capital formation and the asset management process. Even in the unlikely case that isolation is the goal, globalization and increasing cross-border integration of financial markets make the task of imposing effective capital controls increasingly problematic. Neither are capital controls desirable in most cases, in that they carry high costs, impose significant distortions and hence should be discouraged in all but crisis situations.

However, freeing up outward investment to larger, more liquid and more efficient market centers is likely to reduce both domestic listings and local trading activity to the point of endangering the viability of domestic markets. Linkages between developing country exchanges are unlikely to be successful in maintaining the viability of marginal markets, in that the size of the linked or consolidated virtual exchange is still likely to be below the "critical mass" necessary to compete with larger, developed country exchanges. Closing the borders to this larger pool of capital and investment opportunities is more likely to hinder than help domestic capital formation and investment.

Problems of Demutualization

Q: **What additional regulatory issues arise when markets demutualize?**

A: A wealth of issues arise when a market demutualizes. The recent announcement of the New York Stock Exchange (NYSE) of its plans for restructuring as a for-profit entity provides a good example. Of course there are the issues of regulatory approval, and the mechanics of demutualizing, but these do not seem to be too problematic. Two of the most critical issues will be what changes in the role of the self-regulatory organization (SRO) are required and how will the SRO operations be funded and governed. The NYSE's SRO will have to be separated from the exchange just as the NASD spun off NASDAQ (although the mechanics of the separation may be different). This is because it is difficult to place a not-for-profit SRO under the roof of a for-profit holding company, the NYSE Group. What relationships the two entities would have or should have is not clear, but distinct governance structures and separate legal frameworks appear to be a minimum requirement. This could lead to adoption of the Hybrid SRO concept long advocated by the Securities Industry Association.[3]

Funding an SRO and a for-profit demutualized exchange also pose questions. Most of the traditional revenue streams available to an exchange and its SRO are drying up or are becoming difficult to hold onto. Traditionally, exchange revenues come from: membership subscriptions or assessments; listing fees; trading/transaction fees; clearing and settlement charges; and, market data fees (for the dissemination of quote and trade data). It appears

[3] See "Reinventing Self-Regulation," White Paper for the Securities Industry Association, January 5, 2000, Updated by SIA Staff, October 14, 2003, www.sia.com/market_structure/html/siawhitepaperfinal.htm.

likely that an SRO spun off from the NYSE would be funded by assessments on those securities firms subject to its supervision. The exchange itself will be increasingly dependent on listing fees and revenues derived from market data, although both these sources raise extremely contentious issues that have stimulated intense debate in the past and are likely to do so again. Clearing and settlement fees rarely accrue to exchanges and transaction fees have been squeezed to bare minimums.

A Source of National Pride

Q: **Does every country need its own securities market? Would it be preferable to encourage regional or integrated markets?**

A: No. It would be preferable to encourage regional or integrated markets, and in the case of linkages between developed markets (Euronext[4], NOREX[5] and HEX/OM[6]) the record is quite good in terms of the benefits of horizontal integration. In the case of developing countries the record is quite poor: "Of the many attempts at cooperation between exchanges that have been proposed, few have been implemented, of those that have been realized, most have failed."[7] The principal problem, as noted above, is that the larger entity that emerges from integration of individual developing country exchanges or a regional developing country market are still unlikely to have sufficient size to compete with the larger developed markets.

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Senior Vice President, Chief Economist and Director, Research

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[4] Euronext is the result of a merger carried out on September 22, 2000, between the French (SBF), Belgian (BXS) and Dutch (AEX) stock exchanges. Euronext subsequently also bought the London International Financial Futures Exchange (LIFFE) and the Lisbon Stock Exchange.

[5] Norex is a strategic alliance between four of the five Scandinavian stock exchanges, namely those in Denmark, Iceland, Norway and Sweden. Norex was founded on January 21, 1998 when the Stockholm Stock Exchange and the Copenhagen Stock Exchange signed a formal cooperation agreement. The Oslo Bors and the ICEX joined subsequently, and the SAXESS trading system became operational for all four partner exchanges in 2001. See www.norex.com for more information.

[6] The HEX Group, operator of the Helsinki Stock Exchange, bought 62% the Talinn Stock Exchange in Estonia in April 2001 and 93% of the Riga Stock Exchange in Latvia in August 2002 and later merged with the OM, the Swedish Stock Exchange.

[7] Op. cit., 1.

CREDIT RATING AGENCIES[1]

In June 2003, the U.S. Securities and Exchange Commission (SEC) issued a concept release soliciting public comment on various issues regarding credit rating agencies, including whether credit ratings should continue to be used for regulatory purposes under the federal securities laws, and, if so, the process of determining whose credit ratings should be used and the level of oversight to apply to such credit rating agencies.[2] To address certain issues raised in response to that concept release, particularly with regard to the clarity of whether a credit rating agency qualifies as a "nationally recognized statistical rating organization" (NRSRO), the SEC recently proposed defining the term NRSRO in new Exchange Act Rule 3b-10 and to provide interpretations of that definition.[3] The SEC originated the term NRSRO thirty years ago for the narrow purpose of permitting broker-dealers to use certain credit ratings to determine the capital charges on different grades of debt securities under the Commission's net capital rule, and since that date, no-action letters have been issued for nine NRSROs, although there are fewer now due to consolidation in the industry.[4]

The SEC proposed defining the term NRSRO as an entity:

(1) that issues publicly available (*widespread dissemination at no cost*) credit ratings that are current assessments (*actively monitored and updated appropriately on a continuous basis; assessments that reflect the NRSRO's opinion as to the creditworthiness of a security or money market instrument as of the time the rating was issued and until the rating is changed or withdrawn; updated on the occurrence of a material event*) of the creditworthiness of obligors with respect to specific securities or money market instruments;

(2) that is generally accepted in financial markets as an issuer of credible and reliable ratings, including ratings for a particular industry or geographic segment, by the predominant users of securities ratings; and,

(3) that uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of nonpublic information, and has sufficient financial resources to ensure compliance with those procedures.

Providing this definition meets one of the recommendations that the Securities Industry Association (along with most of the commenters to the SEC) has made for a number of years. Specifically, that the SEC should promote transparency in the criteria for ratings agencies and needed to provide more detail on what credit rating agencies need to provide to obtain an NRSRO no-action letter. SIA believes that eliminating the NRSRO concept would be disruptive to capital markets and would be costly and complicated to replace. The regulatory use of credit ratings issued by NRSROs provides a simple, efficient benchmark of credit quality and

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1 Presentation by Frank Fernandez to Bear Stearns' Ratings Agencies / Information Services Day, May 12, 2005.

2 Securities Act Release No. 33-8236, 68 FR 35358, June 2, 2003. The 2003 Concept Release was intended to assist the SEC in addressing issues identified in its January 24, 2003 report on credit rating agencies, which was required by Congress under Section 702 of the Sarbanes-Oxley Act of 2002. See report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, U.S. Securities and Exchange Commission, January 2003, www.sec.gov/news/studies/credratingreport0103.pdf.

3 U.S. Securities and Exchange Commission, "Definition of Nationally Recognized Statistical Rating Organization; Proposed Rule", Securities Act Release No. 33-8570, 17 CFR Part 240, April 25, 2005, www.sec.gov/rules/proposed/33-8570.pdf.

4 U.S. Securities and Exchange Commission, Annette L. Nazareth, Speech by SEC Staff: NRSRO Proposal Opening Statement at March 3, 2005 Open Commission Meeting, Washington, D.C. March 4, 2005, www.sec.gov/news/speech/spch030305aln.htm.

regulatory standards. Providing a clear definition of the term NRSRO, along with details on what is needed to obtain a no-action letter, would afford much needed clarity and transparency in the process, which should add competition in this arena by removing one of the barriers, e.g. the lack of definition of the accreditation standards. Indeed, the current process has been described as opaque and Kafkaesque.[5]

The proposed definition also requires that credit ratings be kept current (actively monitored on a continuous basis and adjusted as necessary) and that the definition is limited to firms that issue security specific ratings. The latter requirement is important because the risk of loss on a particular debt of an issuer can vary considerably depending on the particular type of security and the specific terms written into the security's legal documentation.

The second "prong" of the proposal allows the term to be applied to credit rating agencies that confine their activities to a limited sector of the debt market or a limited (or non-U.S.) geographic area, which lessens barriers to entry and competitiveness problems. In this regard, the SEC staff will issue a no-action letter for A.M. Best, a rating agency that specializes in the insurance area, but which can grow to be an NRSRO in the full sense of the term.[6]

The SEC also provides guidance in the proposal as to how entities can demonstrate compliance with the definition, including through attestations or interviews of key personnel at the predominant users of securities ratings. The third component of the proposal is set forth to ensure that the NRSRO has sound business practices and procedures designed to produce credible and reliable ratings and has processes in place for communicating to the marketplace how these procedures are followed and that its ratings can be used for regulatory purposes. These include procedures to ensure that NRSRO analysts are competent (have adequate experience and training to be able to identify, understand and analyze information relevant to the issuers whose securities they rate) and to assess the integrity of the information upon which the ratings are based. The proposal also requires that NRSROs use systematic procedures to manage potential conflicts of interest, prevent the misuse of nonpublic information, and have sufficient financial resources to ensure compliance with these procedures.

The scope of the proposal is limited, however. What it does not do is provide for ongoing oversight of the NRSROs, which the SEC believes may require additional legislative authority. In the absence of such authority, the SEC has sought to craft a "framework for voluntary oversight" by the Commission[7]. While this framework is still vague, it likely will include general adherence with the International Organization of Securities Commissioners (IOSCO) Code of Conduct Fundamentals, "which sets forth how credit rating agencies can protect their analytical independence, eliminate or manage conflicts of interest, and help ensure the confidentiality of non-public information."[8]

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5 U.S. Securities and Exchange Commission, Cynthia A. Glassman, Speech by SEC Commissioner: Statement Regarding the NRSRO Proposal before the Open Meeting, Washington, D.C., March 3, 2005, www.sec.gov/news/speech/spch030305cag.htm.

6 U.S. Securities and Exchange Commission, Harvey J. Goldschmid, Speech by SEC Commissioner: Statement at Open Meeting Regarding NRSRO Rule Proposal, Washington, D.C., March 3, 2005, www.sec.gov/news/speech/spch030305hjg.htm.

7 Op. cit. 3.

8 "Code of Conduct Fundamentals for Credit Rating Agencies, December 2004, IOSCO www.iosco.org/pubdocs/pdf/IOSCOPD180.pdf.

SIA, along with most commentators, believes that NRSRO credit ratings provide a "simple, efficient benchmark of credit quality" and that "elimination of the NRSRO concept would be disruptive to the capital markets."[9] "Credit rating agencies play an important role in the fixed income markets by providing investors and other market participants with an independent source of information regarding the relative creditworthiness of debt and other fixed income instruments as well as various corporate and other issuers . . . In cases where an issuer's credit standing is an important element in determining price, investors routinely factor into the price discovery process the ratings assigned by recognized rating agencies."[10]

In recent years, the credit rating agencies have been subject to criticism for failing to recognize and warn investors of the impending demise of such large companies as Parmalat, Enron and WorldCom.[11] Similar comments were leveled at the time of multiple emerging market sovereign debt defaults in the 1980s and 1990s. We note, however, that ratings issued by the major rating agencies have generally proved to be a reliable source of information for the fixed income markets. The reputational and commercial interests of the agencies provide a strong motivation to maintain the credibility of their ratings. Historically, a variety of studies have demonstrated a consistent and clear correlation between long-term corporate debt ratings and the probability of default.[12]

SIA believes that it would be unreasonable for market participants or regulators to expect perfection, i.e., that any rating agency, or ratings system, will act as a perfect evaluator of credit risk or quality. One reason for this is the complexity of evaluating the various objective and subjective factors that affect creditworthiness and reflecting them in a single symbolic rating. More importantly, rating agencies should not and cannot reasonably be charged with uncovering and evaluating all possible undisclosed risks or liabilities that might affect credit quality, or with uncovering fraud or other misconduct by issuers. Rating agencies, like other market participants, must be able to rely on the integrity of the audit process to produce financial information that is accurate and complete.

This is not to say that there is not room for improvement in the rating process. For example, SIA believes that the single most important factor in ensuring the integrity of credit research, whether performed by analysts at sell-side firms or at credit rating agencies, is vigilantly guarding the independence of those analysts from conflicting interests, whether such interests are personal (such as personal investments), professional (such as related investment banking or consulting businesses) or third party (such as issuers). It is these concerns, echoed by regulators, on potential conflicts of interest and the potential misuse of confidential information that have prompted calls for regulatory oversight beyond the "voluntary framework" now being contemplated.

Frank A. Fernandez
Senior Vice President, Chief Economist and Director, Research

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[9] Op. cit. 2.

[10] "Joint Comment Letter to the Association for Financial Professionals on the Exposure Draft of the Code of Standard Practices for Participants in the Credit Rating Process released June 1, 2004," Securities Industry Association and The Bond Market Association, June 30, 2004, www.sia.com/2004_comment_letters/pdf/CRAcode063004.pdf. The "Code of Standard Practices" may be found at www.afponline.org/pub/pdf/CSP.final.pdf.

[11] A significant minority of treasury and finance professionals from companies with rated debt believe that their company's credit ratings are neither accurate nor timely.

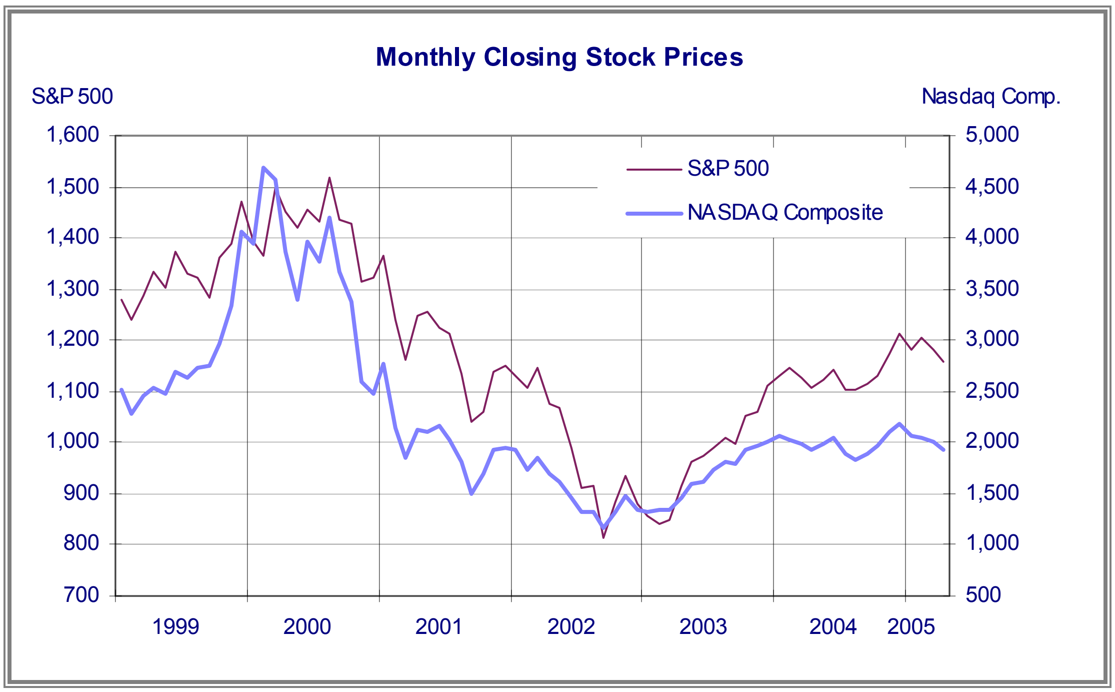
[12] See generally, "Credit Ratings and Complementary Sources of Credit Quality Information," Basel Committee on Banking Supervision Working Papers, No. 3 August 2000, www.bis.org/publ/bcbs_wp3.pdf.

MONTHLY STATISTICAL REVIEW

U.S. Equity Market Activity

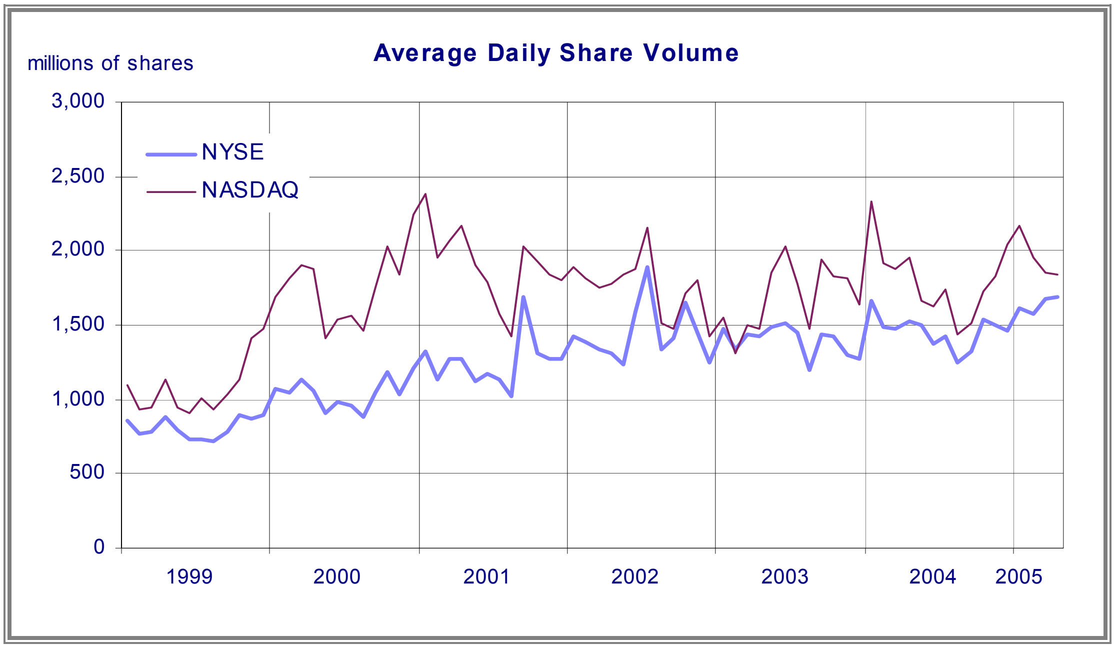
Stock Prices – The U.S. stock market continued to lose ground in April, as concerns over slowing economic growth and rising inflation dampened investor enthusiasm. The Dow Jones Industrial Average and the S&P 500 Index posted losses for the second consecutive month, with the DJIA falling 3.0% in April –- its biggest monthly drop since January 2003 – and the S&P 500 declining 2.0%. The March and April losses represented the first back-to-back monthly declines in both of these indices since March and April of last year. Meanwhile, the NASDAQ Composite Index slumped 3.9% in April, marking its fourth sequential monthly decline and the longest losing streak for this index since its six-month downturn from April-September 2002.

With April's declines, the Dow has fallen 5.5% so far this year, while the S&P 500 has lost 4.5%, and the tech-laden NASDAQ Composite has plunged 11.7%.



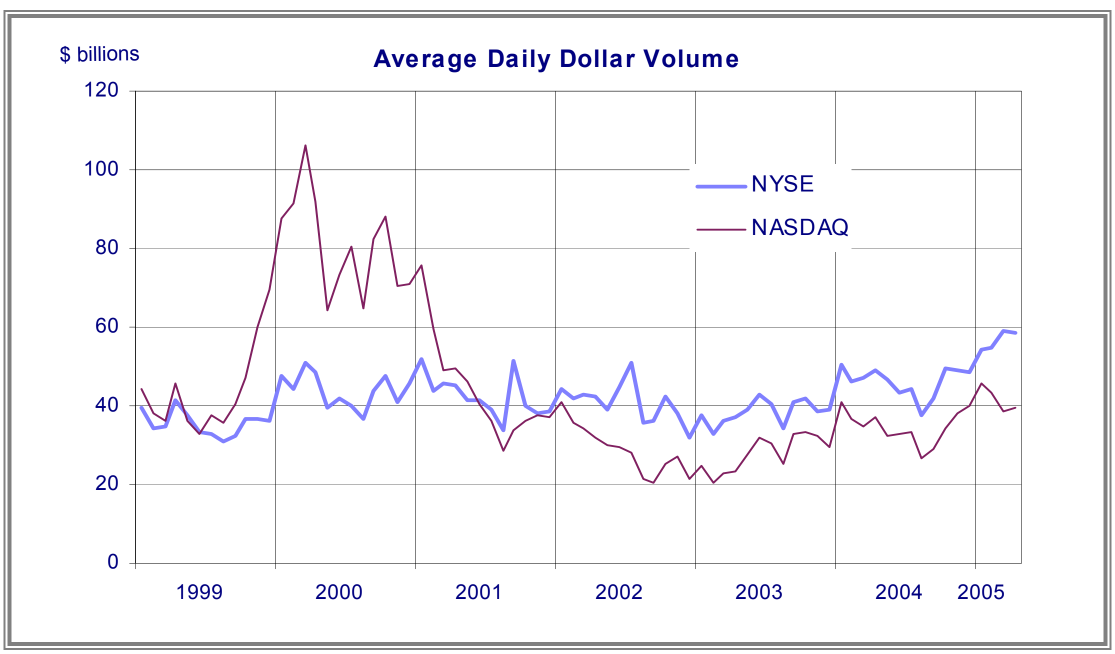
Share Volume – Trading activity was mixed on the U.S. markets in April. Average daily share volume on the New York Stock Exchange increased for the second straight month to 1.69 billion in April, 0.6% above March's results and its highest level since July 2002. That brought the year-to-date average to 1.65 billion, or 13.0% ahead of the annual record pace of 1.46 billion per day set in 2004.

On NASDAQ, average daily share volume slipped 0.5% from March's level to a new 2005 low of 1.84 billion in April. Despite trending downward since January, NASDAQ daily share volume year-to-date is still up 8.2% over last year, averaging 1.95 billion compared with 1.80 billion in 2004.

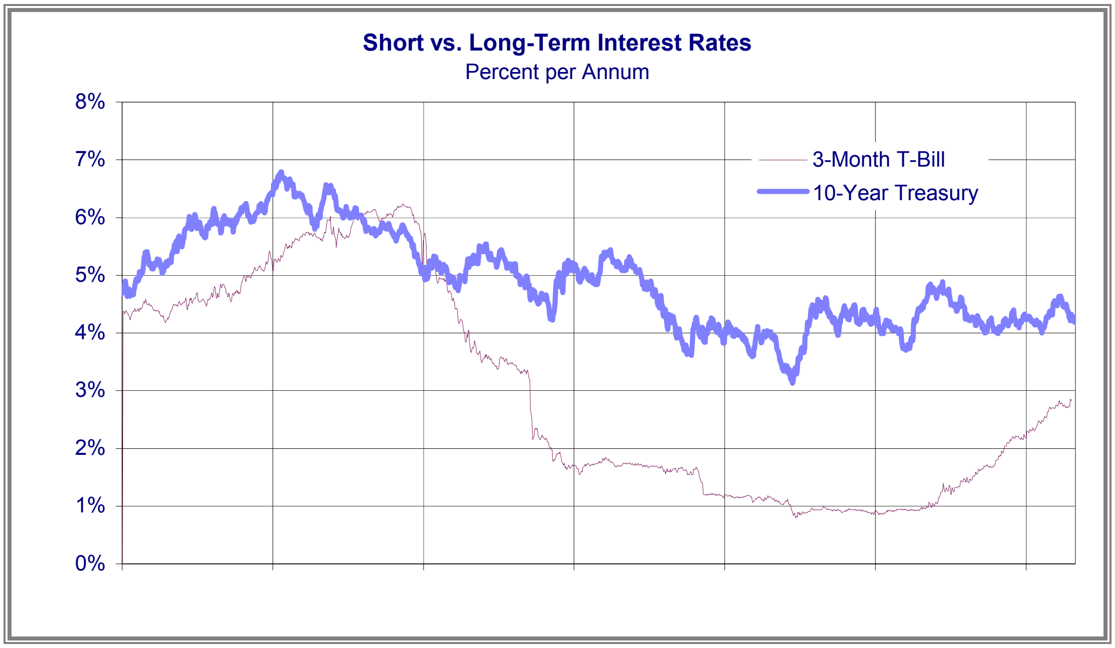


Dollar Volume – In April, NYSE average daily dollar volume registered its first monthly decrease since last December. After climbing to a record $59.1 billion in March, NYSE average daily dollar volume edged down 0.5% to $58.8 billion in April. Year-to-date, the daily value of trading in NYSE stocks averaged $56.7 billion, 23.0% above 2004's $46.1 billion average.

The average daily value of trading in NASDAQ stocks increased 2.1% from March levels to $39.6 billion in April following two consecutive monthly declines. That lifted the year-to-date daily average to $41.7 billion, up 20.5% from $34.6 billion during 2004.



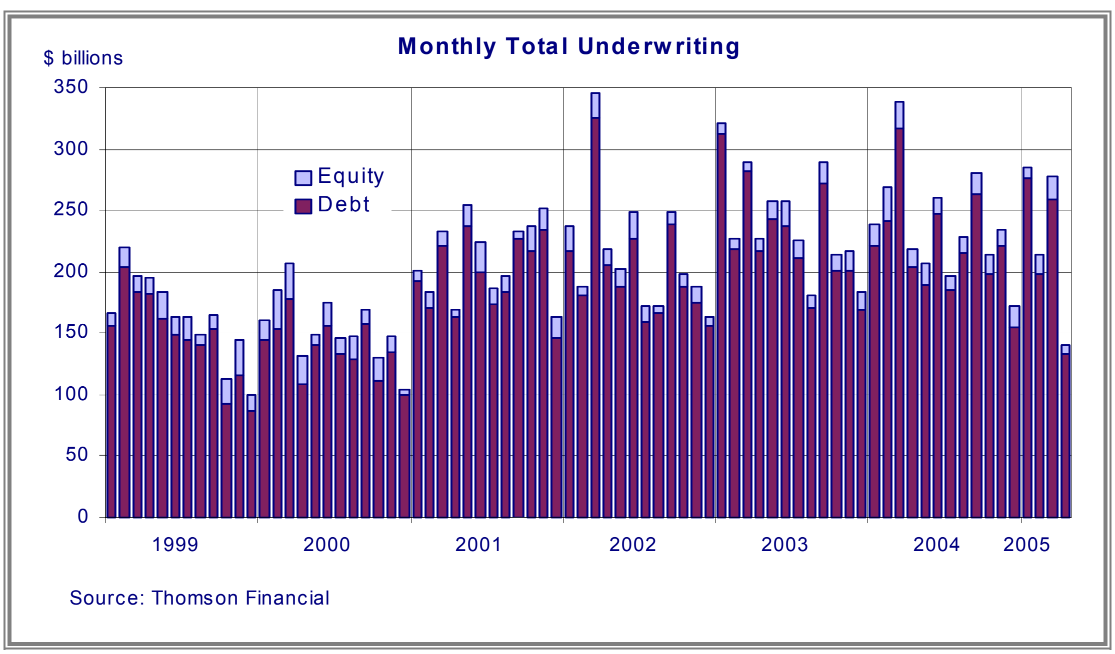
Interest Rates – A Commerce Department report showing weaker-than-expected first quarter Gross Domestic Product (GDP) growth of 3.1% (annualized) helped spark a rally in bonds during April. The yield of the benchmark 10-year Treasury note declined from 4.50% at the beginning of the month to 4.21% by month's end. Meanwhile, the yield on three-month T-bills continued to climb, increasing to 2.84% by April's close from 2.73% at the end of March. Thus, the spread between three-month and 10-year Treasury yields has narrowed to 158 basis points (bps) from 176 bps one-month earlier and 341 bps a year ago.



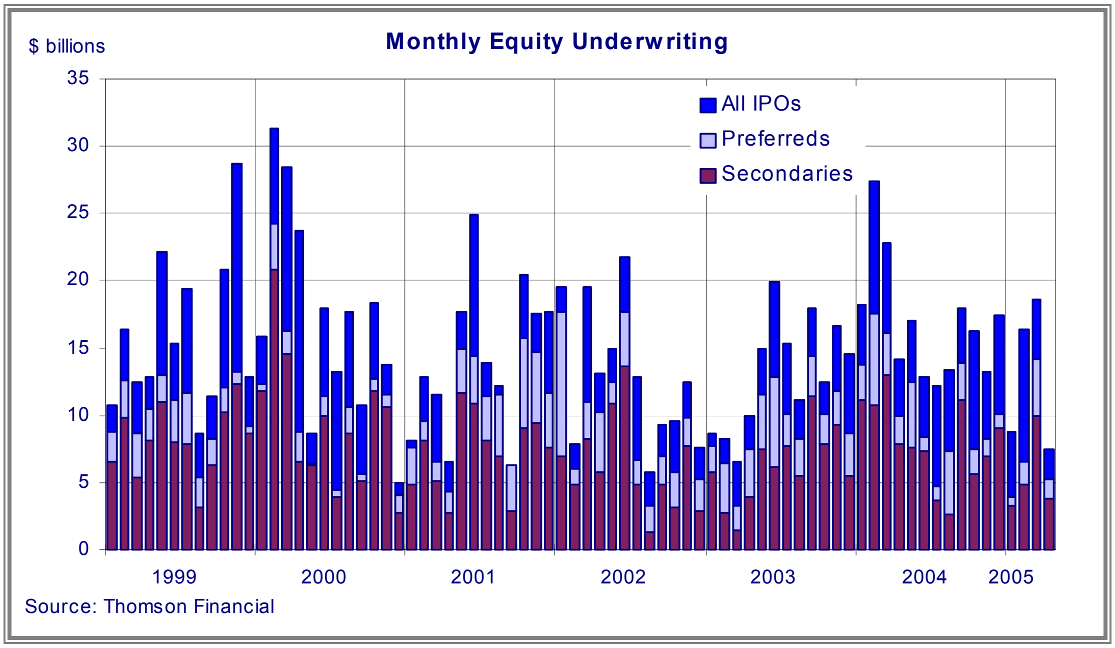
U.S. Underwriting Activity

Total underwriting activity in the U.S. market weakened considerably in April amid tough equity market conditions and widening corporate credit spreads. New issuance sank 49.6% from March's level to $139.9 billion, making it the slowest month since December 2000. A steep cutback in issuance of both corporate debt and equity contributed to the overall decline.

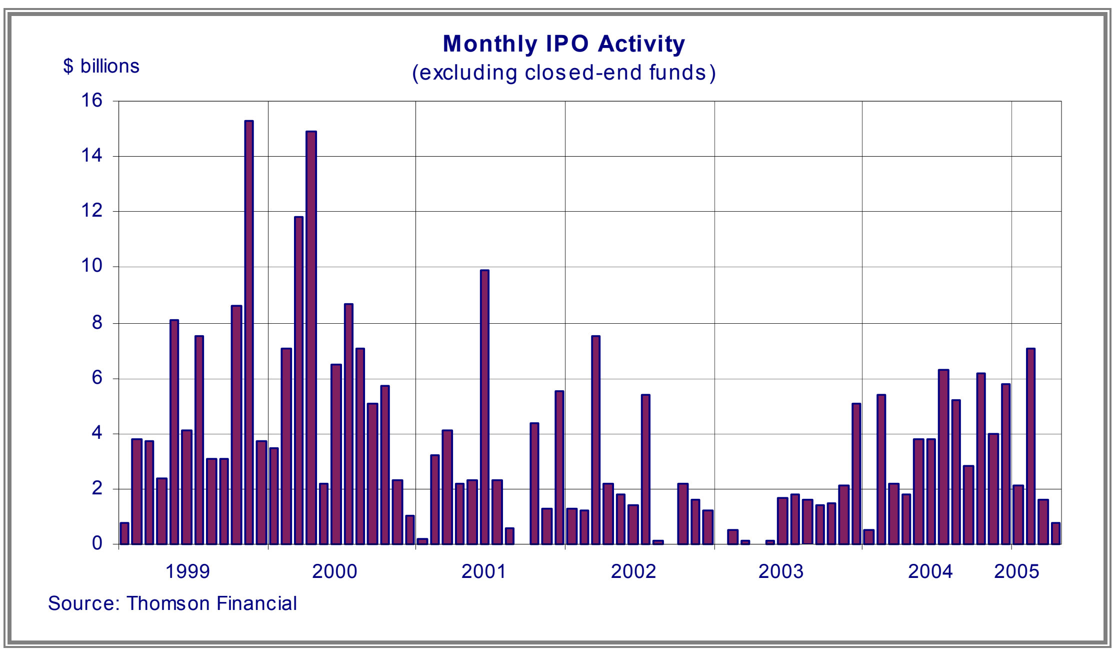
Year-to-date, overall underwriting activity totaled $916.5 billion, down 13.9% from $1.06 trillion in last year's comparable period.



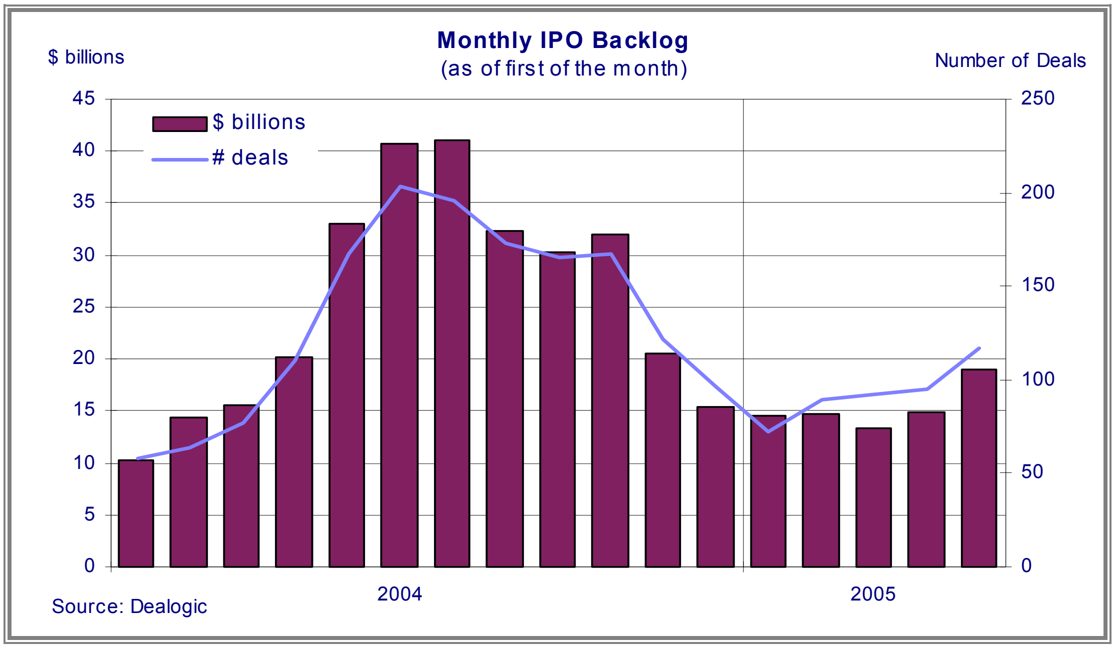
Equity Underwriting – The overall issuance volume of common and preferred stock by U.S. issuers plummeted 60.4% from $18.7 billion in March to a two-year low of $7.4 billion in April. That dragged the year-to-date total down to $51.2 billion, a sharp 37.9% below the $82.5 billion raised in the same period a year ago.



Initial Public Offerings (IPOs) – Activity in the U.S. IPO market waned for the second consecutive month, with IPO volume tumbling 50.0% in April to $0.8 billion. That marked the weakest monthly showing since last January. Despite the recent slowdown, IPO activity year-to-date is running 16.1% ahead of last year's pace, totaling $11.6 billion compared with $10.0 billion in the first four months of 2004.

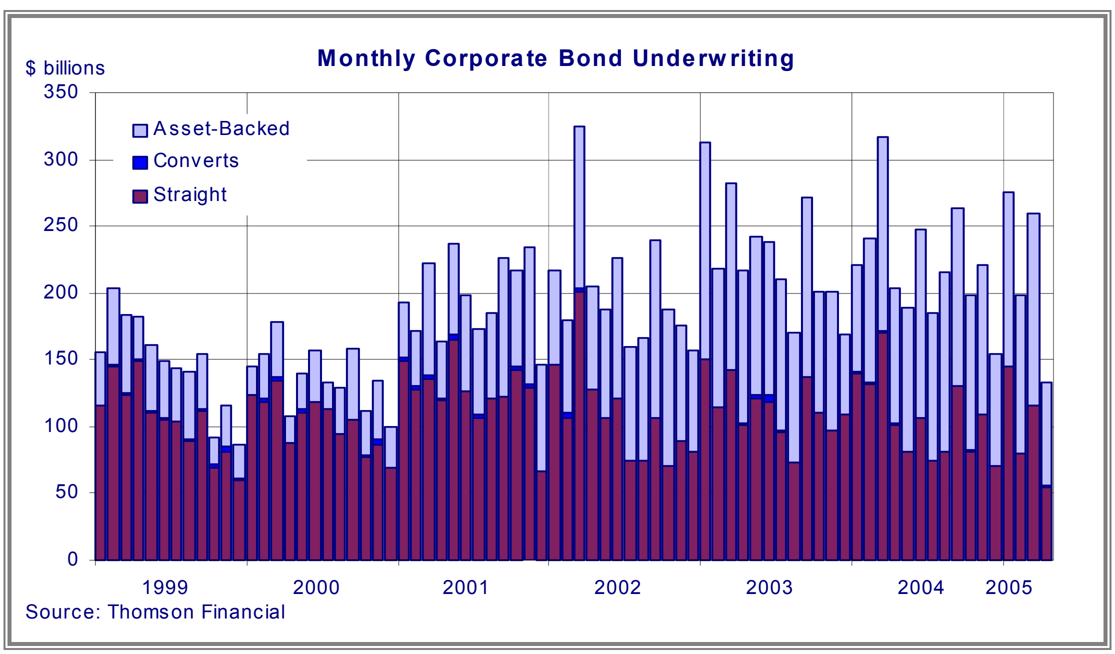


An encouraging sign for this market going forward is the recent pickup in the IPO backlog, with 117 deals totaling $18.9 billion in the backlog as of May 1st.



Corporate Bond Underwriting – New issuance of corporate bonds also slumped to its lowest level since December 2000, totaling $132.5 billion in April. That represented a 48.9% decline from $259.1 billion in March. For the year so far, corporate debt issuance totaled $865.3 billion, 11.9% below the $982.1 billion issued during the same period last year.

Straight corporate debt plunged 52.7% in April from the prior month, and is down 27.3% year-to-date compared with issuance in the first four months of 2004. Asset-backed debt offerings sank 45.9% to $77.3 billion in April from March's level, but activity year-to-date of $469.0 billion is still 7.7% above results in the similar period last year.



Grace Toto
Vice President and Director, Statistics

U.S. CORPORATE UNDERWRITING ACTIVITY

(In $ Billions)

	Straight Corporate Debt	Con-vertible Debt	Asset-Backed Debt	TOTAL **DEBT**	Common Stock	Preferred Stock	TOTAL **EQUITY**	All IPOs	"True" IPOs	Secondaries	**TOTAL UNDER-WRITINGS**
1985	76.4	7.5	20.8	104.7	24.7	8.6	33.3	8.5	8.4	16.2	138.0
1986	149.8	10.1	67.8	227.7	43.2	13.9	57.1	22.3	18.1	20.9	284.8
1987	117.8	9.9	91.7	219.4	41.5	11.4	52.9	24.0	14.3	17.5	272.3
1988	120.3	3.1	113.8	237.2	29.7	7.6	37.3	23.6	5.7	6.1	274.5
1989	134.1	5.5	135.3	274.9	22.9	7.7	30.6	13.7	6.1	9.2	305.5
1990	107.7	4.7	176.1	288.4	19.2	4.7	23.9	10.1	4.5	9.0	312.3
1991	203.6	7.8	300.0	511.5	56.0	19.9	75.9	25.1	16.4	30.9	587.4
1992	319.8	7.1	427.0	753.8	72.5	29.3	101.8	39.6	24.1	32.9	855.7
1993	448.4	9.3	474.8	932.5	102.4	28.4	130.8	57.4	41.3	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	61.4	15.5	76.9	33.7	28.3	27.7	716.4
1995	466.0	6.9	152.4	625.3	82.0	15.1	97.1	30.2	30.0	51.8	722.4
1996	564.8	9.3	252.9	827.0	115.5	36.5	151.9	50.0	49.9	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	120.2	33.3	153.4	44.2	43.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	115.0	37.8	152.7	43.7	36.6	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	164.3	27.5	191.7	66.8	64.3	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	189.1	15.4	204.5	76.1	75.8	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	128.4	41.3	169.7	40.8	36.0	87.6	2,535.1
2002	1,303.2	8.6	1,115.4	2,427.2	116.4	37.6	154.0	41.2	25.8	75.2	2,581.1
2003	1,370.7	10.6	1,352.3	2,733.6	118.5	37.8	156.3	43.7	15.9	74.8	2,889.9
2004	1,278.4	5.5	1,372.3	2,656.2	169.6	33.2	202.7	72.8	47.9	96.7	2,859.0
2004											
Jan	139.4	1.4	80.3	221.1	15.6	2.6	18.2	4.4	0.5	11.2	239.2
Feb	132.2	0.7	108.1	240.9	20.5	6.9	27.4	9.8	5.4	10.7	268.2
Mar	170.5	0.6	145.2	316.2	19.8	3.1	22.8	6.7	2.2	13.0	339.1
Apr	101.6	0.3	101.9	203.9	12.0	2.1	14.1	4.1	1.8	7.9	218.0
May	81.4	0.1	108.1	189.6	12.2	4.8	17.0	4.6	3.8	7.6	206.6
June	107.0	0.0	140.6	247.6	11.8	1.0	12.9	4.5	3.8	7.4	260.5
July	74.2	0.0	110.7	184.9	11.2	1.0	12.2	7.5	6.3	3.7	197.1
Aug	81.0	0.0	134.7	215.7	8.6	4.8	13.4	6.0	5.2	2.6	229.1
Sept	130.5	0.6	132.1	263.2	15.2	2.7	17.9	4.0	2.8	11.2	281.1
Oct	81.0	1.1	115.6	197.7	14.4	1.9	16.3	8.8	6.2	5.6	214.0
Nov	108.7	0.4	111.7	220.9	11.8	1.3	13.1	5.0	4.0	6.9	234.0
Dec	70.9	0.3	83.5	154.6	16.5	1.0	17.5	7.4	5.8	9.1	172.1
2005											
Jan	144.4	0.2	131.2	275.8	8.1	0.7	8.8	4.9	2.1	3.3	284.6
Feb	80.3	0.0	117.6	197.8	14.7	1.7	16.4	9.8	7.1	4.9	214.2
Mar	115.7	0.5	143.0	259.1	14.4	4.3	18.7	4.4	1.6	10.0	277.8
Apr	54.7	0.6	77.3	132.5	6.0	1.5	7.4	2.2	0.8	3.8	139.9
YTD '04	543.7	2.9	435.4	982.1	67.8	14.7	82.5	25.1	10.0	42.8	1,064.6
YTD '05	395.0	1.2	469.0	865.3	43.2	8.1	51.2	21.3	11.6	21.9	916.5
% Change	-27.3%	-57.6%	7.7%	-11.9%	-36.3%	-45.1%	-37.9%	-15.1%	16.1%	-48.8%	-13.9%

Note: IPOs and secondaries are subsets of common stock. “True” IPOs exclude closed-end funds.
Source: Thomson Financial

MUNICIPAL BOND UNDERWRITINGS
(In $ Billions)

INTEREST RATES
(Averages)

	Compet. Rev. Bonds	Nego. Rev. Bonds	**TOTAL REVENUE BONDS**	Compet. G.O.s	Nego. G.O.s	**TOTAL G.O.s**	**TOTAL MUNICIPAL BONDS**	3-Mo. T Bills	10-Year Treasuries	SPREAD
1985	10.2	150.8	161.0	17.6	22.8	40.4	201.4	7.47	10.62	3.15
1986	10.0	92.6	102.6	23.1	22.6	45.7	148.3	5.97	7.68	1.71
1987	7.1	64.4	71.5	16.3	14.2	30.5	102.0	5.78	8.39	2.61
1988	7.6	78.1	85.7	19.2	12.7	31.9	117.6	6.67	8.85	2.18
1989	9.2	75.8	85.0	20.7	17.2	37.9	122.9	8.11	8.49	0.38
1990	7.6	78.4	86.0	22.7	17.5	40.2	126.2	7.50	8.55	1.05
1991	11.0	102.1	113.1	29.8	28.1	57.9	171.0	5.38	7.86	2.48
1992	12.5	139.0	151.6	32.5	49.0	81.5	233.1	3.43	7.01	3.58
1993	20.0	175.6	195.6	35.6	56.7	92.4	287.9	3.00	5.87	2.87
1994	15.0	89.2	104.2	34.5	23.2	57.7	161.9	4.25	7.09	2.84
1995	13.5	81.7	95.2	27.6	32.2	59.8	155.0	5.49	6.57	1.08
1996	15.6	100.1	115.7	31.3	33.2	64.5	180.2	5.01	6.44	1.43
1997	12.3	130.2	142.6	35.5	36.5	72.0	214.6	5.06	6.35	1.29
1998	21.4	165.6	187.0	43.7	49.0	92.8	279.8	4.78	5.26	0.48
1999	14.3	134.9	149.2	38.5	31.3	69.8	219.0	4.64	5.65	1.01
2000	13.6	116.2	129.7	35.0	29.3	64.3	194.0	5.82	6.03	0.21
2001	17.6	164.2	181.8	45.5	56.3	101.8	283.5	3.39	5.02	1.63
2002	19.5	210.5	230.0	52.3	73.1	125.4	355.4	1.60	4.61	3.01
2003	21.1	215.8	236.9	54.7	87.7	142.4	379.3	1.01	4.02	3.00
2004	17.2	209.8	227.1	51.5	77.7	129.2	356.3	1.37	4.27	2.90
2004										
Jan	0.7	10.4	11.1	3.6	5.7	9.3	20.4	0.88	4.15	3.27
Feb	1.0	13.0	14.1	4.8	7.7	12.5	26.5	0.93	4.08	3.15
Mar	2.7	19.7	22.4	5.6	10.5	16.1	38.5	0.94	3.83	2.89
Apr	1.0	18.1	19.0	3.5	8.2	11.8	30.8	0.94	4.35	3.41
May	1.4	28.0	29.5	3.1	4.7	7.8	37.2	1.02	4.72	3.70
June	1.3	24.0	25.3	4.5	5.4	9.8	35.1	1.27	4.73	3.46
July	1.8	14.6	16.5	5.1	3.7	8.9	25.3	1.33	4.50	3.17
Aug	0.6	15.5	16.1	4.0	7.6	11.6	27.7	1.48	4.28	2.80
Sept	1.7	13.2	14.9	5.3	4.8	10.1	25.0	1.65	4.13	2.48
Oct	2.4	17.7	20.0	5.3	6.5	11.8	31.9	1.76	4.10	2.34
Nov	1.1	17.2	18.3	2.3	4.6	6.8	25.1	2.07	4.19	2.12
Dec	1.5	18.5	20.0	4.5	8.3	12.7	32.7	2.19	4.23	2.04
2005										
Jan	1.0	11.6	12.6	3.6	6.6	10.2	22.8	2.33	4.22	1.89
Feb	1.5	15.9	17.3	4.5	9.2	13.6	31.0	2.54	4.17	1.63
Mar	1.2	23.9	25.0	7.1	12.3	19.4	44.4	2.74	4.50	1.76
Apr	1.9	15.1	17.0	5.0	8.4	13.4	30.3	2.76	4.34	1.58
YTD '04	5.4	61.2	66.6	17.5	32.1	49.6	116.2	0.92	4.10	3.18
YTD '05	5.5	66.4	72.0	20.1	36.4	56.5	128.5	2.59	4.31	1.72
% Change	2.5%	8.6%	8.1%	14.9%	13.3%	13.9%	10.6%	181.0%	5.0%	-46.1%

Sources: Thomson Financial; Federal Reserve

	STOCK MARKET PERFORMANCE INDICES (End of Period)				STOCK MARKET VOLUME (Daily Avg., Mils. of Shs.)			VALUE TRADED (Daily Avg., $ Bils.)	
	Dow Jones Industrial Average	S&P 500	NYSE Composite	NASDAQ Composite	NYSE	AMEX	NASDAQ	NYSE	NASDAQ
1985	1,546.67	211.28	1,285.66	324.93	109.2	8.3	82.1	3.9	0.9
1986	1,895.95	242.17	1,465.31	348.83	141.0	11.8	113.6	5.4	1.5
1987	1,938.83	247.08	1,461.61	330.47	188.9	13.9	149.8	7.4	2.0
1988	2,168.57	277.72	1,652.25	381.38	161.5	9.9	122.8	5.4	1.4
1989	2,753.20	353.40	2,062.30	454.82	165.5	12.4	133.1	6.1	1.7
1990	2,633.66	330.22	1,908.45	373.84	156.8	13.2	131.9	5.2	1.8
1991	3,168.83	417.09	2,426.04	586.34	178.9	13.3	163.3	6.0	2.7
1992	3,301.11	435.71	2,539.92	676.95	202.3	14.2	190.8	6.9	3.5
1993	3,754.09	466.45	2,739.44	776.80	264.5	18.1	263.0	9.0	5.3
1994	3,834.44	459.27	2,653.37	751.96	291.4	17.9	295.1	9.7	5.8
1995	5,117.12	615.93	3,484.15	1,052.13	346.1	20.1	401.4	12.2	9.5
1996	6,448.27	740.74	4,148.07	1,291.03	412.0	22.1	543.7	16.0	13.0
1997	7,908.25	970.43	5,405.19	1,570.35	526.9	24.4	647.8	22.8	17.7
1998	9,181.43	1,229.23	6,299.93	2,192.69	673.6	28.9	801.7	29.0	22.9
1999	11,497.12	1,469.25	6,876.10	4,069.31	808.9	32.7	1,081.8	35.5	43.7
2000	10,786.85	1,320.28	6,945.57	2,470.52	1,041.6	52.9	1,757.0	43.9	80.9
2001	10,021.50	1,148.08	6,236.39	1,950.40	1,240.0	65.8	1,900.1	42.3	44.1
2002	8,341.63	879.82	5,000.00	1,335.51	1,441.0	63.7	1,752.8	40.9	28.8
2003	10,453.92	1,111.92	6,440.30	2,003.37	1,398.4	67.1	1,685.5	38.5	28.0
2004	10,783.01	1,211.92	7,250.06	2,175.44	1,456.7	65.6	1,801.3	46.1	34.6
2004									
Jan	10,488.07	1,131.13	6,551.63	2,066.15	1,663.1	83.5	2,331.7	50.3	40.9
Feb	10,583.92	1,144.94	6,692.37	2,029.82	1,481.2	75.6	1,917.2	46.3	36.5
Mar	10,357.70	1,126.21	6,599.06	1,994.22	1,477.5	77.3	1,880.6	47.1	34.9
Apr	10,225.57	1,107.30	6,439.42	1,920.15	1,524.7	78.3	1,950.8	49.0	37.3
May	10,188.45	1,120.68	6,484.72	1,986.74	1,500.0	72.1	1,663.6	46.9	32.3
June	10,435.48	1,140.84	6,602.99	2,047.79	1,371.4	57.4	1,623.3	43.5	32.9
July	10,139.71	1,101.72	6,403.15	1,887.36	1,418.1	54.1	1,734.8	44.1	33.2
Aug	10,173.92	1,104.24	6,454.22	1,838.10	1,243.5	49.9	1,431.0	37.7	26.7
Sept	10,080.27	1,114.58	6,570.25	1,896.84	1,322.2	52.7	1,510.7	41.8	29.1
Oct	10,027.47	1,130.20	6,692.71	1,974.99	1,543.5	61.3	1,730.7	49.5	34.5
Nov	10,428.02	1,173.82	7,005.72	2,096.81	1,494.4	68.5	1,827.6	49.0	38.0
Dec	10,783.01	1,211.92	7,250.06	2,175.44	1,463.3	63.3	2,042.2	48.4	39.9
2005									
Jan	10,489.94	1,181.27	7,089.83	2,062.41	1,618.4	62.5	2,172.3	54.1	45.5
Feb	10,766.23	1,203.60	7,321.23	2,051.72	1,578.2	62.7	1,950.2	54.5	43.2
Mar	10,503.76	1,180.59	7,167.53	1,999.23	1,682.6	66.7	1,849.0	59.1	38.8
Apr	10,192.51	1,156.85	7,008.32	1,921.65	1,692.8	61.7	1,839.2	58.8	39.6
YTD '04	10,225.57	1,107.30	6,439.42	1,920.15	1,535.0	78.7	2,015.4	48.2	37.3
YTD '05	10,192.51	1,156.85	7,008.32	1,921.65	1,645.4	63.5	1,948.8	56.7	41.7
% Change	-0.3%	4.5%	8.8%	0.1%	7.2%	-19.3%	-3.3%	17.7%	11.7%

MUTUAL FUND ASSETS
($ Billions)

MUTUAL FUND NET NEW CASH FLOW*
($ Billions)

	Assets: Equity	Assets: Hybrid	Assets: Bond	Assets: Money Market	**TOTAL ASSETS**	Cash Flow: Equity	Cash Flow: Hybrid	Cash Flow: Bond	Cash Flow: Money Market	**TOTAL**	Total Long-Term Funds
1985	116.9	12.0	122.6	243.8	495.4	8.5	1.9	63.2	-5.4	68.2	73.6
1986	161.4	18.8	243.3	292.2	715.7	21.7	5.6	102.6	33.9	163.8	129.9
1987	180.5	24.2	248.4	316.1	769.2	19.0	4.0	6.8	10.2	40.0	29.8
1988	194.7	21.1	255.7	338.0	809.4	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	248.8	31.8	271.9	428.1	980.7	5.8	4.2	-1.2	64.1	72.8	8.8
1990	239.5	36.1	291.3	498.3	1,065.2	12.8	2.2	6.2	23.2	44.4	21.2
1991	404.7	52.2	393.8	542.5	1,393.2	39.4	8.0	58.9	5.5	111.8	106.3
1992	514.1	78.0	504.2	546.2	1,642.5	78.9	21.8	71.0	-16.3	155.4	171.7
1993	740.7	144.5	619.5	565.3	2,070.0	129.4	39.4	73.3	-14.1	228.0	242.1
1994	852.8	164.5	527.1	611.0	2,155.4	118.9	20.9	-64.6	8.8	84.1	75.2
1995	1,249.1	210.5	598.9	753.0	2,811.5	127.6	5.3	-10.5	89.4	211.8	122.4
1996	1,726.1	252.9	645.4	901.8	3,526.3	216.9	12.3	2.8	89.4	321.3	232.0
1997	2,368.0	317.1	724.2	1,058.9	4,468.2	227.1	16.5	28.4	102.1	374.1	272.0
1998	2,978.2	364.7	830.6	1,351.7	5,525.2	157.0	10.2	74.6	235.3	477.1	241.8
1999	4,041.9	383.2	808.1	1,613.1	6,846.3	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	3,962.0	346.3	811.1	1,845.2	6,964.7	309.4	-30.7	-49.8	159.6	388.6	228.9
2001	3,418.2	346.3	925.1	2,285.3	6,975.0	31.9	9.5	87.7	375.6	504.8	129.2
2002	2,667.0	327.4	1,124.9	2,272.0	6,391.3	-27.7	8.6	140.3	-46.7	74.5	121.2
2003	3,684.8	436.7	1,240.9	2,051.7	7,414.1	152.3	32.6	31.0	-258.5	-42.6	215.8
2004	4,384.1	519.3	1,290.3	1,913.2	8,106.9	177.7	42.6	-10.6	-156.8	52.9	209.7
2004											
Jan	3,804.2	440.7	1,256.6	2,032.1	7,533.7	43.0	5.4	-0.3	-19.5	28.7	48.2
Feb	3,893.5	452.7	1,267.2	2,015.2	7,628.6	26.2	5.0	1.5	-20.9	11.8	32.7
Mar	3,885.1	455.7	1,277.7	2,006.8	7,625.4	15.6	4.8	7.5	-9.0	18.8	27.8
Apr	3,811.3	452.5	1,245.7	1,964.2	7,473.7	23.0	4.6	-7.8	-44.3	-24.5	19.8
May	3,855.0	457.1	1,223.3	1,974.6	7,510.0	0.4	2.3	-16.2	8.6	-4.9	-13.5
June	3,948.0	467.0	1,220.9	1,954.3	7,590.3	10.0	2.4	-7.5	-21.3	-16.4	4.9
July	3,796.9	462.4	1,229.2	1,953.6	7,442.2	9.4	3.0	-1.2	-2.0	9.2	11.2
Aug	3,804.1	469.9	1,253.4	1,944.5	7,471.8	1.2	2.6	4.2	-10.3	-2.3	8.0
Sept	3,916.5	479.0	1,263.9	1,903.6	7,563.0	10.3	3.0	2.8	-42.4	-26.3	16.1
Oct	3,994.1	487.4	1,277.8	1,891.4	7,650.7	7.2	3.5	3.6	-14.1	0.1	14.2
Nov	4,222.3	504.5	1,276.5	1,920.2	7,923.5	21.4	4.1	2.0	26.5	54.0	27.6
Dec	4,384.1	519.3	1,290.3	1,913.2	8,106.9	10.2	1.9	0.8	-8.1	4.9	13.0
2005											
Jan	4,289.2	516.7	1,302.0	1,892.9	8,000.8	10.0	5.3	4.6	-27.5	-7.6	19.9
Feb	4,416.8	529.9	1,304.6	1,875.6	8,126.9	22.2	4.4	2.6	-18.9	10.2	29.2
Mar	4,349.0	526.4	1,294.6	1,875.9	8,045.8	15.0	3.9	-0.8	-2.3	15.8	18.0
YTD '04	3,885.1	455.7	1,277.7	2,006.8	7,625.4	84.7	15.2	8.7	-49.3	59.3	108.6
YTD '05	4,349.0	526.4	1,294.6	1,875.9	8,045.8	47.1	13.6	6.4	-48.7	18.4	67.1
% Change	11.9%	15.5%	1.3%	-6.5%	5.5%	-44.3%	-10.9%	-26.6%	NM	-69.0%	-38.2%

* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges
Source: Investment Company Institute

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