

IOSCO – Global Strategic Issues in Securities Regulation

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Thank you for the invitation to speak, I am especially pleased to be here. Investment funds are so very important to the efficiency, fairness, stability and growth of capital markets worldwide. Robust growth of transparent and efficient global capital markets is an ideal I am passionate about and is a key aim for the International Organisation of Securities Commissions (IOSCO). Looking at your industry, I am very impressed to note that there is now more than US\$20 trillion of funds invested today, most of them in global equity and bond markets.

Global Capital Markets

And capital markets are indeed increasingly global. This is evident in the extraordinary growth rates of cross-border capital flows and investment, and in the interdependence of markets in different national jurisdictions. Global capital flows have surged since 1995 now accounting for around 14.5% of world GDP. Globalisation is accompanied by the constant emergence of new financial products and of new ways of doing business. It is also accompanied by huge growth in retail investment – individuals investing in markets directly or indirectly for retirement and other personal goals. As I look around the room, many of the companies your constituent organisations represent are testament to the global nature of today's capital markets.

Globalisation will be my recurrent theme today – and what better place to talk about this than in Sydney ! With its size, location, sophistication and connectedness Sydney is truly a global city. Around 60 of the world's top 100 corporates have a physical presence here, and the city is one of the banking and financial hubs of the Asia-Pacific region. It's also a beautiful place – and, another reason I am so pleased to be here today, it is my old home town!

Historically capital markets have been in fixed national locations and the regulation and monitoring of these markets has been undertaken by national governments, and in many parts of the world this remains true today. As Sir Callum McCarthy, Chairman of the UK Financial Services Authority said in 2005, “Most regulation is rooted in national legislation. But the business of large firms is increasingly complex and global. Regulators are rightly under pressure to remove duplication or inconsistent regulatory requirements arising from firms having to deal with multiple regulators in the EU and worldwide.”

Global Markets Challenge: Traditional Markets Arrangements

The challenge that globalised market developments are highlighting relates to the fact that increasing portions of the markets are now beyond national jurisdictions, and new marketplace structures challenge these traditional national notions. And as we observe this phenomenon of rapid growth of cross-border trade and consolidation and merging of marketplaces, where does this leave the role of the regulators, a role traditionally vested in national governments? This question is one of the important strategic issues facing regulators and IOSCO, and I’d like to share some thoughts about this with you today.

The Approach of Regulators in Today’s Global Markets

Indeed an important question we regulators might ask both ourselves and key market players such as yourselves is: Are regulators keeping up with the play?

How does the national and regional regulatory framework manage in this globalised environment? If we accept the need to maintain national and regional regulatory authorities what can regulators do to protect investors, and maintain confidence in our markets as they become increasingly global?

Co-operation Between Regulators

I’d like to start with the premise that cooperation between regulators is at the core of any solution.

Charlie McCreevy, the European Commissioner for Internal Markets and Services noted this sentiment, and I quote from a speech he gave in New York in April 2005 “International cooperation in a globalised world is imperative if we are to create level playing fields: if we are to avoid unnecessary, burdensome and costly duplication; and if we are to deliver higher and consistent standards that build confidence in capital markets.

Cooperation between legislators and supervisors urgently needs to catch up with the markets and in the way they work together on a global scale. Increasingly globalisation and integration have changed the business landscape for good. Hand in hand with this development it is unavoidable that regulation in one jurisdiction spills over into others. We must therefore work together to minimize unnecessary regulatory duplication and legal friction.”

IOSCO

Possibly no organization promotes this theme of cooperation more effectively than does the International Organisation of Securities Commissions, known as IOSCO. At this point I would like to describe and introduce the organisation, although I am sure most of you will be familiar with the work we do. I must say I commend your organisation for its commitment to work with IOSCO.

IOSCO is the international standards setter for securities regulation. Our members include 120 regulatory agencies in 109 jurisdictions and many other affiliate bodies.

Members regulate more than 90% of the world's securities 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. It aims to ensure that markets are fair, efficient and transparent; to protect investors; and to reduce systemic risk.

IOSCO – Four Strategic Priorities

IOSCO adopted a bold new strategic direction in 2005 in which it set itself four key priorities. The first of these strategic priorities I will mention is its aim to confirm and develop IOSCO's role as the global leader in regulatory standards setting. That means the organisation must be proactive in identifying and analysing issues as they emerge, and responding promptly in the most appropriate ways. This is essentially the objective of the Technical Committee of IOSCO. Much of its work is undertaken by Standing Committees focusing on five main work streams. In addition, taskforces are set up to address particular issues when and as necessary. The Emerging Markets Committee of IOSCO complements this work by providing the perspective of emerging markets. With the growing importance of emerging markets, their contribution is particularly valuable in our globalised world.

As a second strategic priority IOSCO promotes the full implementation of its 30 broad Principles for securities regulation in the regulatory framework of every member jurisdiction. These principles are recognized as securities market benchmarks by the leading international financial institutions, such as the Financial Stability Forum, the IMF and the World Bank. 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. The aim is to lead to convergence and implementation of consistently high standards of regulation around the world.

A third strategic priority for IOSCO relates to improving enforcement related cross-border co-operation. And the last of the four priorities is about engagement with industry, in other words IOSCO's commitment to further develop and strengthen relationships with stakeholders. I will elaborate on both of these shortly.

Ways to Approach Cooperation

Regulators and national governments have been keenly aware of the increasing globalisation of the financial services industry and have put in place a number of processes and mechanisms to ensure greater global cooperation. Mechanisms are in place for greater cross—border cooperation among regulators for enforcement. IOSCO's standard setting work in securities regulation also provides the seeds for growing regulatory convergence. These developments are proving extremely useful. I believe that the basic infrastructure for solving the tension between the national framework and the globalised framework has to some extent already been put in place. Although much more work needs to be done, some basic building blocks are in place.

Starting with the concept of convergence or standardisation—here the process is often as important as the target itself and frequently requires a “roadmap” with a timetable as well as clearly defined steps and agreed final objectives. The adoption of the IOSCO Principles themselves is a very significant example of the convergence of standards globally.

More recently the work on common global accounting standards is another excellent example. We applaud the huge strides made by the International Accounting Standards Board under the leadership of Sir David Tweedie towards the goal of a single set of global accounting standards, known as the International Financial Reporting Standards (IFRS) regime.

Not all standards and norms lend themselves readily to convergence, and I will turn to mutual recognition. The concepts of convergence and mutual recognition are often complementary. Mutual recognition as an approach is gaining growing international impetus and I note that the G7 made a call in February this year to make progress toward “free trade in securities based on mutual recognition of regulatory regimes.”

Mutual Recognition

With mutual recognition one must agree on a common basis of principles to assess the effectiveness of foreign regulations and the work of the foreign regulator to ensure coordinated responses and consistent approaches to regulating cross-border transactions.

Mutual recognition allows laws and regulations to reflect national imperatives whilst providing the capacity for cross-border co-operation and enforcement.

Apart from initiatives in some European Union jurisdictions and some very 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 recognized principles, has already been established by IOSCO. IOSCO's 30 broad Principles for securities regulation, that I mentioned, earlier provide a primary set of building blocks on which jurisdictions should build mutual recognition arrangements in

the future. Much more detailed work is needed of course, but compliance with IOSCO's Principles is a critically important start.

Taking a look at some examples of the steps along the way to mutual recognition:

IOSCO MOU

IOSCO itself has developed a very good example of a limited form of mutual recognition around enforcement of securities law. In 2002, IOSCO members 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 to cooperate and exchange information for enforcing securities laws. It also sets out conditions under which these information exchanges should occur. Under the IOSCO MOU, signatories in effect delegate the “recognition” to groups of IOSCO experts who audit a jurisdiction's regulatory capacity and legal framework. It is an interesting and innovative model. 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 signatories to the IOSCO MOU or to have committed formally to doing so. To date, 41 members are signatories and 15 others are committed to addressing issues that prevent them from signing on to the IOSCO MOU. Co-operation around enforcement and exchange of information as provided by the IOSCO MOU represents one of the four strategic priorities for IOSCO as I noted earlier.

Other Examples of Mutual Recognition

We have in recent times seen a number of steps taken by some jurisdictions towards mutual recognition in particular areas, such as the MOU of 2006 between the US Commodity Futures Trading Commission and the UK Financial Services Authority dealing with consultation and cooperation for market oversight. There is also the arrangement concluded in January this year by the US SEC with the five European Authorities that oversee Euronext. Bolder still is a concept described in an article by Ethiopis Tafara and Robert J Peterson of the US SEC setting out a blueprint for cross border access to US investors. In this they propose a new framework to apply to foreign financial service providers accessing the US capital market by providing investment services and products not otherwise available on the US market. Effectively it is another mutual recognition approach based on “bilateral substituted compliance”. Rather than requiring such foreign stock exchanges and foreign broker dealers to register with the SEC as is currently the case, the proposed framework relies on a system of substituted compliance with SEC regulations.

Mutual Recognition Continued

As I have said the IOSCO Principles provide a set of preconditions to enable mutual recognition to occur. What will be core to the effectiveness of arrangements based on mutual recognition is the level of trust in the capacity and willingness of the other regulator to enforce and cooperate. It requires a mutually acceptable legal framework, and a similar appetite to take action.

Domestic regulators who wish to participate in mutual recognition arrangements will be compelled to look at their own regulatory arrangements and ensure that they have regulatory frameworks and enforcement capabilities in place that others would wish to mutually recognize. In my view as a prerequisite, adherence to the IOSCO Principles and being a signatory to the IOSCO MOU should be the underpinning to mutual recognition considerations. If a jurisdiction in the future wants to participate in market developments of the future its domestic regulation and capacity will need to be world class. IOSCO's self-assessment tools, assisted assessment programme, and training can assist here.

As I review the steps already taken towards mutual recognition, and the ambitious task still ahead to achieve adoption on a holistic basis, I believe there is a practical way forward in addressing the challenges and progressing this outcome. The work would be well advanced if jurisdictions begin to take steps enabling mutual recognition to be achieved with greatest speed in those areas where there is already close congruence of rules or a market imperative, rather than attempting to tackle a comprehensive mutual recognition scheme in a single project.

New Zealand –Australia Example of Mutual Recognition

The work New Zealand and Australia have undertaken to introduce mutual recognition of securities offerings is a very good example. Both Governments signed an agreement for mutual recognition of securities offer documents between the two countries in February 2006 and are now in the final stages of putting the necessary legal frameworks and processes in place for this to become operative.

This framework mutually recognizes the enforcement mechanisms and capacities of the two jurisdictions in relation to securities offerings. Neither has adopted the laws or regulations of the other. Each is sufficiently comfortable with the other's framework and has sufficient respect in the other's enforcement capabilities to allow cross-border securities offerings with few additional requirements. A next step for those two jurisdictions might well be mutual recognition of financial intermediaries, and thus piece by piece a regime of mutual recognition in all areas of securities regulation will be built up.

Engagement with Industry

Dialogue and consultation amongst all participants is a critical part of evolving efficient solutions. We regulators are but one element in the equation, but organisations such as

yours operate at the coal face of capital market activity. IOSCO aims to achieve much greater engagement with market participants, oversight bodies and organizations such as yours to ensure that its outputs are workable, relevant and cost effective. This is very important to us. As I have already mentioned, it is another of the four strategic priorities for IOSCO. Our principles and standards must be practical and actionable, as well as being capable of implementation in the context of different regulatory frameworks.

In the past two years, we have increased consultation and dialogue with industry bodies, professional associations and others on the broad IOSCO agenda, on our technical work programme and on our specific proposals for standard setting. Through constant internal discussions between regulators and with systematic consultation with industry, we have stepped up our consultation with the securities industry. A starting point of this “industry dialogue” is IOSCO’s launch of a consultative paper on the ongoing work of the Technical Committee. In it we give an overview of the issues we are working on and planning to work on. We are interested to hear market participants’ views on our proposed technical work plans but also if they believe IOSCO should carry out or even refrain from work in other areas.

On the matter of staged approaches to convergence or mutual recognition, we have already received input from some industry groups about functional areas they would like addressed.

You of course will be aware that your organisation, the International Investment Funds Association, responds positively to this invitation for dialogue with IOSCO. Indeed the IIFA in its Statement of Principles notes the importance of its relationship with IOSCO. On Saturday I will continue on to Tokyo to attend IOSCO meetings and am pleased to note that the IIFA will be well represented there at a Technical Committee meeting with industry on 6 November.

Governance Principles for Collective Investment Schemes

But coming back to the subject of mutual recognition, and notably the development of infrastructures for this to occur, let me illustrate an example of particular relevance to the investment funds industry. The size and depth of your market means that fund managers will be impacted in some way by much of what IOSCO does. But I’d like to focus briefly on one area of immediate and pressing interest to both your industry and IOSCO, that of corporate governance in “collective investment schemes”. Over the past three years, IOSCO through the work of its Standing Committee 5 on Investment Management, has examined governance issues specific to collective investment schemes and to the protection of investors, culminating in a two-part report published in June 2006 and in February this year.

As regards collective investment schemes, IOSCO has done an analysis of the different types of scheme, the different mechanisms in place for investor protection, and the oversight roles played by directors, trustees and others.

In undertaking its work the Technical Committee determined that various entities and legal structures existed or are being proposed in member jurisdictions, and that these different structures led to significant differences in how member jurisdictions approach governance issues for such schemes. As a result the Technical Committee agreed as necessary and appropriate to identify one primary general principle concerning collective investment scheme governance that would be sufficiently broad to allow for differences in scheme governance structure and national legal frameworks and sufficiently firm to protect investors.

It determined independent review and oversight of the fiduciary duties of the collective investment scheme operator -- including most notably the prevention of conflicts of interest -- as the primary principle applying in all the jurisdictions examined regardless of the structural form of the collective investment scheme. Additionally the Technical Committee explained how this principle of independent review and oversight applied to or should be evidenced in, the different structural forms of collective investment schemes.

The report notes that independent oversight entities should be empowered with sufficient capacities to exercise their functions effectively and independently. Furthermore, it identifies generic principles relating to the concept of independence, the powers that independent oversight entities should obtain, and the precise functions and tasks they should be entrusted with. These principles aim at promoting the establishment and maintenance of consistently high regulatory standards for the asset management industry in the area of collective investment scheme governance.

Private Equity

Moving to another topic, I suspect your industry shares much of our interest in the rise, and rise, of private equity worldwide. It used to be that private equity was confined to new ventures and high-risk, high-growth businesses – areas outside the public markets and unrelated to the activities of collective investment schemes. We all see how that has changed dramatically in recent years, with a tidal wave of private equity buying into public companies and those previously destined for public listing. 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 2005. It is a boom fuelled by sustained high returns on equity investment around the world over recent years and by the (until very recently) ready availability of credit.

Private equity, and its associated surge in corporate indebtedness, is generating plenty of interest around the world. In some markets, the debate is around the loss of transparency and public accountability by once-public companies that have disappeared in firm ownership. In this country, Australian Reserve Bank Governor Glenn Stevens has gone public with warnings of possible problems in the financial system arising from the extensive use of leverage by private equity firms.

At another level in Australia the Standing Committee on Economics has reported to the Senate that it sees no need for further regulation of private equity activity in Australia at the present time.

So what issues, if any, are of particular interest to securities regulators? We start with two familiar concepts: “transparency” and “responsible governance”. How does the conduct of private equity firms impact these across a capital market, in Australia, the United Kingdom or wherever. Private equity might once have been beyond securities regulation. But in the current climate, we must take a strong interest in the main points of intersection between private and public markets. Here are three likely, if not typical, examples:

- First, private equity firms 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. There may well be transparency-related issues at various points of the private-public intersection.

Given the global prominence of private equity, and the cross-border activities of many firms, this is an obvious area of focus for IOSCO. The organisation has this year formed a Task Force on Private Equity to review private equity markets and identify any suitable issues that could be addressed by IOSCO.

Investment funds are obviously intersecting with private equity in many ways. I have little doubt that your industry will be interested in due course in any outcomes from this work.

Hedge Funds

From our perspective, there are some parallels with the global rise of hedge funds – another form of market innovation in which funds from diverse sources are being pooled, and leveraged, for often aggressive investment activity.

Hedge funds have, I believe, even more intersection with traditional investment funds, and some hedge funds or hedge fund activities are an integral part of this sector. They are certainly a legitimate and efficient element of capital markets globally. IOSCO’s interests lie in watching the level of transparency around hedge funds as well as their linkages

through to the public markets. And indeed, we have been monitoring issues that arise with their growth since 1999.

Last year, we undertook a major survey of the regulatory environments of hedge funds. With respect to hedge fund portfolio valuation, IOSCO released a major written contribution for consultation last March. That report describes nine principles with a purpose of strengthening valuation reliability, reducing real and/or potential conflicts of interest and increasing transparency for investors. IOSCO will publish a final paper on this topic taking into account recent comments received.

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. I believe that will be to the overall benefit of the investment funds industry – and again IOSCO welcomes your ongoing contribution to our analysis and standards-setting.

Conclusion

In summary, I believe it is imperative that securities regulators not only respond to and keep up with rapid developments occurring in today's globalizing capital markets, but also look over the horizon for tomorrow's developments. It is in our interests for a number of reasons. We should aim to expand investors' choice and reduce transaction costs that investors pay when investing overseas while increasing investor protection and ensuring global market stability. We need to improve investor access to foreign investment opportunities, while guarding the integrity of domestic markets. And to better protect investors we need to enhance the ability of national regulators to combat breaches of securities law across borders.

So to come back to my earlier question of just how effectively regulators are able to achieve these and other objectives in the current environment. How well are regulators keeping up with the fast moving trends ?

My conclusion is that we have the building blocks for significant progress, starting with the effective implementation of the 30 IOSCO Principles. We have seen benefits in the adoption of a convergence approach to modern common global standards. The IOSCO MOU has provided an early example of effective mutual recognition around cooperation and information exchange in enforcement of securities law. We can be encouraged by the types of bilateral and multilateral approaches moving towards mutual recognition that I have outlined, and we can see the implementation of the IOSCO Principles forming the substantive basis for this. We should encourage jurisdictions taking an appropriately staged approach in embracing a regime of mutual recognition with jurisdictions of key trading partners. These are all positive stepping stones towards a more all-encompassing approach in the future.

In all this I am proud that IOSCO is taking a leading role. There is however much more work to be done, and many areas to focus on as for example the work underway on

collective investment schemes, private equity and hedge funds that I have discussed today. In advancing all these and more, we will very much value our engagement and dialogue with organisations such as yours here today.

We are at the cusp of a huge global adventure into new realms of mutual recognition and consistent standards around the world. We live in exciting times!