

Regulating the market

India has a good system



*As financial markets the world over swing more in the direction of securities markets and market based financing, securities regulators in IOSCO are ramping up their efforts to improve their risk analysis, says **David Wright**, Secretary General, The International Organization of Securities Commissions*

Interview/International

IOSCO is recognized as the body setting key international standards for financial markets. How has been the journey so far? Different economies need regulations conducive to their own social and economic paradigm. How did IOSCO manage to achieve the harmony?

I think it is fair to say that today IOSCO is already recognized as the global standard setter in the securities markets sphere. Not only are IOSCO's principles of securities regulation and their accompanying methodology recognized as the global benchmark standards (and are used as such in all IMF FSAP assessments) but this massive financial crisis has resulted in IOSCO also being tasked with preparing a host of new standards in the areas of shadow banking (e.g., money market funds, securitization), OTC derivatives (e.g., margin requirements, trading, clearing, trade repositories), on resolution of critical infrastructures with CPSS-IOSCO's Principles for Financial Market Infrastructure (PFMI) etc. IOSCO's work on credit rating agencies and its benchmarking standards after the LIBOR scandals are further examples of

wider variety of education, training and technical assistance programs tailored to our members' needs.

Sunset clauses are an established feature of the regulatory toolbox, used to bring about political compromise, to foster better regulation and evidence-based policymaking. Experience in the emerging market is that new regulations are flooding; however old regulations though redundant, are not taken out of statute. How does IOSCO ensure that its members undertake periodical reviews of the formulated regulations?

IOSCO carries out periodic reviews of its standards and principles - it is the right thing to do as financial markets and products change and regulation and supervision become more sophisticated. Such work is ongoing in all our major committees.

It is true that there has been a deluge of financial rules as a result of this deep and worrying financial crisis, the effects of which are not finished. We must recall here that the world has lost approximately 15% GDP so far against trend, with severe social consequences in many Western markets. Politicians want to ensure that in the future finance works for the economy, not the other way round.

As financial markets the world over swing more in the direction of securities markets and market based financing, securities regulators in IOSCO are ramping up their efforts to improve their risk analysis, early warning systems and cooperative mechanisms to help ward off brewing market trouble, failures or bubbles.

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IOSCO's outreach. IOSCO's recent Board meeting in Kuala Lumpur in late February has triggered further IOSCO work on securities-related issues like cybercrime, crowd funding, the corporate bond markets, audit quality and long term financing.

It is true that IOSCO has a very diverse membership - but among all of the world's standard setters IOSCO is the most inclusive. We have over 125 of the world's securities regulators as our members, covering more than 95% of securities markets around the world. IOSCO's standards tend to be high level which facilitates some flexibility in adapting to them. Interestingly adhering to the IOSCO standards is seen to be beneficial for domestic capital markets. A cachet of quality and security. We do not see evidence of incessant pressure to weaken the basic "rulebook" by emerging market economies. On the contrary, many participate actively in our working groups at all levels, including the Board itself.

IOSCO tries hard to be inclusive and balanced between the interests of developing countries and emerging market countries. We also are trying to strengthen our capacity building efforts with a

Prior assessment and cost-benefit analysis of policies and regulations have become a buzz word across all regulators. It is expected that it will bring more transparency in effective policy-making. How are IOSCO members reacting to this concept?

Prior assessment and cost-benefit analysis are necessary ex-ante tools for good policy making. An alternative formulation is economic impact analysis. But this is not an exact science. Judgement is required. Patient listening to expert opinion is essential. Understanding market practice. Examining and learning from other regulators. But perhaps the most important issue is to fully define the regulatory objective (e.g., what is the market failure; what is the public interest that needs regulation etc.) and to ensure that the regulatory response is appropriate, balanced and with the right incentives and regularly reviewed for impacts.

The fundamental problem we all face as regulators is a sub-optimal understanding of the global financial system - its complexities; interactions;

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contagion channels etc. This is compounded by having inadequate data - and little or no real time data with which to judge rapidly emerging risk.

Practical difficulties arise from overlapping regulations and regulatory arbitrage. What do you suggest in terms of unification/integration of regulatory activities, particularly when KYC (Know Your Client) has become a benchmark across all markets?

Both overlapping regulation and regulatory arbitrage are the curse of the global regulatory community. But let us not be surprised! As long as we have no legal enforcement at the global levels; no disputes settlement which is binding (like in the WTO); no Treaty base for our work, the global regulatory system will resemble the emmental cheese - i.e., full of holes. There is a clear choice here: either a best efforts but weak global regulatory institutional environment, which will inevitably lead to more fragmentation as many more big capital markets emerge interpreting the rules as they see fit, or a treaty-based system with real teeth and powers. Regrettably, the latter is not on the cards for the foreseeable future.

SRO model for efficient regulations is gaining ground in Emerging Countries. Your reaction and suggestion.

Each country will design its own regulatory and supervisory system according to its own needs, market structure and culture. There is no wrong and right solution. Until a few years ago the integrated horizontal model was all the rage. This financial crisis has shown that this model did badly and the new regulatory direction seems to be towards a twin peaks model separating prudential regulation from conduct of business. SROs certainly can play an important role in the overall regulatory framework provided the overall system is coherent and legally clear.

IOSCO under its Financial Sector Assessment Program - FSAP acknowledged that the comprehensive risk management framework pre-



scribed by SEBI is one of the pillars of the Indian securities settlement system. What other areas, do you think, SEBI should focus on?

Without being specific, there is no doubt that SEBI has some outstanding people and policies. In general EMCs, and India, have been less caught by this crisis than DCs. My impression is that India has created a good and comprehensive regulatory system tailored to its own market and societal needs. India's regulators also seem to have a very good understanding of how their markets function.

SEBI has not only been a member of IOSCO but also an active partner, particularly for comprehensive risk management framework under Financial Sector Assessment Program - FSAP. How has been this relationship?

SEBI I am pleased to say is a permanent board member of IOSCO and plays a major role in many

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of our work streams. This will grow in the future as its global market share expands. I am impressed by SEBI's staff and leadership, many of whom have come from India's demanding civil service administrative programmes - including my own outstanding Deputy - Tajinder Singh.

We understand that IOSCO is reviewing extant objectives and principles of securities regulations. Do we expect large scale change keeping in view the recent volatility and economic crisis?

I think I would describe the likely changes to be "evolution" not "revolution". Remember IOSCO traditionally works wherever possible by consensus - which can be difficult to obtain. Consensus pushes participants towards the middle ground and away from radicalism.

As secretary general of IOSCO what do you think is necessary for emerging economies to follow in practise to adhere to global standards?

It is important for EMCs to apply the best securities standards in the world. This will build market confidence, attract inward flows of the right type of capital for long term development needs and enhance stability. As important is the assurance of good governance, clean markets, and the rule of law carried out by a sound and impartial legal system.

Practising economic standards - where do you think India ranks? Do you suggest any steps to improve on?

I cannot answer this question precisely. We have no league tables. But I refer to my earlier statement that I am impressed by the quality and knowledge of India's securities regulators.

You have had a key role in resolving the financial crisis and the European Commission's aims for the long-term. What are the key lessons to be learnt by Asian and South Asian economies to safeguard from future distress?

Let me suggest two thoughts. First, understand your markets and structures in great detail: the contagion channels; the risks; the products on sale; and the interface with global financial markets and the linkages with the key macro-economic drivers of the economy. Second, scrutinize the property markets daily. Most trouble is fanned through these markets and into the wider financial system.

What market reforms do emerging markets need?

The most important market reforms should be to diversify the supply of capital and credit in the economy. Widen the choice of financial instruments; deepen liquidity; encourage a wider and deeper retail and SME client base on the basis of strong consumer protection and very tough sanctions for those abusing markets and customers, including long jail sentences. Ensure good corporate governance and an effective legal system in which all market participants can have full confidence.

*Acknowledgment to Dr. Naresh Maheshwari
(Director & Past President of ANMI)
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So many of our dreams at first seem impossible, then they seem improbable, and then, when we summon the will, they soon become inevitable.

:: CHRISTOPHER REEVE ::

Educationists should build the capacities of the spirit of inquiry, creativity, entrepreneurial and moral leadership among students and become their role model.

:: A.P.J. ABDUL KALAM ::