International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

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Let me begin by thanking the Atlantic Council for this kind invitation and platform, and to Fred Kempe and Alexei Monsarrat in particular. I am looking forward to debating the issues I raise – and I am expecting some sharp questioning from my moderator, Frank Kelly, and others here this afternoon.

I want to emphasize that I am speaking in a personal capacity this evening and my remarks should not be interpreted as being an official IOSCO position or necessarily reflective of IOSCO members' views.

The issue I would like to discuss this evening is the future of global financial regulation. I want to look forward 15 or 20 years and ask if we have the right global institutional structures in place for the tasks at hand and the profound market changes that are likely. Are we building sufficient rigor and discipline in the global regulatory reform process that has been set up so that we are truly minimizing the chances of a repeat of this massive systemic financial crisis that has caused so much economic damage to a significant number of OECD countries? Note I am saying a significant number, but not all. And not in Emerging Market economies; any damage there has been mostly limited to the indirect macroeconomic effects of weakening OECD economies. Most estimates I have heard suggest a loss of around 15% of global GDP due to this crisis so far. We have witnessed very large increases in unemployment and as we can see the social fabric of some European countries is being stretched to the limit. It seems to me that there will be some more years of pain ahead as deleveraging continues and as some major economies restructure.

Let us begin by a quick analysis of the current global regulatory situation. We are in year six of this financial crisis, but the global regulatory job is far from being completed. But let's look at the **positive side** first.

- We have set up the G20 and given the Financial Stability Board (FSB) enhanced global regulatory coordination. This is working and, so far, is reasonably functional. The UK, in particular, played a major role in establishing these new arrangements but, as always, the U.S position was vital as well;

- Work is proceeding apace –very process and timetable driven – but, rightly, often in horizontal groups, with Basel Committee on Banking Supervision (BCBS), IOSCO, FSB, Committee on Payment and Settlement Systems (CPSS) the most prominent International Organizations;

- Work is being carried out on a vast range of subjects: one leading US agency claims there are no less than 182 global working groups of various types that they should really attend at global level;

- Decisions are almost always taken on a consensual basis – the" sense of the room" at best – but unanimity in some circumstances;

- There is some regulatory progress on most of the key subjects : recovery and resolution planning (financial institutions and financial market infrastructure), too-big-to fail and global SIFI (systemically important financial institutions) identification, bank capital requirements through the Basel III agreement, OTC derivatives and the shadow banking system;

- A serious effort is underway to strengthen implementation – through regular G20 Financial Sector Assessment Programs (FSAP), the FSB's Standing Committee on

Standards Implementation (SCSI), IOSCO's Assessment Committee, BCBS' monitoring etc;

- There has been strong leadership of the FSB, formerly by the European Central Bank's President Mario Draghi and now by Governor Mark Carney.

Now the **problems**.

- There is insufficient prioritization of the many subjects on the agenda;
- Very few bodies involved in this work can claim they represent the whole global community of regulators in their sphere of influence. (IOSCO, however, can). Emerging countries, in general, are under-represented in the global financial reform process;
- Consensual/unanimous decision making often dilutes the policy outcomes;
- On occasions here are too many global bodies scrapping for competence or competing in "beauty contests" for new regulatory subjects, wasting scarce resources. Two examples – a proliferation of groups dealing with the financial benchmarking scandals; no less than 18 international Organizations cited in the most recent G20 Finance Ministers communique in barely two pages of text on the financial reform agenda;
- There is a domination of Central Banks and bank regulators in the key global policy committees (e.g., in the FSB), leading to the predominance of a policy culture of risk minimization, rather than risk optimization, that some feel may not be always appropriate for securities markets.
- In some cases economic impact analysis of policies are being carried out ex-post, downstream of policy determination; insufficient consideration of cross border legal complexities is another concern. Basic global data bases are also still incomplete with

insufficient attention being paid to property market developments – the frequent catalyst of systemic financial crises;

- Does the global agenda sufficiently take into account the crucial need to change behavior, ethics and incentives in firms – e.g., the importance of corporate governance reform in firms, deterrent sanctions regimes and remuneration discipline? In my view, no. The major firms that failed in this crisis were characterized by megalomaniac male CEO's; woeful risk management; with Boards frequently composed of "nodding heads" or "poodles"; along with auditors who did not warn about the risks building up in spite of their public watchdog function;

- One leading expert concluded recently on the global reform process that "…enthusiasm is waning; cohesion weakening; political focus drifting; there is a need for re-energization…"

- **And now the crucial issue** – will the agreed global policies and standards that are emerging be properly implemented by all jurisdictions? Evenly? Equivalently? Without distortion of competition or capital flows? Without regulatory arbitrage?

Leaving aside the current difficulties on global accounting convergence, or cross-border conflicts of laws for auditors, or OTC Derivative implementation – margin requirements and swap dealer registration, or the timing and uncertainty of Basel III implementation, let's consider the toolbox that global regulators have available to ensure consistent implementation.

The tools can at best be described as soft: peer review; transparency; monitoring plus and, depending on your faith, perhaps the most potent of all… prayer! There are no binding tools whatsoever at the global regulatory level. No legally binding enforcement; no disputes

settlement, like in the WTO; no sanctions. In short any jurisdiction can basically do what it wants and face no effective or deterrent repercussions.

Does this matter?

Leaving aside the issue of political credibility of the whole global regulatory edifice – and nothing erodes international politics more than the non-delivery of agreed policies, especially when endorsed by the leading Heads of State and Government in the world – yes it really does matter.

It does matter of course because financial markets are highly interconnected, and in more and more complex ways. Interconnectedness means risk sharing and risk transfer. A crisis in one affects others, and as we have seen can be quickly amplified into dangerous global contagion. It does indeed matter if the US allows the selling of trillions of dollars of mortgages irresponsibly, like subprime, with the resultant packaged securities flogged around the world with AAA ratings; it does matter for global financial stability and economic confidence that EU banks are properly capitalized; or that the accounts of financial institutions are understandable and transparent, using realistic impairment formulae. Or that failing financial institutions can be wound up and deposited in the corporate graveyard without contagion, collateral damage or Governments providing expensive backstops and bail-outs. The EU, for example, has poured 1.7 trillion euros so far into propping up its banking system, the equivalent of 13% of GDP with authorization to go further. If bank capital is low and leverage dangerously high in one part of the world that has a significant financial market and subsequently there is a big property market crash there are bound to be both micro- and macroeconomic contagion effects elsewhere in todays' globally interconnected markets. And what about Madoff type scandals? Or the LIBOR debacle? Are there not serious global concerns in these cases as well?

Compliance with agreed, well worked out, effective global standards is a public good that, ceteris paribus, will enhance global financial stability and economic welfare. Yet, in reality the global implementation tool box is bare to ensure it.

Now let us look forward 15 -20 years, maybe less. What can we say about possible financial market developments?

- First, that there will be many more big capital and securities markets in the world because they are needed for economic development which is powering ahead in Asia, parts of Latin America and beginning also in Africa. A few figures: in the last decade growth in emerging market countries has expanded by 82%, but only 14% in developing countries. Developing countries are now 2/3 of the size of advanced economies. By 2020 PWC projects that China, Brazil, Russia, Mexico, India and Turkey (E7) will have overtaken the G7 in terms of GDP. China overtakes the U.S by around 2040. By 2050 E7 could be twice as large as G7. HSBC's research ("The world in 2050") identifies 26 fast growing countries (>5% annual growth to 2050) and 43 growth countries (3-5% annual growth/year to 2050), 11 from Latin America. Of the top 30 economies in the world in 2050 their research suggests 17 could be emerging countries.

- Securities markets provide 60% of total financing for the BRICS (Brazil, Russia, India and China) – similar to the U.S. BRICS equity markets are currently about half the size of U.S. markets and growing very fast. They are six times larger than they were in 2002. BRICS bond and derivative markets are smaller in relative terms but are also beginning to grow quickly as well.

- Brazil, India, China, Indonesia, Singapore, Hong Kong, Russia, Turkey and Mexico to name a few will have much bigger markets than today. Interestingly we are seeing capital market integration projects spawn in ASEAN, East Africa, Southern African

Development Community (SADC) and in Latin America. I can see my members' urgency to progress their capital and securities markets by wanting the cachet of becoming signatories to the IOSCO MMOU on cooperation and exchange of information, or by the growing demands we are facing for technical assistance from them to adopt core IOSCO principles of securities regulation. The good news here is virtually all countries get it – e.g., that they have to develop their local capital and securities markets. There is no other option.

- Second, all the fast growing regions of the world fully realize that they cannot rely on the international banking system to support their economic development ambitions. This crisis has demonstrated, again, that the latter are often fair weather friends – there in the good times, but "arrivederci "if things are tough back home on the ranch and capital is needed at base camp;
- Third, banks will be permanently restrained in the future with much higher levels of capital and lower leverage. Basel III ramps up bank capital requirements so far by a factor of five or more. Margin requirements for OTC derivative trading, for clearing, for repo haircuts and collateral for central bank loans will absorb further capital. This means that the worlds' capital and securities markets must develop and take up the financing and credit supply slack which evidently will not be provided by the public sector, often weighed down itself by high levels of debt.

These trends taken together, mean a major global expansion of market based financing and securities markets is going to happen – replicating in many ways the U.S financial model.

If this is broadly correct it can be argued that we have a "simple" world today – by which I mean only a few big capital markets, with varying levels of compliance and interpretations of global rules. A five by five matrix say of big, weighty capital markets and interpretations. Maybe just

about manageable in most cases with ad-hoc firefighting and informal agreements. But now add in another 10 big capital markets, or more, in the near future so that the matrix of big markets and interpretations is 15 by 15, or more. This future interconnected world – with the distinction between developed and developing countries more and more blurred - will have many more big financial markets and could be much more prone to shocks and cross-border contagion: More vulnerable, perhaps, to new forms of capital protectionism; far more prone to widely different interpretations of global standards, with a higher propensity for overlapping laws and cross-border legal disputes. And certainly with the risk of much higher frictional costs for business who could face multiple sets of regulatory rules.

So who will resolve the global disputes? Or ensure correct interpretations of global standards? What penalties will there be for global regulatory pariahs and miscreants? The dual answer is that if we don't change our global financial regulatory institutions, no one; and none.

In essence we have three global financial regulatory options for the future:

(1) The law of the jungle and the survival of the fittest. I would suggest from a global financial stability perspective this would be highly prejudicial and dangerous;

(2) The Status Quo we have today – loose forms of cooperation, hope for the best, best efforts and of course prayer;

(3) A global institutional framework, probably established by International Treaty, that has some enforcement authority, binding disputes settlement and sanctioning possibilities. Now before I lose you all in the U.S., and in this room, ask ourselves who would gain most from such a constellation? Certainly there would be a global gain in terms of financial stability because global standards would be consistently applied; smaller jurisdictions could protect themselves, like in the WTO disputes settlement process, by

having rights to defend sound regulatory practice and avoid suffering the dis-benefits of erratic implementation say in bigger jurisdictions.

This global Institutional framework should encompass at least the FSB and the main global sectoral standard setters. Its role would not be to try to enforce a one-size-fits-all harmonized set of rules – but rather to ensure and, if necessary legally require, that the basic globally agreed policy principles are properly implemented by all jurisdictions who are signatories to the Treaty arrangements.

But surely the biggest gainer of all would be the U.S. itself – notably its financial industry writ large which is still the most powerful and diverse on earth. The U.S. industry would have huge export opportunities in the predictable, big, well regulated markets of tomorrow. Indeed agreement on the new global financial regulatory framework could be accompanied by supplementary market opening initiatives in the WTO.

There is also an important Emerging Market perspective here. Some Emerging Market countries are (rightly) growing in confidence to consider themselves as having graduated to the "emerged" category. Others continue to look towards developed economies by learning from their successes and, recently, their shortcomings. IOSCO has a major role to provide technical assistance to help its members develop their securities markets on the basis of sound IOSCO standards and principles and intends to step up its efforts by developing an IOSCO Foundation for this purpose. That said the U.S. is still considered to have the leading technical expertise on the intricacies of financial markets – but will this always be the case as the ladder changes? Could U.S influence decline significantly if it shuns efforts to enhance global regulatory coordination and institution building?

So the U.S. has a unique opportunity now, perhaps with coalitions of the willing, to help shape and lead a movement towards more effective global regulatory institutions – a window that may

last 5-10 years or so, but not more. After that the U.S.' relative share of global financial markets is set to decline significantly, and naturally its influence as well.

I believe most of the world would be prepared to consider work on such a project – and I believe, with or without the U.S – it will eventually happen like with the International Financial Reporting Standards or IFRS. Isolationists will no doubt plead what they always plead. They will argue, with their 19th century logic, that the U.S. will be better off alone, not sharing any sovereignty. Perhaps they will continue to believe that in 15-20 years' time the world will be composed of disconnected, independent islands – the biggest of which can project its views on others. But surely that is the past and a denial of globalization. To repeat the new emerging world will have very soon many big, interconnected capital markets. There will be many more sharks in the pond with far more influence.

So is it to be the law of the jungle, the soft toolbox or really effective global institutions with some legal authority, built up step by step, that will give us the best chance to enhance global financial stability and maximize economic welfare? Mutual recognition, substitute compliance or equivalence regimes could be first steps on the path but they will not suffice because they are subjective and contestable and practically unrealistic in the 15x15 matrix I described above. Some suggest a TransAtlantic Treaty would be a good start – even as part of an EU-US FTA agreement. Such initiatives could also be useful and a good catalyst, but again they are insufficient given the massive growth of financial markets elsewhere in the world that I have described above.

I end with a European thought. For all its faults, the EU would never have progressed its single market or global footprint without Institutions to propose, enforce, resolve disputes and if necessary sanction. Without these fundamental institutional elements people, capital, goods and

services would not circulate rather freely in the EU on the basis of common enforceable standards.

This European institutional logic applies, pari passu, at the global level and the sooner we recognize it the better. The alternatives contain unacceptable long-run risks to global financial stability.

Thank you.