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Plenary 6

Transparency in the Regulatory Process

19. Why Transparency Matters to Markets,

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Good morning. I am extremely happy to be here. Being a private sector participant presenting what our moderator Jim Newsome has called a "wish list" on regulatory transparency to regulators – as I and the International Committee of the US Securities Industry Association have been doing – doggedly, probably annoyingly – for the last two years may be seen as overly aggressive. But, in fact, the process of urging regulators all over the world to consider our paper – and interacting with them as they respond – has exemplified, at its core, exactly what we in the private sector view as the benefit of regulatory transparency: a frank, constructive, sophisticated – even if occasionally contentious – conversation about ideas, markets and rules between regulators and the regulated.

To avoid loneliness on my part and to confirm the global trend toward regulatory transparency Chairman Newsome earlier described – let me emphasize that the SIA and I are in very fine company on this issue. IOSCO (of course), the OECD, the regulators at Basel, the WTO, the IMF, the World Bank and APEC have all strongly endorsed regulatory transparency over the last years – whether through binding rules, through papers setting forth basic principles or codes of conduct, or through examinations and training programs for regulators.

In the UK and Japan – surely among the largest, most successful and liquid markets in the world – regulators have recently committed themselves to extensive disciplines of regulatory transparency. And the European Union is experiencing nothing less than a true revolution in financial sector regulatory transparency – inspired, certainly in part, by the Report of the Wise Men's Commission chaired by Baron Alexandre Lamfalussy whose speech opened this IOSCO conference. As you know, the Lamfalussy report pulls no punches. It endorses prior notice and comment, regulators' explanations and public hearings– at virtually <u>every</u> stage of the regulatory process, from conception to implementation.

We applaud and welcome these efforts and these new regimes – and look forward to participating actively in all of them.

Earlier this year, PricewaterhouseCoopers published a study proving that regulatory transparency is not merely a theoretical issue. They called it "The Opacity Index[1]. Rather than extolling the "softer" – less quantifiable – virtues of transparency with which we are all familiar, they chose to quantify the "hard" costs of its absence: the costs of "<u>opacity</u>."

How much does it actually cost a country, they asked – in lost foreign direct investment, in lost portfolio flows, in higher bond premiums, in market participants who go home – to keep its regulations a secret? to enforce them selectively and unfairly? to spring them on the marketplace without warning? to enact them without the benefit of prior notice or consultation? They concluded that countries with a high "Opacity – or 'O'

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[1] <u>**The Opacity Index**</u>. A Project of the PricewaterhouseCoopers Endowment for the Study of Transparency and Sustainability. January 2001.

-Factor" – a blended number reflecting weak rule of law, corruption, untrustworthy accounting principles and low regulatory transparency – do in fact suffer a great deal. The costs are real: risk premiums for high "O-Factor" countries can be as much as 10 percentage points higher than for comparable markets with lower "O-Factors."

I am here as additional proof – luckily more anecdotal – that the PricewaterhouseCoopers study is very right. The costs of opacity – to countries, to markets – are huge. In fact, too huge to ignore.

I know because our own people tell us so. The SIA Committee's interest in regulatory transparency in fact grew out of the new round of financial services trade talks in Geneva. We asked our business units what barriers they faced in the countries in which they do business. In past negotiations, such as the Uruguay Round, their answers were typically: "We can't open an office in country A," or "Country B won't let us own a seat on the local exchange."

This time, however, reflecting the progress made by so many countries on market access and national treatment, their answers were very different. This time, the bankers' answers almost always focused on regulatory barriers:

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- "We don't know the rules in country X and we can't find them out."
- "The rules keep changing and we don't know about it until after we're told we've violated them."
- "New rules are constantly being published and they're usually terrible for the market."
- Finally, the bankers would complain about the bad new rules. They'd say: "If only they'd asked our advice…"

Our firms in their many roles – as underwriters, as mutual fund advisors, as portfolio investors, as direct investors in the local financial sector – will commit less capital and resources to countries that make it harder to do business. Where the rules that govern returns are not known or predictable, inbound investment is jeopardized. Investors simply don't like to do business or invest in markets where they can't find out the rules or where, worse yet, only local firms know the rules or know which ones will be enforced. They don't like to do business or invest where the ground rules change without warning.

Clear and understandable regulations provide market participants with predictability and the knowledge to comply with regulations. Regulatory transparency serves the healthy goal of requiring regulators to articulate their regulatory objectives. Opaque or ambiguous regulations and rulings create uncertainty – and uncertainty is an enemy of the capital markets.

Finally, we believe transparency makes for better regulation. We regard ourselves as professionals with expertise. We believe our input can help make regulation better. And not only our input. Frankly the greater the range of interested parties that is solicited for input – both inside and outside the market – the more prepared regulators will be and the better the resulting regulation will be. Just look at the comments submitted on the new Basel capital adequacy proposal. At last count there were 244 responses (including one from IOSCO!) – sent in from nearly every continent. We truly believe if the Basel Committee genuinely considers these comments, its final proposal will more accurately reflect – and address – market realities. You simply don't know who is affected by a rule – or how – until you ask everybody.

Unintended consequences are also enemies of markets.

So that is why we think transparency is so essential.

But what do we mean by regulatory transparency? What is this great good to which we and so many august institutions are now committed?

We often say, in the words of a US Supreme Court justice talking about something else (obscenity, actually), that you know transparency when you see it – or, perhaps in this case more precisely –see *through* it. In principle, everyone in the world endorses transparency. Who could not? Or could afford to say they don't? But defining it is hard. After all, transparency is fine – as long as you're asking someone else to be transparent. It's fine – as long as you don't make it compulsory. Because when you make regulatory transparency compulsory, when you make it statutory – it's not enough to "know it when you see it." At that point, you have to write it down. At that point, you have to agree about what it means.

The US securities industry, with great support from our colleagues abroad, decided to take up that challenge and articulate what <u>we</u> think regulatory transparency means specifically for the capital markets – and to see if we could get others to agree with us. That is what the paper – "Promoting Fair and Transparent Regulation" – sets out to do.

We thought it was worth the effort – because, as you've seen, we believe regulatory transparency is not only critical to, but an essential foundation of "just, efficient and sound" capital markets -- the creation of which is, after all, one of fundamental goals of IOSCO itself.

Let me first reassure you about what we <u>don't</u> think regulatory transparency means – and get that out of the way. We do <u>not</u> mean to prohibit regulators from adopting rules or taking enforcement actions based on prudential concerns or to accomplish legitimate public policy objectives. We fully support those rights. Indeed, the WTO enshrines them.

Also, our definition is purely procedural. We do not purport, in the paper, to tell regulators what substantive rules to adopt. We focus on creating a regularized process by which rules – we hope <u>good</u> rules – have the best chance of being adopted, known to all and applied consistently and fairly. (Let me make clear, we fully intend to take advantage of the process the paper describes, to tell regulators when we think rules are bad and when we support them. However, the paper itself merely sets forth a process.)

We began looking for our definition of regulatory transparency in the best of all possible places: the IOSCO principles themselves, of course.

Section 6.5 of IOSCO's *Objectives and Principles of Securities Regulation* recommends that regulators adopt processes and regulations that are:

- consistently applied;
- comprehensible;
- transparent to the public; and
- fair and equitable.

We then amplified Section 6.5 – based on our own global experience – in order to complement IOSCO's work. We concentrated our vision into six basic principles, which built upon, and are supportive of, Section 6.5:

1. Rules, regulations and licensing requirements should be considered and imposed, and regulatory actions should be taken, only for the purpose of achieving legitimate public policy objectives that are expressly identified.

2. Regulation should be enforced in a fair and non-discriminatory manner.

2.1. Regulations and regulators should not discriminate among licensed market participants on the basis of the nationality or jurisdiction of establishment.

2.2. The relationship between a regulator and a licensed market participant should be governed by the standards set forth in relevant rules and regulations.

2.3. The introduction of new securities products and services by firms should be governed by the standards set forth in relevant rules and regulations.

3. Regulations should be clear and understandable.

4. All regulations should be publicly available at all times.

5. Regulators should issue and make available to the public final regulatory actions and the basis for those actions, in order to enhance public understanding thereof.

6. Regulators should use open and public processes for consultation with the public on proposals for new regulations and changes to existing regulations. A reasonable period for public comment should be provided.

From the start we said our paper and our project was the beginning of a dialogue with regulators about best transparency all over the world. Based on our experience we tried to write down what we think works best in most cases. But we have always recognized that there is no “one-size-fits-all” regulatory system.

Furthermore, we know there are – and must be – exceptions to regulatory transparency in order to protect market participants and to protect regulators. Formulating those exceptions, without eviscerating the system, is one of the hardest challenges of all.

Finally, let there be no doubt that regulatory transparency – especially prior notice and public comment – does not obligate regulators to follow what they consider to be bad advice. In the US, just as we often file comment letters disagreeing with a proposed rule, so too do our regulators often disagree with our comments and proceed to adopt the rule anyway or decline to make our changes. Regulation FD, which the industry uniformly deplored, is a recent example. By contrast, the "Aircraft Carrier Release" – which would have changed much of the underpinnings of securities registration in the U.S. – was withdrawn by the SEC after heavy industry criticism.

But the point of transparency is as much the explanation as the result. As I said at the outset, it is the process – the frank, open and genuine conversation – that is so good for markets.

We are gratified that Europe and FESCO and other IOSCO members are moving towards procedures that will involve market participants early and at all subsequent stages of the regulatory process.

Our global experience teaches us that transparent regulatory regimes result in regulations that reflect the best experience and wisdom of each market. They enable regulators to assess the full range of sound alternatives available to them and allow them to avoid initiatives that waste time and money and can harm their markets.

We are very grateful to IOSCO for creating a panel on the subject of regulatory transparency – and especially for giving us the chance to participate on it.

As an industry we believe wholeheartedly in regulatory transparency. As a result, we stand ready to help, to advise, to participate – and to offer our best judgment – at any time, and on any subject, wherever that advice may lead.

Thank you.