

Opening speech of the IOSCO Technical Committee
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Minister Watanabe,

Commissioner Sato,

Ladies and Gentlemen, dear Colleagues,

I would like first to congratulate and thank our host, the Japanese financial services Authority, for its warm welcome and for the outstanding organisation of this conference. As the themes are very topical and the panellists of the highest level, I have no doubt that this 4th Technical Committee conference will be successful and will provide useful input and benefit to IOSCO's work and visibility.

On the occasion of this conference, I took the opportunity to make a short trip across the country, and I have to say how impressed I was, once again, by the capacity of the Japanese people to maintain, in such a specific way, a delicate balance between tradition and harmony, on the one hand, and the most sophisticated modernity on the other hand. Visiting Japan is not merely a wonderful experience from a touristic point of view, it makes you feel better and spiritually enriched. And this is most welcome as we have recently lived through a period of irrational exuberance, which ended up, as usual, in a serious turmoil. Let us hope that thinking about our human failures here in Japan will be beneficial to the soundness of our analysis and commitments.

At the opening of this conference, I guess I can't avoid to start by saying a few words on the present situation on the regulatory front and on the lessons of the turbulences which are affecting the financial markets.

Although it may be too early to draw lessons on recent events, it appears that this crisis is mainly the consequence of

credit mismanagement, together with poorly managed disintermediation.

For a securities regulator, it should be noted that regulated markets were not affected and were even remarkably resilient.

Moreover, this turmoil has not affected all financial markets to the same extent, and took place at a time of robust growth of the world economy, sustained by the dynamism of emerging markets and more specifically Asian countries.

This being said, we have seen credit discipline deteriorating seriously, inadequate risk pricing, ambiguous risk transfer, and therefore, when markets participants became conscious of the situation, market paralysis, liquidity crisis and even interbank market disfunctioning.

Andrew Sheng, who chaired the IOSCO TC when he was the Chairman of the Hong Kong SFC and who will participate to our work in the coming panels, delivered recently a very interesting speech from which I quote “ The derivative markets have overshoot the capacity of issuers, investors, accountants and regulators to understand their true value and

measure their risks.” He then underlined the lack of transparency and understanding of the complexity of the derivative risks.

Indeed, the growth of the structured finance market was supported by a particularly robust demand from institutional investors looking for higher yields, a continuous flow of technical innovation and the strengthening of a broad trend toward disintermediation. The Financial Stability Forum had, for some time, underlined the potential risk caused by these evolutions and in particular the risk raised by the securitisation of high yield mortgages into complex products that are potentially illiquid.

The analysis of the functioning of the structured finance markets and of the mechanism that propagated the phenomenon does not only raise questions for prudential supervisors and central bankers. It also raises questions for securities regulators and invites us to review the robustness of our standards and principles and to ask ourselves whether they adequately respond to the issues that are at stake.

With regards to the concerns of securities regulators, I have identified three main issues.

Firstly, the existing process of credit risk assessment and the role of rating agencies with regard to structured products. On this issue, it may well be that the meaning of ratings was misunderstood by buyers and that the rating was used, in many cases, as the only reference to price the structured product, without liquidity risk being taken care of.

The next issues are those of the transparency of the underlying assets of the securities transactions, as well as the level of disclosure of the structured product made by issuers, the question being whether the final holders of structured finance products have sufficient information on the dispersion of credit risk and whether regulators and market participants receive sufficient and regular information flows on the nature, the amounts and the location of these desintermediated risks.

Lastly, comes the issue of the valuation of structured products, which leads to the broader issue of accounting norms, risk modelling and the information given by financial institutions to their exposure to these products. It is indeed a

question of prudential supervision, but it is also an issue in terms of disclosure to shareholders, fund managers and markets participants when financial institutions are public companies.

Recent events have revealed that good coordination exists amongst financial regulators around the world and demonstrated the reactivity of international organisations. At the request of the G7, The Financial Stability Forum has set up a working group of chairmen presided by Mario Draghi to analyse and draw lessons from the crisis. In particular the mandate of the group is to develop a thorough diagnosis of the causes of recent events, identify the weaknesses that merit attention from policymakers, and recommend actions needed to enhance market discipline and institutional resilience.

This group is composed of the chairmen of the main financial regulators and of the international organisations of regulators such as IOSCO, the Basel Committee and the IAIS. In this particular circumstance, the FSF has clearly demonstrated its role within the global framework of international regulation

and standards setting. By initiating and ensuring consistency between the actions and work of the sectoral regulators and the ministries of finance of the G7, the FSF ensures coordination and efficiency at this critical level.

In order to contribute to the FSF's work and to analyse whether initiatives related to securities market standards and principles are to be considered in relation to the recent turmoil, the IOSCO TC has decided to set up a chairmen's task force.

In line with the mandate we adopted last Tuesday, we will, in particular, analyse the result of the recent review of the Code of Conduct Fundamentals for Credit Rating agencies which focuses specifically on the role of the rating agencies in the development of the structured finance market. We will also consider the issue of valuation. It is worth noting that IOSCO has just released its final version of a document on the principles of valuation of hedge funds. These principles, elaborated in close cooperation with the industry, could usefully serve as a reference to answer some of our current

concerns. IOSCO could then decide to continue and expand its work in this field. In this perspective, I would like to mention the recent contribution to the debate on hedge funds regulation delivered by the Hedge Fund Working Group under Andrew Large's chairmanship. I would like to congratulate the authors for this report published a few days ago, which will certainly be a cornerstone for further global discussions on the subject. I have noticed with great satisfaction that, wherever this report focuses on the same issues as the ones currently dealt with within IOSCO, such as valuation of hedge funds, the analysis and the recommendations made are indeed very close. It did not escape my mind that the report also promotes a dialogue between IOSCO and the Board which should be in charge of maintaining these standards. I am sure IOSCO would be very keen on developing such a dialogue within a framework that needs now to be further defined.

The TC Task Force will also consider the issue of transparency of the structured finance market, as well as some issues related to accounting principles. In this domain,

the question of special purpose vehicles is also at stake. Last year's report on this subject will be reviewed to see if additional work is needed.

Recent events highlight, were it needed, the importance of cooperation between regulators, as financial centres and financial markets are closely linked together and interdependent. I would also like to stress the importance of working in close cooperation with the industry, as the regulation of more and more complex and innovative products in a global market makes necessary the development of industry codes and guidance.

May I remind you that on the occasion of our last year TC Conference in London, I announced that IOSCO had the ambition to develop a more fruitful dialogue with the international financial services community. For the first time, we published last spring a work program outlining the main streams of our work and the issues identified as potential concerns. I would like to thank market participants for their

very positive, numerous and rich comments and proposals. It has shown that a true and significant interest exists for the exercise. Our purpose in proposing this dialogue is twofold. The IOSCO Technical Committee would like to gather views from the market stakeholders on possible areas for work in the future with the goal of increasing convergence and harmonised supervisory practices to enhance cross border business, but also to share concerns with the industry on possible market weaknesses, in order to better anticipate regulatory failures.

Following a first informal meeting in Madrid with representatives of international associations of market participants, we devoted the afternoon session of the TC meeting yesterday to a formal meeting with the industry. The TC has decided to hold such a meeting annually to address issues and concerns raised by market participants, to discuss the work program in greater detail, and to identify progress and weaknesses in terms of convergence. Yesterday's meeting was very fruitful. We have not only discussed a way forward in broad terms, but also initiated substantive

discussions on various issues. I do believe that this dialogue will be productive for both regulators and market participants.

Finally, I would like to say a few words on two important reports IOSCO has just released. The first one is on private equity.

This report addresses risks that also appear to be topical to me. Indeed, loans linked to LBO also end up in the securitisation market and lessons can be drawn from the subprime crisis to better assess the robustness of the market.

The second report addresses conflicts of interest that may arise when intermediaries are involved in securities offerings, in particular the management of information flows. It is a very useful report that provides examples and discusses various approaches. We have taken on board comments received during the public consultation and I hope the industry will read it carefully and implement its recommendations.

To conclude, I wish to underline the commitment of IOSCO's Technical Committee members to cope with the issues of today, their willingness to work with other regulators and supervisors, and with our colleagues of the emerging markets Committee, as well as with the Industry, to improve our

standards and their effective implementation. Market turmoil is probably a fact of life. But we can draw lessons for the future and improve the resiliency of our market systems.

May I express the wish that the debates of this Technical Committee Conference enlighten our work of tomorrow and may I once again whole heartedly express my thanks to our friends of the Japanese FSA for their hospitality.

I wish you all fruitful debates.

Thank you.