IOSCO 2017 Annual Conference

Panel 1: How can we make capital markets more structurally resilient and address any evolving systemic risks? Are we striking the right balance between financial stability, investor protection and market efficiency?

Prepared by:
George Roper

Scotiabank

Viewpoint

- We could rephrase the panel discussion theme as:
  - *"How can regulators avoid adverse unintended consequences when taking steps to enhance the resiliency of capital markets?"*

- This question supposes that regulators ought to try and avoid adverse unintended consequences.

- We agree with that proposition and believe that an exclusive focus on the fundamental pillars of securities market regulation greatly helps the effort to minimize unintended consequences.

Situation Analysis

- Current context of Jamaica:

  - Significantly enhanced regulatory framework following mid 1990's financial sector crisis, culminating in creation of Jamaican FSC in 2001.

  - Enhanced economic prospects following commendable fiscal restraint under IMF agreements since 2013.

  - Jamaica Stock Exchange was leading exchange globally in 2015.

  - Focus of Jamaican regulator (FSC) has been on containing systemic risk by way of:
    - Facilitating independent custody of assets sold by securities dealers under repurchase agreement
    - Removing legal impediments to establishing collective investment schemes
    - Enhanced prudential requirements for securities dealers

Regulatory Risk

- Regulators are in the business of influencing behavior. They do so by creating incentives for good behavior and disincentives for bad.
- Unintended consequences often arise from actions taken by Regulators as they pursue their aims.
- Some unintended consequences are adverse in nature:
  - Hanoi Rat plague of early 20th century
  - Delhi Cobra plague

Why didn’t we see that coming?

- Robert K Merton – the renowned American sociologist - in 1936 wrote an influential article on “*The Unanticipated Consequences of Purposive Social Action*”. In that paper Merton posited the view that unintended consequences of conduct often had five sources:

1. error;
2. ignorance;
3. imperious immediacy of interest;
4. basic values; and
5. self-defeating prediction.

Why didn't we see that coming?

- Failure on the part of regulators to account for or foresee adverse unintended consequences is often rooted in the following:

  i. **Confusing correlation with causality** thus leaving root causes of problems unaddressed;

  ii. **Ineffective prior consultation** with stakeholders because of undue haste;

  iii. **Linear thinking** that focuses on one or two variables instead of taking a more dynamic view of possible reactions to a proposed regulatory measure;

  iv. **Assuming one size fits all** and so not taking into account factors such as stage of market development or cultural differences before adopting rules from other markets; and

  v. **Not adequately assessing the costs versus benefits** of a proposed measure before implementation.

How can we make markets more resilient without hurting the interests of investors?

1. Follow Ontario Securities Commission’s (“OSC”) example of issuing statement of priorities periodically. This gives early signal to stakeholders as to what subject matter they need to conduct research into. This in turn will lead to a more efficient and effective consultation process.

2. Recognize that simplicity is a virtue. In that vein I urge our regulators to consult on how regulatory burden may be reduced. This is something that is actively being pursued by the OSC and the other members of the Canadian Securities Administrators (CSA).

How can we make markets more resilient without hurting the interests of investors?

3. Recognize that robust investor protection and enhanced market efficiency will foster the desired financial stability since they engender confidence in the markets and financial institutions. As such securities regulators should focus on the key pillars that undergird efficient markets, namely transparency and fairness

How can we make markets more resilient without hurting the interests of investors?

4. The regulators must also be fearless in enforcing the laws whenever bad actors violate the rules. The enforcement must however be proportionate. We have seen some commentators making a link between recent heavy fines of international banks to the correspondent banks de-risking of the Caribbean. Correspondent banking de-risking of indigenous Caribbean banks threatens to undermine the health of our economies.

5. Enhance coordination between regulators, nationally, regionally and globally. IOSCO’s enhanced MMOU should assist in this area.