

Global Markets and the Recent Turmoil: Lessons Learned

Presentation to IARC /
COSRA Seminar

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International Organization
of Securities Commissions

What I'll Cover Today...

- A little background about IOSCO and its mission
- Findings on causes of Sub Prime turmoil: Joint Forum work, Financial Stability Forum, IOSCO
- Policy recommendations for securities and derivatives regulators, in particular related to global markets and trading platforms
- What might recent events mean for securities firm and markets regulation?

So..... What is IOSCO?

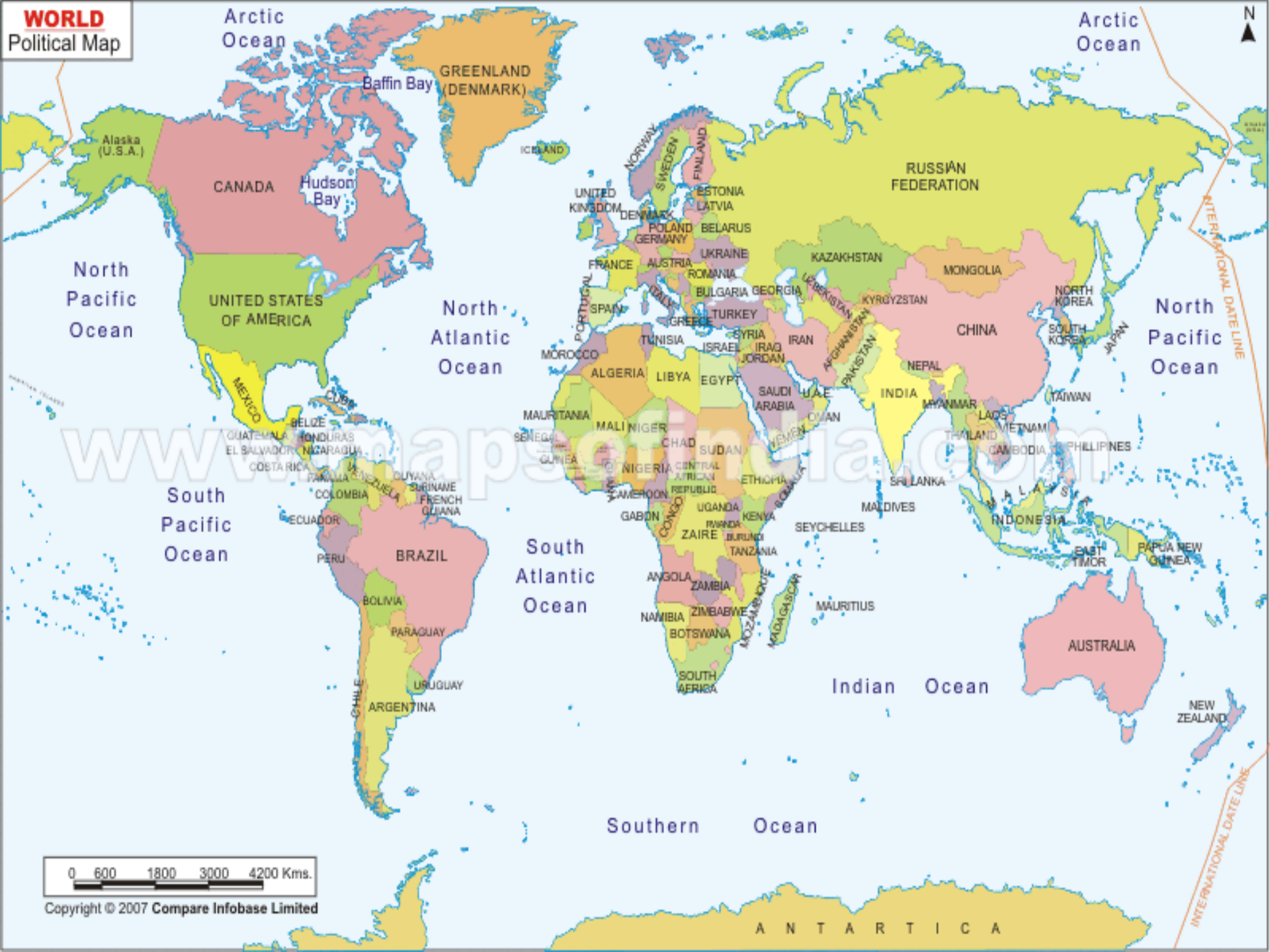


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WORLD

Political Map



IOSCO's mission

- To cooperate to promote high standards of regulation to maintain just, efficient and sound markets
- To exchange information and experience to promote the development of domestic markets
- To unite efforts to establish standards and an effective surveillance of international securities and derivatives transactions
- To provide mutual assistance to promote the integrity of markets by a rigorous application of the standards and by effective enforcement against offences

IOSCO's Principles of Securities Regulation

- Adopted by IOSCO in 1998, and updated in 2003 and 2008
- Accepted by IMF and World Bank as global standard
- Currently being reviewed:
 - IOSCO infrastructure, eg MMOU
 - More recent IOSCO technical work, eg Credit Rating Agencies
 - Alternative trading platforms?

IOSCO's responses to the Sub Prime Turmoil



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Sub prime turmoil

Sources:

- Joint Forum reports on Credit Risk Transfer, March and July 2008 (link on www.iosco.org)
- IOSCO CRA Task Force: Changes to IOSCO Model Code of Conduct: Consultation Paper March, Final May 2008, media release 17 September 2008 (www.iosco.org)
- Financial Stability Forum report on enhancing market and institutional resilience, April 2008 (link on www.bis.org)
- IOSCO Task Force on Sub Prime: Final report May 2008 (www.iosco.org)

Causes

- Exceptional boom in credit growth and leverage
- Expanded securitisation of credit risk and aggressive use of the originate-to-distribute model: distortions or misalignments of incentives
- Concern over defaults in sub-prime mortgages in the US spilling into structured products more generally
- Many banks took non-performing assets back on their balance sheets
- Credit markets closed

Policy recommendations

- Improved transparency, both in the primary and secondary market for structured products
- Due diligence processes of investors in making investment decisions: noting that this was a professional market
- Valuation of complex products, especially in illiquid markets
- Regulators should review their use of credit ratings in regulatory requirements

Credit ratings

Changes to IOSCO Code of Conduct:

1. Give attention to the information required to produce a quality rating
2. Preference for CRA to use a different nomenclature for structured products, but in any case clearly disclose the extra risks involved
3. Conflicts of interest: prohibit advising on structured products which they rate
4. Disclosure of break fees

Credit ratings (cont.)

- Some other jurisdictions considering direct regulation of CRAs: Europe, Japan, Australia
- Strong preference for international consensus on content of regulation
- Compliance with Code: IOSCO proposes:
 - Coordinated action by members to check compliance and report by January 2009
 - Work on details of information exchange and joint inspections
 - Potential for an international oversight body based on auditing model

More recently....

- Continuing closure of credit markets and falling valuations of financial assets undermines financial firms: Bear Sterns; HBOS; Lehmann Brothers
- Coordinated Central Bank action to improve liquidity and ease capital strains for banks
- Insolvency of Lehmann; mergers of other large firms and banks
- Focus on independent investment banks

What might this mean for securities regulation?



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Implications for Securities Supervision

- Market structure changing radically:
 - insolvency, merger of some firms
 - adoption of banking structures
- Nature of prudential regulation of brokers:
 - Regulatory interest in reducing arbitrage opportunities (conforming to Basel approaches)
 - Are the objectives the same as for banks and insurance?
- Role of Disclosure as a regulatory tool

Implications for Securities Supervision

- **Future of securitization:**
 - General recognition of legitimacy of securitization as a tool for spreading risk
 - Concern about complexity and opacity
 - Changing risk appetite
- **Reaction against unregulated sectors:**
 - How does this relate to the position of established exchanges? An opportunity for growth at the expense of competition?
 - Value of clear and robust clearing and settlement

Questions?

OR

Time for coffee???



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