

EUROPEAN PARLIAMENT
COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
Public Hearing
Tackling the culture of market manipulation
- Global action post Libor/Euribor-

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1. Introduction

It is my great honor and pleasure to be given this opportunity to speak to you about this important topic. My name is Masamichi Kono, Vice Commissioner for International Affairs at the Financial Services Agency of Japan. In my capacity, I represent my Agency in various international organizations of financial regulators and supervisors. I am also currently Chair of the Board of IOSCO, International Organization of Securities Commissions. I must mention that any views I express today are not necessarily the official views of the organizations that I represent, and are also preliminary.

IOSCO is the international organization of market regulators, responsible for setting global standards in the area of financial market regulation and for developing policy guidance for market regulators worldwide. IOSCO currently has some 200 members from 115 separate jurisdictions. Its primary objective is to establish and promote high-quality international standards with a view to promoting transparency and efficiency of securities markets, reducing systemic risk in those markets, and facilitating cross-border cooperation between market regulators. The ultimate objective of such work is to protect investors and enable capital markets to help provide necessary funding for economic growth and development, as well as job creation.

Recently, there has been great concern over the integrity and accuracy of benchmarks widely used in global financial markets, most notably LIBOR. However, the issues raised are not entirely new. Financial market regulators have been continuing their efforts to prevent market abuse and correct misconduct in many of the areas under the spotlight today for years. What is

perhaps new is the increasingly global outreach of the issues.

The growth of globalized financial markets must be underpinned by appropriate regulation and supervision at the global level. In light of the significant doubts expressed over the integrity of benchmarks, financial market regulators need to urgently strengthen their cooperation, and coordinate their efforts to develop global policy guidance and principles for benchmark setting processes and related activities.

2. Relevant issues

Given the wide-spread use of benchmarks in financial markets, the integrity of benchmarks and benchmark setting processes is critical to the pricing of many financial instruments that use those benchmarks for reference. Any doubts over the integrity and accuracy of those benchmarks will severely undermine market confidence, could result in distorting the allocation of funds needed for the real economy, and potentially cause significant losses to investors and market participants.

However, ultimately, the choice of benchmarks for financial contracts must be largely market driven. Appropriate regulation and supervision are required to ensure proper governance, transparency, and fairness of the benchmarks and benchmark-setting processes. Proper enforcement and deterrent sanctions are needed to prevent market abuse and correct misconduct. But such regulatory intervention must be measured and balanced with the need to maintain competitive and well-functioning financial markets.

The major supervisory and regulatory issues raised are the following:

- The process and procedure for benchmark calculation may not be sufficiently robust and transparent;
- The governance structure over the benchmark setting process and procedure may not be strong enough to address the conflicts of interest which may exist in the benchmark setting process;
- Incentives and opportunities may exist for those attempting to manipulate the submissions used in the calculations;
- The tools and sanctions for proper enforcement of rules may not be

sufficiently strong or adequate for the purpose.

Here, I should mention a word of caution. Applying any set of reform measures to existing benchmarks and benchmark setting processes and procedures should not destabilize nor create legal uncertainties in existing contracts. This is even more relevant in the international context, where international law and jurisprudence are not sufficiently robust to cope with large differences in national laws and regulations applicable to those contracts. Another word of caution is that, in the international context, a one-size-fits-all approach is not feasible nor appropriate. Due account must be taken of differences in market conditions and players from country to country.

3. Need for global coordination

I understand the European Union is now at the forefront of international efforts to ensure the integrity of benchmarks and the benchmark setting process. I am aware that proposals have been made to amend the market abuse Regulation and Directive, so that manipulation of market benchmarks are clearly prohibited and shall be subject to criminal sanctions. The European Commission's consultation paper aims to identify the key issues and shortcomings in the production and use of benchmarks, in order to assess the need for any necessary changes to the legal framework to ensure the future integrity of benchmarks. Such efforts are most welcome and appreciated.

However, I believe that in order to restore confidence in the broad range of benchmarks used in global financial markets, and prevent regulatory arbitrage, there must be strong global coordination. Efforts need to be stepped up to promote an internationally consistent regime and its implementation at global level, by developing global policy guidance and principles. Rigorous periodic assessment will be needed to ensure consistent implementation across countries. There needs to be strong cooperation in enforcement actions by market regulators to prevent market abuse and correct misconduct worldwide.

Distinguished members, IOSCO is best placed to deal with such issues at global level. IOSCO has already started a new project to work towards that goal. In the course of its work, IOSCO will learn from and leverage the initiatives undertaken

by the European Union and others, in order to achieve its goal of developing global policy guidance and principles.

We will take into account the results of the UK 's "Wheatley Review" which is focused on the reform of LIBOR. We will also be working closely with BIS Central bank Governors Group set up to examine these issues and with the Financial Stability Board.

In my country, Japan, the Financial Services Agency has been in close touch with counterparts in several countries in conducting investigations and in issuing corrective orders against banks and securities companies in which internal controls to prevent inappropriate practice regarding rate submissions of TIBOR and LIBOR were found to be deficient or weak.

All these developments demonstrate the seriousness of these scandals, and have led to a firm recognition on the part of financial market regulators and supervisors that only globally coordinated approaches to these issues will work.

4. Work at IOSCO

IOSCO has been making considerable progress in taking forward its work mandated by the G20 and the FSB, for reforming the international financial system. In this context, IOSCO has been developing global policy recommendations on the functioning and oversight of oil price reporting agencies. This work is quite relevant for any work to be undertaken in addressing the issue of benchmarks and the benchmark setting process. While the role and functioning of the oil PRAs differ from benchmark setting entities in the area of interest rate benchmarks, many of the same principles could apply. Our final report will be published very shortly.

Concerning benchmarks and benchmark setting process and procedures, IOSCO has now set up a Board-level Task Force within its Board to conduct work from the standpoint of financial market regulators. The mandate for this Task Force is to:

- identify relevant benchmark-related policy issues across securities and derivatives, and other financial sectors;

- define the types of benchmarks that are relevant to financial markets;
- identify the relevant policy issues including:
 - exercising appropriate regulatory oversight of the process of benchmarking,
 - having in place robust processes and procedures for benchmark calculation, and constructing credible governance structures to address conflict of interests in the benchmark setting process,
 - and ensuring transparency and openness in the benchmarking process;
- develop global policy guidance and principles, including those related to effective self-regulation.

In developing policy guidance and principles for financial market benchmarks, the Task Force will consider issues related to necessary enforcement powers, information sharing, and sanctions regimes in coordination with IOSCO's expert committees.

Cross-border cooperation is indispensable for effective enforcement action against market abuse, attempts of manipulation, and other misconduct. In this regard, the IOSCO Multilateral Memorandum of Understanding (MMoU), which facilitates its signatories to exchange confidential information in enforcement on a timely and efficient basis, contributes significantly to effective action by national authorities.

The Task Force is co-chaired by Martin Wheatley, the Managing Director of the UK Financial Services Authority, and Gary Gensler, the Chairman of the US Commodity Futures Trading Commission. It will aim to produce a consultation report towards the end of this year or early next year, with completion around March 2013.

5. Conclusion

Given the global nature and extensive use of benchmarks in an extremely broad range of financial markets and products, it is imperative to develop internationally coordinated policy guidance and principles that ensure their credibility and integrity. Failure to address this issue would, without exaggeration, put the integrity and stability of the global financial system at risk, and could

result in significant losses for the economies and investors worldwide. National and regional reform efforts must be coordinated and be held consistent with those of other jurisdictions.

Finally, let me emphasize that IOSCO is firmly committed to restoring confidence in benchmarking activities globally, and will carry forward the needed work expeditiously through this Task Force we have organized. Benchmarks in use across global financial markets constitute the very foundation of free, fair and transparent market transactions, and doubts over their integrity and sound operation must be removed completely.

Thank you very much for providing this opportunity to share my views with you today. I would be happy to respond to any questions you may have.