



The Road to Global Reform: How the International Head of Securities Regulators Sees the Future

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The International Organization of Securities Commissions (IOSCO) may have its hands full fleshing out the G20's global reform program, but that hasn't stopped IOSCO Secretary-General David Wright from spelling out an even more comprehensive agenda. Canadian securities executives will get a chance to meet with Mr. Wright on December 12, 2012 an opportunity to offer feedback and comment on his vision of capital markets, the strengths and weaknesses in securities regulation and IOSCO's strategic agenda.

As Mr. Wright underlined in his comments to the International Council of Securities Associations (ICSA) in Istanbul last month, IOSCO has a critical role in promoting global reform. IOSCO is leveraging its strengths for consultation and information exchange among regulators to push jurisdictions forward to meet the implementation deadlines and advance regulatory comparability. The task is made difficult by the limited toolbox to force compliance by member countries to the IOSCO agenda. IOSCO is not a global regulator with rule-making and enforcement powers; therefore, it is limited to peer pressure exercised through Memoranda of Understanding.

The Secretary-General's Vision

Mr. Wright, however, envisions IOSCO going well beyond that, foreseeing over the next 10 to 15 years an expansion of the global marketplace with a proliferation of regional capital markets developing in the emerging countries to complement the existing market centres in the developed world. He anticipates the evolution of strong regional capital markets across the globe, both seeking capital and offering investment opportunities, and providing long-term capital for offshore investments. Many of these markets will spring up in the emerging world, from Turkey to India, and to Latin America and Africa. IOSCO will have an important role encouraging this market expansion through education and technical assistance.

The Immediate Challenge: Fulfilling the G20 Agenda

IOSCO's current priority is fulfilling the G20 mandate. There are five key components of the IOSCO regulatory agenda:

1. Develop an effective resolution mechanism to enable the orderly windup of troubled institutions. The resolution

mechanism would anticipate institution failure and initiate a defined windup plan that would sell assets and allocate losses among stakeholders, including shareholders and creditors. The U.S. authorities have invested considerable effort in defining the details of a resolution mechanism.

2. Implement the G20 directive for derivative securities, an agenda that includes trading platforms, central clearing and repositories for standardized OTC securities, and capital standards for non-cleared derivative securities.
3. Develop a regulatory framework for the shadow banking system. This framework would involve regulations for hedge funds and other private equity funds, securitization, the treatment of money market funds and repo/securities lending transactions.
4. Develop appropriate capital and liquidity standards for securities firms. This work would be undertaken in close consultation with the Basel Committee on Banking Supervision.
5. Implement appropriate standards for corporate governance.

Mr. Wright has made it clear that IOSCO will play a prominent role in shaping and streamlining global regulation by encouraging ongoing reform to meet the mandated deadline of year-end. IOSCO will have an advisory role on the rule-making process, by providing rules and standards, to achieve congruence in regulation across independent jurisdictions. Wright mentioned that, while IOSCO is the de facto global regulator, it must rely on a peer review process that works effectively in bringing non-compliant jurisdictions into line.

Winding Up Troubled Institutions

Mr. Wright indicated that some aspects of this comprehensive reform agenda are more complex than others. He referred specifically to resolution mechanisms to alleviate troubled large institutions. U.S. regulators have already spent considerable time focused on wind-up plans or living wills that would maintain the viability of a troubled institution confronting serious business pressures. There are, however,

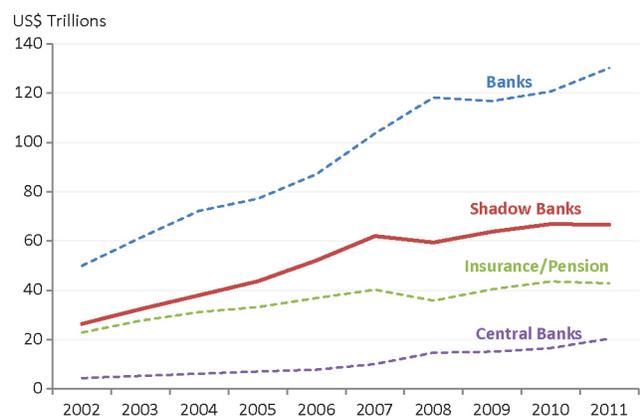
circumstances that complicate the planned adjustment process. First, the problems of troubled institutions usually surface in times of financial crisis, and coincident difficulties at other institutions interfere with planned wind-up plans; and turbulent and often synchronized market movements across asset classes, and collapsing liquidity damage planned asset sales. Second, the wind-up of large global institutions depends on strong regulatory coordination to enable the timely disposal of offshore financial assets when the institution faces a crisis situation. Offshore regulators are often reluctant to relinquish control over these assets when local investors and depositors are involved.

Bringing Shadow Banking Out of The Shadows

Another challenging area is the complexity of the shadow banking system, requiring a multi-faceted regulatory approach. The shadow banking system includes the inter-financial system that funds the large financial institutions. These repo and securities lending trades need appropriate capital and trading rules, with transactions cleared through a central clearer and trade repositories to measure exposures. Hedge funds, private equity funds and money market mutual funds – the other aspect of the shadow banking system – must be subject to an appropriate regulatory framework. The inability to find an acceptable regulatory solution to money market funds in the United States indicates the complexities of the agenda.

Global Shadow Banking System

Assets of financial intermediaries



Source: Financial Stability Board

Mutual Recognition: Difficult, But Do-able

While the structural reforms for the OTC derivatives market are straightforward, and considerable progress has been made in the rule-making exercise, the implementation of a globally integrated and efficient marketplace for swap transactions remains a difficult process. Unfettered access to offshore swap markets and to global central clearers will enhance the efficiencies and liquidity of the global market. However, the challenge is to design a framework that minimizes extra-territorial regulation, which adds rule duplication and cost.

In discussion, Mr. Wright was not enthusiastic about the prospects of achieving mutual recognition, citing the many

different jurisdictions and complexities of forging agreement on regulatory standards. Further, independent jurisdictions are pre-occupied with the rule-making process and meeting the G20 deadlines, relegating no priority to discussions to mutual recognition, or even congruence in rules and regulations.

We suggested nonetheless that mutual recognition would have a reasonable chance of success if the exercise were concentrated in a smaller group of jurisdictions, with a roughly similar regulatory framework. For example, the effort could be focused on regulations for OTC derivatives in the G20 countries, one of the key G20 Directives. An effort to achieve mutual recognition on the regulatory standards for financial compliance, as opposed to trading and clearing rules, could be achievable.

The Transatlantic Coalition and ICSA have proposed a mutual recognition scheme facilitated by IOSCO. Independent jurisdictions would compare their regulatory regime against the IOSCO Standards for Securities Regulation. This comparative analysis would be the focus of discussion and negotiations among those jurisdictions interested in mutual recognition. ICSA has sent a written submission to Mr. Wright on this subject and established a working group to flesh out the details of the proposal.

A Full Agenda

Both in solving problems from the past and bringing to life a vision for the future, the IOSCO Secretary-General is addressing issues that are important to Canada's investment industry. We look forward to the opportunity for IIAC member firms to discuss these issues with him.

Yours sincerely,

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