

Developments in Global Securities Regulation

Jane Diplock AO

**Chairman, Executive Committee of IOSCO
Chairman, New Zealand Securities Commission**

**Institute of Actuaries of Australia – Biennial Convention 2007
Christchurch, 25 September 2007**

Introduction

Thank you for the invitation to this biennial convention. Let me start by confirming the intense interest of securities regulators in risk and risk management. Our job is promoting growth and stability in capital markets, and confidence among investors. Risk is, of course, fundamental to any capital market, and investors certainly need confidence as they weigh risk and expectations of return. The concept of risk and return also needs to be fully understood by investors, and in our domain this is, right now, one of the concepts most discussed in these turbulent times for finance companies.

You will appreciate that securities regulators do not protect investors from risks associated with specific investment decisions. We do, however, work to reduce risk from a market-wide perspective: we require comprehensive and timely information disclosure from the issuers of securities; we set high expectations of corporate governance; and we combat fraudulent and manipulative behaviour that threatens the integrity of the capital markets.

Global Capital Markets

And capital markets are, indeed, increasingly global. Global capital flows have surged since 1995 and tripled to US\$6.4 trillion reaching around 14.5% of world GDP. With globalisation has come the constant emergence of new financial products and of new ways of doing business. There has also been huge growth in retail investment – in individuals investing in markets directly or indirectly for retirement and other personal goals.

In this climate jurisdictions must develop legislative and regulatory mechanisms to help protect investors, and build confidence in their capital markets from both domestic and international perspectives. Countries need fair, efficient and transparent regulatory frameworks which are internationally acceptable. Securities regulators in New Zealand, Australia and around the world certainly have their hands full! And as an aside, as Chairman of New Zealand's securities regulator I am proud to note that New Zealand has embraced the challenge and been on a journey over the last two decades to bring significant changes to its regulatory framework. It has moved from an extremely light-handed regime to one close to international best practice, and is now a confident performer in the global capital markets.

Today I want to start with an overview of developments from a global perspective. The International Organisation of Securities Commissions (known as IOSCO) was established in 1983. I will review recent developments and some key initiatives led by IOSCO. I will also discuss regulatory developments in our particular part of the world. And finally I want to touch on private equity – a topic of intense interest here and internationally, and just one of the areas on the frontier of regulatory developments globally.

IOSCO

IOSCO has developed substantially over recent years in its global reach and standing. It is now recognized as the international standards setter for securities regulation. Its membership includes securities regulators in 109 jurisdictions – together members regulate and oversee over 90% of global capital markets.

IOSCO has a clear vision of markets which operate across the world on sound principles and standards, and regulators who can cooperate and exchange information across borders to enforce securities law. Members actively contribute to a broad and highly relevant programme of issues analysis, consultation and standards setting. Cooperation is centred on information exchange and on enforcement of regulation with securities regulators assisting each other where needed. In the language of IOSCO, we are working

to make markets everywhere “just, efficient and sound” – these are prerequisites for investor confidence and for the growth and stability of global investment activity.

The high quality of IOSCO outputs and the committed contributions made by members continue to strengthen IOSCO’s standing in the international financial community. One example of such leadership is our investigation into regulatory issues raised by Parmalat and other corporate collapses earlier this decade. IOSCO published a major report entitled “*Strengthening Capital Markets against Financial Fraud*” in March 2005. In this, and follow-up work, IOSCO led development of practical initiatives for the guidance of regulators, corporate leaders and other market participants.

IOSCO works with the Basel Committee on Banking Supervision, and the International Association of Insurance Supervisors -- the global standard setters for banking and insurance -- through the Joint Forum. We also work closely with the IMF, the World Bank and other bodies focused on the growth and stability of markets globally. Our standards are picked up and used throughout the financial community.

The process of analysing issues and developing the best regulatory responses is, of course, never ending. That is the nature of global markets. In 2005 IOSCO adopted a bold new strategic direction. It set itself four strategic priorities. First, IOSCO is confirming and developing its role as the global standards setter in securities regulation. That requires a proactive approach to promptly identifying emerging global issues and responding as appropriate. The organization has a very full technical programme, grouped into five main areas, these include:

- Multinational Disclosure and Accounting
- Regulation of Secondary Markets
- Regulation of Market Intermediaries
- Enforcement and the Exchange of Information
- Investment Management

One example of IOSCO’s leadership in promoting a high level of consistency in standards globally is our advocacy for International Financial Reporting Standards

(IFRS), and the establishment of an IFRS database. The database is a store of decisions on the regulatory interpretation and enforcement of these international standards in different jurisdictions. IOSCO member regulators participating in the database, including New Zealand and Australia, can use the database as a resource. When IOSCO notices a discrepancy in interpretation we refer it to the IASB.

This leads me to our second strategic priority – Our aim here is to have all IOSCO member jurisdictions implementing IOSCO’s *Objectives and Principles of Securities Regulation*. During the late 1990s, IOSCO identified three objectives of securities regulation. These are to:

- ensure that markets are fair, efficient and transparent;
- protect investors; and
- reduce systemic risk.

To support these goals, IOSCO established 30 broad Principles for securities regulation. The Principles are sufficiently high level to enable all jurisdictions to implement them in any institutional or legal setting. To help achieve implementation IOSCO provides technical assistance, advice and training to members.

New Zealand has undergone an assessment against the 30 Principles in recent years: We were found to have full, broad or partial implementation on all Principles against which we were assessed except two. I might add that this situation has been addressed through last year’s amendments to the Securities Markets Act, and through other current reform processes.

A third IOSCO priority is further developing and strengthening relationships with all stakeholders. This includes consulting with the international financial community, professional associations and industry on our technical work programme and on our standard setting proposals. This input helps ensure standards are relevant, workable and cost effective. The Technical Committee regularly publishes consultation documents and receives comments from professional service firms and others. IOSCO also works with a

number of other international bodies including those that share our concern about uncooperative or under-regulated jurisdictions. We are taking practical steps to help bring these “outliers” on securities regulation into the mainstream.

IOSCO’s fourth priority is to promote greater cooperation between regulators and I have already mentioned the importance of this as capital markets become more global – and securities regulation converges across borders. IOSCO has been particularly proactive here. In 2002, IOSCO adopted a *Multilateral Memorandum of Understanding on Consultation and Cooperation, and Exchange of Information* – the “IOSCO MOU”.

This defines the legal authority that regulators must have in order to cooperate and exchange information for enforcing securities law. It also sets out conditions under which these exchanges should occur. IOSCO has a clear vision of effective cooperation between securities regulators for enforcement across jurisdictional borders. This is happening with increasing frequency under the IOSCO MOU, and it is imperative in today’s globalised securities markets.

IOSCO has adopted a deadline of January 2010 for all member regulators to become full signatories to the IOSCO MOU or to have formally committed to doing so. To date, 41 members are signatories and 15 more are committed to addressing issues that prevent them from signing on to the IOSCO MOU.

The New Zealand Securities Commission has certainly made good use of the IOSCO MOU, most notably in its landmark action on insider trading in Tranz Rail shares. In October 2004 the Commission filed proceedings against six defendants who were or subsequently became resident in Australia, the United States or Europe. We secured the cooperation of regulators in relevant jurisdictions, enabling us to obtain documents and formal oral evidence. That case was finally settled without admission of liability with all six defendants in June this year, for a total settlement of over NZ \$27.5 million. It was a very positive outcome for the New Zealand market – certainly an outcome enabled by the cooperation of regulators around the globe.

Cooperation is certainly the dominant theme between the New Zealand Securities Commission and the Australian Securities and Investment Commission, ASIC. Indeed, the trans-Tasman relationship is a good example of how different countries can develop a common approach to regulation, while retaining their own institutional and legal structures.

Of course New Zealand and Australia are two countries with a long history of economic and political cooperation. Following on from our Closer Economic Relations Agreement of 1982, we now have the concept of a “Single Economic Market” – a concept much broader than CER which aims to achieve a seamless business environment between the two countries. A great deal of progress has been made over recent years in coordinating securities regulation on both sides of the Tasman. The next step is the mutual recognition of securities offer documents. New Zealand and Australia signed a treaty on this in February 2006. This is a major step, unrivalled by cross-border arrangements anywhere else in the world. The necessary legal frameworks and processes are almost in place for this to become operative.

Mutual recognition of offer documents means that securities issuers in either country will be able to offer securities in both countries using essentially (in most cases) the same offer documents and offer structure. The issuer will no longer be required to comply with most of the substantive requirements of the other countries domestic fundraising laws. However issuers who wish to operate under the proposed regime will have to comply with some entry and ongoing requirements agreed between the two countries and prescribed in each country’s law. The aim is, of course, to promote investment in both countries, while increasing capital market competition in each and giving investors greater choice.

My key point is that progress on securities regulation is illustrating just how much mutual recognition and practical cooperation can be achieved in trans-Tasman relations, without the need for substantial changes in institutional and legal structures. I acknowledge that

more work is needed, notably in the regulation of financial intermediaries and investment schemes – those are topics for another day. And in this context no-one should underrate the importance of a solid working relationship between the regulators. The Securities Commission and ASIC have built mutual understanding and confidence over some years. Today, both commissions meet at least twice a year to talk about matters of common interest and concern. Operationally, our staff share information and cooperate on enforcement on a very regular basis.

Progress between New Zealand and Australia also has a strong IOSCO context. We are a good working model of two markets and two regulatory frameworks joined by common adherence to consistent, high quality standards and to robust processes of cross-border cooperation!

Private Equity

I repeat that nothing stands still in the world of securities regulation. In our bilateral relationships and in IOSCO, we must constantly look for capital market developments that require regulatory response or may do so in future. Private equity is one such development – and certainly, IOSCO has this topic under current investigation. Recent years have seen a global boom in the size and activities of private equity firms, thanks to sustained high returns on equity investment in general and to the ready availability of credit. Traditionally, private equity was invested in new ventures and high growth businesses – higher risk areas less attractive to other forms of capital. In fact, private equity used to be invested largely outside the public markets which are the principal focus of securities regulation.

That has changed dramatically. There has been a tidal wave of private equity buying into public companies and those previously destined for public listing. The capital comes from private and institutional investors, and from bank lending. Private equity firms tend to be aggressive users of debt. On one estimate, the value of private equity transactions

in public markets across the world last year was US\$660 billion – double an estimate for the previous year.

The rise, and rise, of private equity has generated plenty of concern internationally, based on an associated surge in corporate indebtedness and on the loss of transparency around companies that are no longer public. In the UK, private equity investors have met their critics with voluntary proposals for greater disclosure on the affairs of their so-called “portfolio companies”. Closer to home, Australian Reserve Bank Governor Glenn Stevens has warned of possible problems in the financial system arising from the extensive use of leverage by private equity firms. In New Zealand, debate is more muted.

To securities regulators, transparency and corporate governance are issues that impact on the fairness, efficiency and soundness of public markets. To a large extent, private equity is beyond our concern. What we do care about, however, are the points of intersection between private equity and public markets. Take these three instances:

- First, private equity firms can gain control and use of funds that have been sourced from public investors via institutions and financial intermediaries.
- Second, private equity firms are active in markets for control of publicly-traded companies.
- Third, private equity firms often emerge as promoters of IPOs in companies that are being introduced, or re-introduced, to public markets after restructuring under private ownership.

Each of these points of intersection is, of course, subject to regulation today. But there may well be issues arising from the particular characteristics of private equity. We do not know enough about the implications of having this large and somewhat opaque sector on the fringe of public markets, and sometimes slap in the middle. I think there may be transparency-related issues at various points of private-public intersection. Given the global prominence of private equity, and the cross-border activities of many firms, this is an obvious area for attention by IOSCO and we have launched a Task Force on Private

Equity. We all await the outcome of the current work and any regulatory proposals that may follow.

From our perspective, there are strong parallels between private equity and hedge funds – both are high-growth sectors where funds from diverse sources are being pooled for aggressive investment activity: both are lacking in transparency compared to public markets. With hedge funds, IOSCO has been monitoring the issues since 1999. Last year, we undertook a major survey of the regulatory environments of hedge funds in the most developed jurisdictions. With respect to hedge fund portfolio valuation, IOSCO released a major written contribution for consultation last March. This report describes 9 principles whose purpose is to strengthen valuation reliability, reduce real and/or potential conflicts of interest and increase transparency for investors. IOSCO will publish a final paper on this topic before the end of the year which will be take into account public comments received over recent months. On funds of hedge funds, where retail investors are more involved, a new work stream was launched a few months ago. These initiatives are part of a more general effort to increase the level of transparency of hedge funds for investors. IOSCO will, most likely, follow the same careful process of research and consultation on the public market operations of private equity firms.

Conclusion

I want to finish by emphasising the commitment of IOSCO and its members to the development of consistent, high quality securities regulation in capital markets worldwide. In doing this, we must recognise that different jurisdictions will always have different institutional and legal structures. The 30 core IOSCO Principles are a means of benchmarking the regulatory framework in any particular market against expectations of international consistency and high quality.

Cross-border cooperation between regulators is a very high priority for IOSCO. We are making progress with the IOSCO MOU – it is creating a highly functional international network of regulators who can cooperate with speed and efficiency. The organisation has

an ambitious 2010 deadline for all members to sign on or commit to becoming a signatory.

New Zealand and Australia have emerged as countries at the forefront of international securities regulation, in terms of both IOSCO Principles and cross-border cooperation. The degree of dialogue and practical operational cooperation between the Securities Commission and ASIC is a matter of deep personal satisfaction for me. And soon we will have mutual recognition of securities offer documents on both sides of the Tasman – a world-first that will, over time, help boost investment in both countries and stimulate growth in their capital markets.

One further and final thought about investment and market growth: Never before have these been as important to New Zealand and Australia. We have a rapidly increasing pool of personal savings and retail investment capital, thanks in large part to 15 years of the Australian Superannuation Guarantee and to the recent KiwiSaver initiative on this side of the Tasman. It seems to me that the social and economic importance of this growing pool of retirement savings underscores the importance of growth and stability in capital markets, on both sides of the Tasman and globally. This, of course, brings me back to the role of securities regulators and of IOSCO. We live in challenging and exciting times!