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Trends in Global Financial Regulation

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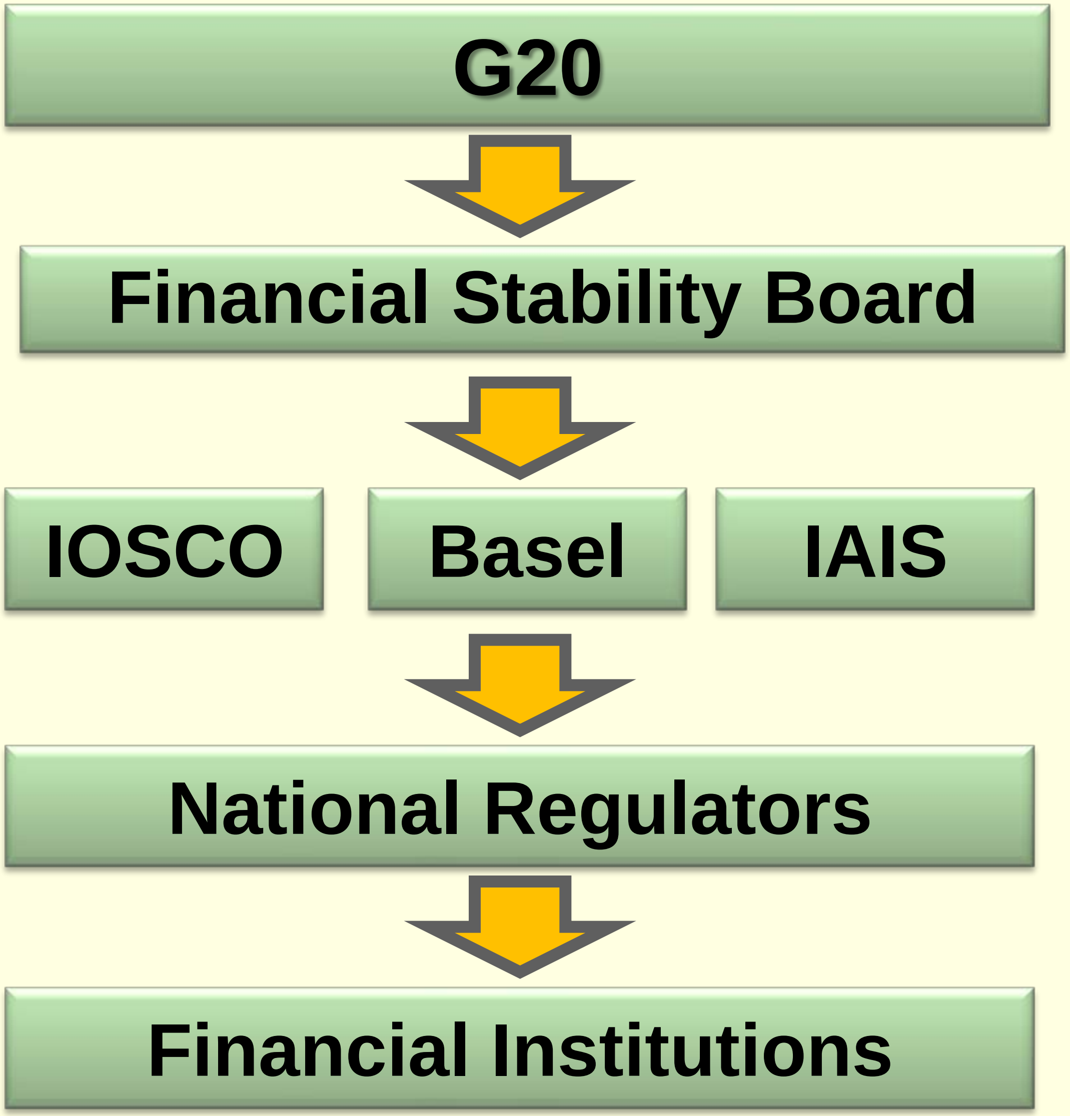
1. International Regulatory Framework

Application of International Regulatory Standards



Financial Stability Board (FSB)

- **The G20 established the Financial Stability Board (FSB) in 2009 with a mandate to promote financial stability.**
- **FSB works with the three recognized global standard-setting bodies to set the regulatory agenda for the financial sector -**
  1. **Basel Committee for Banking Supervision**
  2. **International Organization of Securities Commissions (IOSCO)**
  3. **the International Association of Insurance Supervisors (IAIS)**
- **These three global bodies set the relevant sector standards that national regulators will implement to ensure a coherent international regulatory framework.**

International Organization of Securities Commissions (IOSCO)

- An international organization of the world's securities markets regulators.
- IOSCO has over 120 members whose jurisdictions regulate the world’s major securities markets.
- IOSCO’s objective is to improve the regulation of securities markets.
- The IOSCO Principles set the regulatory benchmark for securities markets worldwide.

2. Strengthening the stability of global financial system

Non-Bank, Non Insurance G-SIFIs

The G20 Leaders Declaration of the St. Petersburg Summit on 5-6 September states:

"We ask the FSB, in consultation with the International Organization of Securities Commissions (IOSCO) and other standard setting bodies, to develop for public consultation methodologies for identifying global systemically important non-bank non-insurance financial institutions by end-2013."

Methodology For Assessing Global Systemically Important Non-Bank, Non-Insurance Financial Institutions

- Impact of the entity on financial stability
- Global in focus
- Practical, objective and implementable
- Consistent with other G-SIFI methodologies

Effective Resolution Regime for Financial Institutions

- **Any financial institution that could be systematically significant or critical if it fails should be subject to a resolution regime.**
- **The resolution regime should require that at least all domestically incorporated global SIFIs (“G-SIFIs”):**
    1. *have in place a recovery and resolution plan (“RRP”) including a group resolution plan;*
    2. *are subject to regular resolvability assessments; and*
    3. *are the subject of institution-specific cross-border cooperation agreements.*
- **RRP should serve as guidance to firms and resolution authorities in a recovering or resolution scenario.**
- **The goal is that all relevant jurisdictions should have the capacity to resolve SIFIs without systemic disruption and without exposing taxpayers to risk of loss.**

Reducing Reliance of Credit Rating Agencies

- **The G20 Leaders Declaration of the St. Petersburg Summit on 5-6 September states:**

  "We call on national authorities and standard setting bodies to accelerate progress in reducing reliance on credit rating agencies, in accordance with the FSB roadmap.[…]"

- **The FSB Roadmap consists of work to reduce mechanistic reliance on CRA ratings through standards, laws and regulations.**
- **IOSCO principles and standards do not require the use of credit ratings in regulation. An important distinction vis-à-vis the Basel Committee, which has required the use of credit ratings.**
- **To develop best practices at financial institutions with regard to alternatives to the use of credit ratings to assess creditworthiness.**

3. Improving investor protection

Client Asset Protection

- **The Lehman Brothers and MF Global insolvencies highlighted the importance of clients assets protection and the intermediaries' role and responsibilities.**
- **IOSCO to provide greater clarity and guidance to intermediaries:**
  - Transparency in the arrangement and consequent risks involved
  - Notify clients of the assets being held, in particular in foreign jurisdictions
  - Understand the foreign regime where client assets are placed in a foreign jurisdiction
  - Maintain current and up-to-date records
  - Minimize the risk of losses and misuse of client assets
  - Safeguard against waiver of client assets protection regime

Selling of Financial Products

- **IOSCO published the "Point of Sale Disclosure" Report in February 2011 covering what key information that customers ought to receive at the point of sale to support sound investment decision making.**
- **IOSCO published a report in January 2013 setting out 9 principles relating to the distribution of complex financial products by intermediaries such as:**
  - Classification of customers
  - Disclosure requirements
  - Protection of customers for non-advisory services
  - Appropriate incentive policies

Selling of Financial Products (Cont'd)

- **UK FCA published a paper on behavioural economics exploring how people make financial decisions.**
  - Many products are inherently complex
  - Many products involve trade-offs between the present and the future
  - Decisions may require assessing risk and uncertainty
  - Decisions can be emotional
  - Some products permit little learning from past mistakes
- **IOSCO to review the impact of social media and automated advice on the sale of financial products.**

4. Enhancing market integrity

OTC Derivatives

- **FSB reforms cover standardization, central clearing, exchange or electronic platform trading, reporting to trade repositories and mutual recognition.**
- **IOSCO Report on Trading of OTC Derivatives published on February 2011: more co-ordination of regulatory efforts to reduce risk in the OTC derivatives industry.**
- **Report analyses the characteristics, cost and benefits of exchanges and electronic platforms.**
- **BCBS and IOSCO released the final framework for margin requirement for non-centrally cleared derivatives in September 2013.**
  - All financial firms and systemically important non-financial entities that engage in non-centrally cleared derivatives will have to exchange initial and variation margin commensurate with the counterparty risks arising from such transactions.
  - “One-time” re-hypothecation of initial margin collateral is permitted subject to a number of strict conditions.

Business Continuity and Recovery Plan

- **Joint Forum: The regulators and financial industry participants have a shared interest in promoting the resilience of the financial system to major operational disruptions.**
- **Events such as natural disasters, terrorists attacks, technology failure, other intentional or accidental acts can cause major operational disruption in the financial market and threaten the global economy.**
- **IOSCO will consider to provide guidance on business continuity management.**

Dark Liquidity

IOSCO has introduced six principles which are designed to:

- **minimise the adverse impact of the increased use of dark pools and dark orders in transparent markets on the price discovery process by generally requiring pre-trade and post-trade transparency and encouraging the priority of transparent orders;**
- **mitigate the effect of any potential fragmentation of information and liquidity by generally requiring pre-trade and post-trade transparency;**
- **help to ensure that regulators have access to adequate information to monitor the use of dark pools and dark orders for market monitoring/surveillance purposes and to enable an appropriate regulatory response to market developments; and**
- **help to ensure that market participants have sufficient information so that they are able to understand the manner in which orders will be handled and executed.**

Concluding Remarks

"Strong regulations – like Basel III – are only the starting point, and even this becomes ineffective without strong supervision."

"Strong capital and comprehensive risk coverage are not supervisory silver bullets that can cover up deficiencies in risk management or substitute for effective market discipline."

Nout Wellink, Chairman Basel Committee (May 2011)