International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

12 May 2010

The Russian National Association Of Securities Market Participants (NAUFOR) 2010 Annual Conference Moscow

The International Organization of Securities Commissions and the Future of Securities Regulation

12 May 2010

Speech by

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SP04-10

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I would like to commence by thanking the Russian National Association of Securities Markets Participants, NAUFOR, for their very kind invitation to speak to you here today. It is a very great pleasure for me to be here with you today, at what is a critical time for the development and regulation of the global capital markets.

The International Organization of Securities Commissions (IOSCO) is a unique organisation which brings together securities regulators from all over the globe with the stated aim of promoting common standards, or objectives, for the regulation of securities markets. Its members, who are government or semi-government authorities responsible for securities regulation in their particular jurisdictions, come from over 100 countries across the world, from jurisdictions with the largest and most developed capital markets to those with newly developing markets. It also counts within its membership a wide variety of self regulatory bodies and other stakeholders with a shared interest in securities regulation.

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Agenda

1. IOSCO and the Global Financial Crisis
2. Cooperating to tackle the Financial Crisis
3. Common international approaches
4. Enforcement
5. The Future

Presentation to NAUFOR annual conference 2010, Greg Tanzer 2

Prior to the onset of the financial crisis in September 2007, IOSCO was primarily engaged in what some may view as a niche activity focused primarily on dealing with the needs of securities regulators. The organisation was involved to a degree in cross-sectoral work, through the Joint Forum[1], with banking and insurance supervisors, however it remained resolutely focused on what were deemed to be securities markets issues.

This approach and outlook has now changed forever, it would seem, and IOSCO, as the sectoral technical expert, has found itself drawn into the wider global effort to tackle the ills ravaging the financial system.

[1] http://www.iosco.org/joint_forum/;

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IOSCO and the Global Financial Crisis

IOSCO and the Global Financial Crisis (1)

The IOSCO Task Force on the Subprime Crisis was formed in November 2007 and reported in May 2008. Its recommendations related to:

- Issuer transparency and investor due diligence;
- Firm risk management and prudential supervision;
- Valuation issues, especially valuation in illiquid market conditions.

In addition, IOSCO focussed on the role of Credit Rating Agencies (CRAs).

Presentation to NAUFOR annual conference 2010, Greg Tanzer

3

IOSCO initially responded to the onset of the financial crisis with the creation in November 2007 of its Task Force on the Subprime Crisis[2] to review the issues facing securities regulators. The Task Force reported in May 2008[3] outlining a programme of work targeted at addressing the failings identified in the structured finance market, specifically dealing with:

- Issuer transparency and investor due diligence;
- Firm risk management and prudential supervision: and
- Valuation issues, especially valuation in illiquid market conditions.

The other area identified for action related to the role credit rating agencies (CRAs) had played in the structured finance market. IOSCO had already embarked, in early 2007, on a

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[2] *IOSCO Launches Task Force on Recent Market Events* November 2007, available at http://www.iosco.org/news/pdf/IOSCONEWS108.pdf;

[3] *Report on the Subprime Crisis - Final Report*, Report of the Technical Committee of IOSCO, May 200, available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf;*

review of its *Code of Conduct Fundamentals for Credit Rating Agencies*[4] (IOSCO Code of Conduct) which resulted in amendments[5] being made to the IOSCO Code of Conduct which were aimed at strengthening CRA processes and procedures to protect the integrity of the ratings process, ensure that investors and issuers are treated fairly and safeguard confidential material information provided to them.

Also as IOSCO's members favour a consistent regulatory approach to monitoring the activities of CRAs, and in order to avoid regulatory fragmentation, it is working toward developing mechanisms whereby regulators and investors can be assured that CRAs are adhering to the IOSCO Code of Conduct and to allow national regulators to coordinate their oversight of CRAs.

The G-20 subsequently endorsed[6] the IOSCO Code of Conduct as the international standard which its members should adhere to in their oversight of CRAs within their jurisdictions.

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[4] *Code of Conduct Fundamentals for Credit Rating Agencies*, Report of the Technical Committee of IOSCO, May 2008, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf;

[5] *The Role of Credit Rating Agencies in Structured Finance Markets - Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf;

[6] *G-20 Declaration* – Washington, USA, 15 November 2008 http://www.g20.org/Documents/g20_summit_declaration.pdf

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IOSCO and the Global Financial Crisis (2)

Since 2008, IOSCO has continued to focus on addressing areas that are primarily the province of securities regulators but have implications for the wider financial system including:

- International financial reporting standards;
- Building investor confidence;
- Building a more resilient financial system; and
- Transparency in markets and disclosure standards with respect to structured financial products.

Presentation to NAUFOR annual conference 2010, Greg Tanzer 4

Since 2008, in line with its aims of promoting cross-border regulatory and enforcement cooperation, reducing global systemic risk, protecting investors and ensuring fair and efficient securities markets, IOSCO has continued to focus on addressing areas that are primarily the province of securities regulators but have implications for the wider financial system including:

- International financial reporting standards – enhancing the accountability of the standard setter, the International Accounting Standards Board, to the community of national authorities for reporting by public companies;
- Building investor confidence – through measures such as strengthening cross-border enforcement cooperation;
- Building a more resilient financial system – through new regulatory approaches to hedge funds and strengthened clearing and settlements arrangements; and
- Transparency in markets and disclosure standards with respect to structured financial products.

Co-operating to tackle the financial crisis

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Cooperating to tackle the Financial Crisis (1)

- The G20 and Financial Stability Board have emphasised the need for cooperative global solutions.
- There is a need to focus on market conduct and infrastructure: much of the underlying problems raised in the crisis occurred in markets.

Presentation to NAUFOR annual conference 2010, Greg Tanzer 5

In order to resolve the current financial crisis, cooperation and coordination among financial regulators and policy makers, supported by the political will to make necessary regulatory or legislative changes, is critical. This has found expression in the G-20's determination to produce recommendations and guidelines to support the development of a more credible global system of regulation and surveillance of capital markets and financial products, a task which has been primarily delegated to the Financial Stability Board (FSB).

Following the G-20 Leaders' Statement in October 2008 on tackling the financial crisis IOSCO, previously focused on securities market issues, moved to ensure that the views of securities regulators on a number of issues raised by the G-20 were coherently represented to that forum. There had been a risk that solving the financial crisis was being viewed solely through the prism of assisting failing banks and insurers with insufficient regard to the need for an equal emphasis on the effective regulation of markets.

The need for a focus on market conduct issues and market infrastructure in any reform of the financial sector is pertinent given that it was in markets that much of the underlying behaviours that led to the crisis actually occurred, including the conflicts of interest, the profligate lending, excessive leveraging, inappropriate valuations, overvalued securitisations, off balance sheet vehicles, and extravagant compensation. Moreover, markets both regulated and those exempt from regulation themselves played an unfortunate role as the transmission mechanism for much of the risk these behaviours produced. In other words markets matter for systemic stability.

Cooperating to tackle the Financial Crisis (2)

IOSCO's response to the G20 Washington Summit was to create three Task Forces:

- Short Selling
- Hedge Funds
- Unregulated Markets and Products

More recently, with CPSS, IOSCO has been working on payment, clearing and settlement systems infrastructure.

Presentation to NAUFOR annual conference 2010, Greg Tanzer 6

Therefore IOSCO's response to the Washington Summit was to launch three Task Forces[7] to address market integrity in the areas of short selling, unregulated financial markets and products and unregulated financial entities.

These Task Forces completed their work during the course of 2009, with each presenting high level principles to support a coordinated international approach to the oversight of these markets segments. Briefly, the Task Forces' recommendations were as follows:

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[7] *IOSCO Technical Committee Launches Task Forces to Support G-20 Aims*, 25 November 2008, available at http://www.iosco.org/news/pdf/IOSCONEWS134.pdf;

- **Short Selling**[8] – the final report set out four principles for the effective regulation of short selling which focused on: the need for regulators to have adequate controls to minimise the risks posed by short selling; that the practice should be subject to a reporting regime; an effective compliance and enforcement system should exist; and the need for any regulation not to impede legitimate market-making activities.
- **Hedge Funds**[9] - the six high level principles include in relation to hedge funds or hedge fund managers requirements on mandatory registration, ongoing regulation, the provision of information for systemic risk purposes and international regulatory cooperation.
- **Unregulated Markets and Products**[10] - the report set out a number of recommendations aimed at addressing incentives, risk management procedures, counterparty risk, product and market transparency, and regulatory structure and oversight.

More recently, IOSCO and the Committee on Payment and Settlement Systems (CPSS) have collaborated on a review of the existing regulatory principles for payment systems, clearing and settlement systems and central counter parties (CCPs). These systems form an essential part of the infrastructure for financial markets and for the financial system as a whole, and it is notable that they performed so well during the height of the crisis with no or virtually no failures in payment and clearing systems. It is also notable that a large part of the uncertainty that beset financial markets in the wake of the collapse of Lehmann Brothers in September 2008 was driven by uncertainty about how and where the outstanding liabilities of that firm would be resolved, because so many of those liabilities arose from over-the-counter transactions which were not centrally cleared. So it is critical that we assure ourselves that our payment, clearing and settlement systems are robust and that we consider ways to

8 Regulation of Short Selling, Report of the Technical Committee of IOSCO 19 June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf;

9 Hedge Funds Oversight, Report of the Technical Committee of IOSCO 22 June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf;

10 Unregulated Financial Markets and Products, Report of the Technical Committee of IOSCO, 04 September 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf;

encourage OTC transactions to be cleared in such a way that reduces uncertainty and potential systemic risk.

In addition to undertaking pieces of work that address specific securities markets issues that also support G-20 needs, IOSCO is a member of the FSB – where it sits as the international standard setter for securities regulation – and was invited to participate in the G-20 Working Group on Enhancing Sound Regulation and Strengthening Transparency and its Working Group on Financial Market Integrity and International Cooperation. As well as recognising IOSCO's central role in the development of international securities regulatory standards, participation in these supranational bodies ensures that the views of securities regulators are present at the political policy formulation stage.

Common International Approaches

Common international approaches

- IOSCO invited Brazil, India and China to join its Technical Committee in Feb 2009
- IOSCO is reviewing its own structure and organizational goals
- IOSCO is reviewing its Principles of Securities Regulation:
  - New Principle on identifying and monitoring sources of systemic risk
  - Need to regularly review the perimeter of regulation

Presentation to NAUFOR annual conference 2010, Greg Tanzer 7

IOSCO, as the international standard setter for securities regulation, is committed to the concepts of international cooperation being promoted by the G-20.

At the onset of the financial crisis IOSCO recognised the need to ensure the involvement of all the major markets in its policy response, inviting[11] members from Brazil, China and India to join its key policy-making committee, the Technical Committee, in February 2009.

The organisation has also embarked on a review of its own structure and strategic goals to ensure that it is aligned with the other international policy making bodies in its capacity to react quickly to emerging markets issues, and to be in a position to provide the necessary input to the FSB/G-20 process.

The actions of the G-20 and the creation of the FSB recognise that, while day to day regulation of financial markets remains the responsibility of national regulators, today's reality is that financial markets are global in their nature, structure and operation and therefore require increased international cooperation and oversight amongst regulators and policy makers. It also reflects the need for the strengthening of international standards and their consistent implementation as a means to prevent further market deterioration and to ensure the future viability of financial markets.

Bearing in mind the need for common international standards, it is important to recognise that IOSCO's Objectives and Principles of Securities Regulation[12], first formulated in 1998, provide a consistent benchmark against which governments and regulators can gauge the effectiveness of their securities regulation and we exhort all jurisdictions to ensure that their regulatory regimes comply with them.

In recognition of the fact that the financial world has changed drastically in the last 3 years, IOSCO has been engaged in a major review of the Principles to ensure that they reflect the reality of today's markets and regulatory structures. Central to this review has been ensuring that the revised Principles adequately reflect the role that securities regulators and regulation should play with regard to identifying and combating systemic risk and the need for them to

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[11] *IOSCO Technical Committee Invites Brazil, China and India to Join Its Membership*, 19 February 2009, available at http://www.iosco.org/news/pdf/IOSCONEWS136.pdf;

[12] Objectives and Principles of Securities Regulation, May 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf; and

consider the impact that activities and participants who fall outside the existing perimeter of regulation.

In formulating its new Principles on Systemic Risk IOSCO has adopted the approach of viewing systemic risk as any widespread adverse impact on the financial system, and thereby the wider economy, caused by the design, distribution or behaviour under stressed conditions of certain investment products; the activities or failure of a regulated entity; a market disruption; or the impairment of a market's integrity. Systemic risk can also take the form of a more gradual erosion of market trust posed by inadequate protection standards, lax enforcement, or insufficient disclosure requirements.

To address these challenges IOSCO believes that securities regulators should have in place, or contribute to, explicit regulatory processes, which may be cross-sectoral, to monitor, mitigate and appropriately manage risks emerging from their securities markets and infrastructure. Areas that require specific attention in this respect relate to investor protection, market integrity and the proper adherence to conduct of business standards.

While developing its new principles IOSCO has also been involved in practical efforts to identify systemic risk through its involvement in producing the Joint Forum's report entitled *The Differentiated Nature and Scope of Financial Regulation*[13]. This report analysed the key issues arising from the different approaches to financial regulation in banking, securities and insurance and addressing the gaps arising from the scope of regulation as it relates to financial activities, particularly in relation to unregulated and under-regulated firms and market segments. The review identifies areas where systemic risks are not adequately captured under current systems and includes recommendations on how to strengthen oversight of the global system.

[13] *Review of the Differentiated Nature and Scope of Financial Regulation - Key Issues and Recommendations*, Joint Forum, 11 January 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD315.pdf.

Alongside its new focus on systemic risk IOSCO's recent work has impressed upon it the need for regulators to adopt explicit processes for conducting a rigorous and regular review of investment products, markets and market participants' activities so as to identify and assess possible risks to investor protection, market fairness, efficiency, transparency and/or financial stability; and to regularly review the perimeter of regulation to mitigate against emerging risks to their objectives from activities outside their current regulatory ambit.

This should be supported by a process to periodically, and on an ad-hoc basis, determine whether regulators' existing powers, operational structure and regulations are sufficient to meet any emerging risks. Any such process should necessarily involve sufficiently senior staff that any necessary changes to the existing perimeters of regulation can be made quickly and effectively in response to an emerging risk.

In support of this extended focus for securities regulators IOSCO has been engaged, through its Task Force on Supervisory Cooperation, in developing principles for regulatory cooperation in the supervision of systemically important market participants operating across national borders. The principles will focus on the information needs of regulators both for domestic and international oversight.

Enforcement

Enforcement

- Enforcement is the bedrock of any effective regulatory system
- The international standard for enforcement cooperation in securities regulation is the IOSCO Multilateral Memorandum of Understanding (MMoU), established in May 2002:
  - **65** full signatories, and **45** Appendix B members
- IOSCO has also been engaging in dialogue with uncooperative or under-regulated jurisdictions

The final strand in IOSCO's own work in tackling the current crisis, and preparing for the next, is in the field of enforcement cooperation. Any system of regulation and oversight must have built into it the threat and ability to undertake effective enforcement action against those who contravene or seek to circumvent its rules. This has been a focus for much of IOSCO's work in the last decade, beginning in May 2002 when IOSCO developed and adopted the Multilateral Memorandum of Understanding on Cooperation and Exchange of Enforcement Information (MMoU). The MMoU is the global information-sharing arrangement amongst securities regulators and sets an international benchmark for cooperation critical to combating violations of securities laws and regulations, and seeks to overcome the barrier of banking secrecy laws that prevent the exchange of essential information. Currently 65 regulators from across the globe have signed onto the MMoU, with an additional 45 members committed to making the changes necessary to do so. Existing signatories use the MMoU as their mechanism of choice for enforcement cooperation and the expanding membership of the MMoU will deliver significant benefits for global capital markets, as well as investor confidence.

IOSCO has also been engaged in tackling the risks to the global securities markets cooperation by uncooperative or under-regulated jurisdictions. It has been proactively engaging with a variety of jurisdictions with which problems have been experienced regarding enforcement cooperation, and has made excellent progress with a number of uncooperative jurisdictions to the point that a number of these are no longer viewed as uncooperative due to their satisfactory progress in meeting the international cooperation standards.

The future

IOSCO´s Work on the Crisis:

all available on www.iosco.org/library

- Task Force on Unregulated Products and Markets: Report with new standards on CDS and securitization (Sept. 09)
- Task Force on Unregulated Entities: Report with new standards on Hedge Funds (June 09, March 10)
- Task Force on Credit Rating Agencies: Report with new standards on CRA´s (March 08)
- Task Force on Short Selling: Report and new principles on short selling (June 09)
- Task Force on Commodities: Report (Dec 08, new mandate in progress)
- Task Force on Supervisory Cooperation: Currently active (report due June10)
- Task Force on Implementation of Principles: Revising and updating the new principles (due June 10)
- Task Force on Audit Services: Report on regulators' contingency plans for service disruption of auditors (June 09)
- Task Force on Corporate Governance: Report on protection of minority shareholders in listed issuers (Feb. 09)
- Task Force on Subprime Crisis: Report on the subprime crisis (March 08)
- Standing Committee 1: Report with principles for periodic disclosure of remuneration by listed entities (July 09, Feb. 10)
- Standing Committee 1: Report with disclosure requirements for public offerings of ABS (July 09, Apr. 10)
- Standing Committee 1: Report on transparency of firms that audit public companies (June 09)
- Standing Committee 2: Report with principles for outsourcing by markets (July 09)
- Standing Committee 2: Report on transparency of structured finance products (Sept. 09)
- Standing Committee 2/3: Report Principles for Direct Electronic Access to Markets (Due June 10)
- Standing Committee 5: Report with regulatory standards for funds of hedge funds (July 09)
- Standing Committee 5 : Report on due diligence good practices for investment managers investing in structured products (June 09)
- Emerging Markets Committee: Report with recommendations in response to the financial crisis in emerging markets (June 09)
- Joint Forum: Differentiated Nature and Scope of Regulation (January 10)
- Joint Forum: Report on Special Purpose Entities (April 08)
- Joint Forum: Report on credit risk transfer (April 08)
- Joint Forum: Report on risk concentrations (April 08)
- Joint Forum: Cross-Sectoral Review of Group-Wide Identification and Management of Risk Concentrations (current)
- CPSS-IOSCO Working Group on the Review of the Recommendations for Central Counterparties (due 2010)

Presentation to NAUFOR annual conference 2010, Greg Tanzer 9

I hope I have given you a broad overview of the work that IOSCO has been engaged in throughout the global financial crisis, and a sense that this work is part of a truly global effort to improve the capacity of the financial system to withstand shocks and contribute to global economic growth. For those of you interested in more detail, please feel free to visit the IOSCO website, www.iosco.org, for more information.

The Future

- IOSCO's members believe that through the combination of these different initiatives and activities securities regulators can ensure:
  – their voice is heard in the reform of global regulation needed to address the current crisis, and
  – they are equipped with the necessary tools and powers to identify and mitigate possible emerging risks in the future.
- The evolving approach of regulators includes a focus on possible capital ratios for securities firms, increasingly exacting product regulation and an increased emphasis on transparency and disclosure to the market and investors.
- There is a natural emphasis on seeking to reduce or eliminate risk in the financial system, given the amount of taxpayers' money that has been devoted to supporting the system and its largest participants.
- But in seeking to promote a safer financial system, are we giving investors a false impression that all investments are safe?

IOSCO's members believe that through the combination of these different initiatives and activities securities regulators can ensure their voice is heard in the reform of global regulation that is under way, but also that they are equipped with the necessary tools and powers to identify and mitigate possible emerging risks in the future.

However I would like to leave you with a question to ponder regarding the evolving approach of regulators including the focus on possible capital ratios for securities firms, increasingly exacting product regulation and an increased emphasis on transparency and disclosure to the market and investors. Regulators are condemned, in part, to fight the last conflict but in remedying the faults that led to the current financial crisis might we be embedding flaws that could contribute to the next financial conflagration? For example there is a natural emphasis on seeking to reduce or eliminate risk in the financial system, given the amount of taxpayers' money that has been devoted to supporting the system and its largest participants, but in seeking to promote a safer financial system, are we giving investors a false impression that all investments are safe? Or in concentrating on areas of risk that were missed in the past under our 'light touch' regulation, are we overlooking another currently benign activity which may be developing in an unwanted direction?