

## IIF-Frankfurt, Germany-June 27, 2007

### Introduction

When financial fraud makes the evening news, you can usually rest assured that there are cross-border elements in the fraud. Let's take the example of false disclosure by a listed firm: this firm will have foreign shareholders that, if any wrongdoing is concluded, will request compensation. The firm may have received credit or support from a foreign bank which may or may not have known about the fraudulent practices. The stock of this firm may be traded in the exchanges of different countries so if one supervisor or exchange stops trading the stock, the other exchanges will have to react. Financial markets form a huge international chain, undeterred by borders, and touching the lives of millions of persons all over the world. Many financial regulators are involved, all having the responsibility for their own national markets and the welfare of their own investors. But who takes responsibility for the smooth functioning and the welfare of international investors as a whole? Officially, nobody. In practice, IOSCO has tried to fill this gap. Indeed, it is now more than 20 years ago since IOSCO was established as the common voice of the international securities regulatory community.

While over the last few years we have witnessed large international financial frauds, we have seen relatively few problems in the coordination of adequate responses by enforcers and regulators. Of course there are regulatory burdens and firms still have to deal with a large number of regulators and an increasing number of regulations worldwide, but in enforcement matters the financial regulators have usually been able to come to agreements on where regulatory responsibilities lie and how to come up with concerted and adequate regulatory responses.

One of the ways through which they have been able to do this is by taking advantage of the opportunities provided by IOSCO to act as a forum for regulators to come together. For years now, IOSCO has been a platform on which the regulators of the world meet to exchange experiences, try to come up with common regulatory responses and inform each other of issues they perceive as emerging threats to the integrity of financial markets. One of the most significant achievements of IOSCO is that this is done in an apolitical and pragmatic way so that, if necessary, IOSCO can respond within a relatively short time frame. For example after the corporate scandals at the early part of this decade, IOSCO developed a series of principles on financial analysts and auditors independence to address conflicts of interest issues. We then designed a Code of Conduct for Credit Rating Agencies within a matter of months. Not only has this Code been welcomed and implemented within the industry but it is now widely accepted as the international standard.

I would now like to discuss how IOSCO has developed its principles for securities regulation which form a key contribution to worldwide financial integrity and stability. This is what I call the IOSCO Method. Afterwards, I will outline a few concrete examples of our activities, particularly the cross border mechanism for the exchange of

information. Finally, I will conclude by saying something about our dialogue with the securities industry.

### **The IOSCO Method**

The IOSCO principles form the basis of securities regulation worldwide. IOSCO's 30 principles which were endorsed in 1998 cover most aspects of securities regulation and give clear guidelines to securities regulators as to what minimum requirements their regulations and day-to-day practices should meet.

IOSCO principles are outcome based. In general terms, they do not prescribe rules or policies that should ensure investor protection. Rather, they indicate that investor protection is ensured when it meets certain requirements. How regulators want to achieve this worthy objective is up to them (examples: "Principle 14: there should be full, timely and accurate disclosure of financial results and other information that is material to investors" or "Principle 22 : There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake").

The IOSCO principles need to be outcome based as different national securities regulations operate in different circumstances. They need to be adjusted to the level of development of a market as well as local market circumstances. For instance, a country with one exchange and 9 liquid listings will demand a different approach than a highly developed capital market. Likewise, there is a need to take into account issues such as the general sophistication of investors in each market.

We should naturally take into account the intentions of investors that operate within different jurisdictions. The USA counts many retail investors as they invest in order to ensure their pensions. In many countries of the EU people rely more on collective and public pension schemes and therefore retail investors are less active in these countries. In yet other countries, such as Spain, people are more inclined to invest in real estate in order to ensure financial security into their retirement years.

We also need to take into account that principles might be used under different regulatory frameworks. Often cited, for example, are the rule based approach and the principle based approach. Regulators from emerging markets along with new members of the EU often opt for a rule based approach as the participants of their markets are not used to sophisticated markets and are it is argued, better served by strict and unambiguous rules. On the other hand, the sophisticated markets of some of the more mature European markets have applied principle based supervision for a few years now as they feel that their market participants should interpret their own responsibilities within a broader regulatory framework. IOSCO does not take a view one way or the other about the appropriateness of any of these systems and nor should it since quite clearly problems and successes seem to occur in all.

IOSCO continually reviews its principles to ensure they are up to date. If needed, principles are added, but more often, instead of reverting to principles, IOSCO will choose to issue guidance or recommendations both for regulators as well as for the industry. A good example of this flexible approach is the CRA Code of Conduct where we rely on market discipline through a comply or explain rule.

One area where we are making recommendations is Market Intermediary Management of Conflicts that Arise in Securities Offerings. In this project, we are investigating information flows within market intermediaries as well as between them and issuers and investors in order to identify potential conflicts of interest and how the market intermediaries involved manage information. In a consultation paper that was published in March of this year, IOSCO proposed some possibilities for addressing the conflicts of interest that we think arise in securities offerings. We believe that issuing recommendations such as these provides useful guidance to the industry and ultimately helps to promote convergence of the approaches of regulators.

### **International convergence and mutual recognition**

Major corporate scandals at the beginning of the decade led to a strengthening of securities regulation worldwide, particularly in the USA, with more stringent enforcement actions. At the same time other significant international regulatory initiatives took place including the IFRS implementation in Europe and in other parts of the world, the new Basel II framework, the FSAP in Europe including MIFID along with other major pieces of regulation. All these evolutions converged together and added extra requirements which were perceived and described by some as a regulatory “burden”. This resulted in what some commentators have called “regulatory fatigue”. Meanwhile competition between financial centres is growing and is leading to questions about the adequacy of the legal and regulatory environment in a global financial world. The most recent NYSE and Euronext merger for example, raises questions on the same complex topic of what is meant by “good” or a “better” regulation.

To improve the regulatory environment and develop efficient regulation without gaps and/or overlaps there are usually three methods in an international context which are not mutually exclusive:

- Harmonization, which can be a long and complicated process which is usually costly and not always practicable,
- Convergence, where the process is as important as the target itself and which often requires a “roadmap” with a timetable as well as clearly defined steps and agreed final objectives such as in the case of IFRS/US GAAP, and finally
- Mutual Recognition, where one must agree on a common basis of international principles to assess foreign regulations and ensure coordinated recognitions and global consistency.

Apart from the European jurisdictions and some promising steps by the US, a worldwide application of mutual recognition is still very far away. However, the core requirement of mutual recognition, a clear and common set of globally recognised principles, has to a large extent already been established by IOSCO. It provides, I believe, the foundation for the recognition of a satisfactory degree of equivalent or comparable regulation.

The best example of a form of mutual recognition is provided by the IOSCO MMoU. Following the tragic events of September 2001 and the subsequent threats to market integrity we realized that we had to make significant progress on the issue of information exchange for enforcement purposes. After 6 months of hard work we ended up with the now widely accepted IOSCO MMoU which was then endorsed in 2005 as the international benchmark to be met by 2010 by all securities regulators. The strength of the MMoU is that it is based on common international principles while recognizing regulatory variations in each jurisdiction.

IOSCO has a firm record of information exchange. Not only is regulatory information exchanged on the basis of the IOSCO MMoU, within standing committees and working groups regulators exchange information about their supervisory rules and policies as well. Apart from dealing with the exchange of information, IOSCO also provides guidance on what type of information can be exchanged. A clear example is the report on Multi-Jurisdictional Information Sharing which was published in April of this year. In this report IOSCO identifies the kind of information multi-jurisdictional exchanges and/or supervisors might need to exchange when fraud is suspected by one of the regulators involved. By identifying the kind of information, different regulators have the same perception of what information their counterpart might need, thus simplifying cooperation between them and speeding up the enforcement process.

## **Industry dialogue**

As was said before, globalisation is an unstoppable process and one of IOSCO's main objectives is to contribute as much as possible to limiting regulatory differences and regulatory burdens for firms that trade cross border. We do this through constant internal discussions between regulators and with systematic consultation with the industry. In addition, this year IOSCO launched an attempt to increase the quality and added value of its work by stepping up its dialogue with the securities industry. IOSCO does not only do this to consult on its existing work. It also wants to have an active dialogue with the market about existing and future problems in the market. We want to know, for example, how present regulation is experienced. Do existing regulations contribute to the overall integrity of the markets? Do they create unnecessary burdens? Further, we also want to hear the industry's views about current developments. Does a new trend pose a threat to the integrity of the market and are new principles or guidelines necessary?

The answer to these questions is important because IOSCO principles lead to conformity in the markets. If individual regulators create rules completely on their own initiative they

might do so from different starting points, different considerations and in the end might come to different regulations, creating new regulatory obstacles for cross-border firms.

In contrast, if a common response is created by IOSCO first, national regulators will still impose their own national rules, but they will do so on the basis of common international principles. There will still be cross-border differences, but at least the industry and IOSCO are assured that the individual regulations are based on the same principles. For that reason a pro-active attitude from both the industry and IOSCO is all-important.

Another important advantage of the industry dialogue is that through this dialogue IOSCO can make clear what the expectations of the regulatory community are vis-à-vis the industry. By discussing things first instead of resorting to prescriptions, IOSCO hopes to increase the awareness of the industry about certain issues.

A starting point of this “industry dialogue” is IOSCO’s launch of a consultation paper on the ongoing work of its Technical Committee. In it we give an overview of the issues we are working on or are planning to work on. We are interested to hear from market participants how they feel about these issues but also if they believe that IOSCO should carry out or even refrain from work in other areas.

During a recent meeting in Madrid with industry representatives in March, the feedback from industry was very positive. While there was initial feedback on IOSCO’s ongoing work, the main message was that the industry representatives recognise the importance of IOSCO’s work and that they are very happy to work closely together with IOSCO in order to achieve optimum international regulations.

## **Conclusion**

In the course of my contribution today, I hope I have helped to increase your understanding of the many ways in which IOSCO contributes to a more cooperative global regulatory environment. Chief among these are the IOSCO principles and our information exchange mechanisms known as the IOSCO MMOU. In addition, we try to be in constant dialogue with the industry to gain their perspective on the global regulatory environment. Likewise, we are continually working to update our own work, to identify regulatory gaps and to take away regulatory burdens through publishing recommendations or updates of our work.

Finally, I would like to assure you that regulatory burdens due to cross-border differences in regulation are not in the interest of regulators either. Our work is facilitated by knowing that our colleagues across the border have approaches comparable to our own and that we can have faith in the integrity of the firms operating from their jurisdictions. Therefore, the IOSCO members will continue to exchange experiences and to make common recommendations and principles thus creating a common and firm base for efficient regulations worldwide. We look forward to your input in these efforts.