IOSCO and the international reform agenda for financial markets

A speech by Greg Medcraft, Chairman, International Organization of Securities Commissions, to the National Press Club, Washington DC, 22 June 2015

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Introduction

Good morning everyone.

I would like to thank the National Press Club for the opportunity to talk about some important issues on the international regulatory agenda.

I am here today in my capacity as Chairman of the Board of the International Organisation of Securities Commissions (IOSCO).

Today, I'd like to touch on 3 topics:

1. One – to briefly describe what IOSCO does and our role in building integrated global capital markets that are underpinned by investor and issuer trust and confidence – capital markets which support economic growth.
2. Two – to comment from a market regulators perspective on where the international regulatory debate has been since the Crisis;
3. Three – to comment on where the debate might head and what IOSCO thinks is required in the asset management sector.

I should say at the outset that I will limit my comments to the international regulatory agenda and experience.

It is not appropriate for me to talk about issues at a national level. These are matters for your own regulators and policy makers.

Let me first turn to IOSCO – who we are and what we do.

1. IOSCO – who we are and what we do

IOSCO brings together markets regulators from over 120 jurisdictions – which together account for over 90% by value of global capital markets.

Our members include regulators from the largest and most developed jurisdictions to frontier jurisdictions with tiny capital markets.

Our fundamental objective is to build trust and confidence in global capital markets by working to ensure:

- they are fair, efficient and transparent;
- the systemic risks they pose are mitigated; and
- the investors who use them are protected.

This is because markets in which there is trust and confidence will be better able to support the broader economy in generating wealth and jobs.

We work towards our objective in a number of ways, which all have co-operation and collaboration at their core.

Let me touch on seven activities:

1. First – we co-operate in **developing guidance** for our members to use in deciding how they regulate.
    - Regulation in our space focuses on supervising conduct and enforcement.
    - Since the Crisis, we have developed guidance on regulating credit ratings agencies, hedge funds, securitisation, asset management and financial benchmarks.
    - We have also recently published guidance on what credible deterrence frameworks require.
2. Second – we co-operate on **enforcement**.
    - The best example of this is the Multilateral Memorandum of Understanding between our members about co-operation in investigation and enforcement activity.
    - 105 of our members are now signed up to this MoU and are using it to ensure the prosecution of cross border market abuse.
3. Third – we co-operate in **supervising** the conduct of those we regulate.
    - Our members are using the Principles on Supervisory Co-operation we developed in 2010.
4. Fourth – we support our members in growth and emerging markets to **build their regulatory capacity**.

- We do this through education and training programs.
- We focus the work on areas of need identified in our implementation assessment programs.

5. Fifth – we support the development of our **people** by encouraging and supporting secondment activity between our members.

6. Sixth – we work with our members to understand **emerging risks** to global markets.

7. And seventh – we collaborate with industry and other international forums like the Financial Stability Board where we represent the interests of our members.

These activities have seen us emerge as the **key global reference point** on markets regulation.

We have grown more important with the increased importance of the markets we regulate.

These markets now play a greater role for three reasons:

1. The significant increase in the global retirement savings pool;
2. The impact of regulation post-Crisis in the banking sector; and
3. The impact of digital disruption.

In the longer term, IOSCO's activities will help build globally integrated capital markets which support the free flow of capital around the world. In particular:

- Markets which have the trust and confidence of those who use them.
- Markets which investors, issuers and participants can access wherever they are – be it New York, London, Johannesburg, Beijing, Mumbai or Jakarta.
- And, markets which fund the real economy and economic growth.

2. The Post-Crisis Reform Agenda

Let me now turn to my second topic – the Post Crisis Reform Agenda.

I'd like to make two comments which provide important context to where I think we should be heading.

1. The first is about the **types of issues** we have had to address since the Crisis; and
2. The second is about how we have gone about addressing these issues.

2.1 Post-Crisis issues

Many of the issues we have had to address since the Crisis were cross-sectoral in nature requiring cross-sectoral solutions.

- Our work on securitisation is an example of this.

In addition, many of the issues raised have been new.

- The regulation of OTC derivatives is an example of what has been largely greenfields territory.

At a national level, markets regulators have had to work with central bankers and banking supervisors more intensely than ever before.

Globally, IOSCO has had to work with the FSB and the Basel Committee more intensely than ever before.

This has been a challenging exercise for all of us, but a necessary and fruitful one.

2.2 Addressing post-Crisis issues

My second comment is about how we have addressed those issues.

Let me focus here on the reform agenda for what has been called 'shadow banking' but we now prefer to call '**sustainable market based finance'**.

Let me make three points:

1. The first is the fact that the agenda has for some time been driven by financial stability and systemic risk considerations – and not by the role market-based financing can play in funding the real economy.

2. The second is about how we have assessed the risks posed by market-based finance.

   The international regulatory community may have been too willing to draw conclusions about the nature and scale of risks posed by market-based finance to financial stability.

   Given our traumatic experiences in 2007 and 2008, this is not surprising.

   But there is a concern that the international regulatory community may have gone too far in seeing problems and has underestimated the effectiveness of existing tools to regulate market-based finance

3. The third is about the thinking that has gone into policy prescriptions and tools to address these risks.

   These tools have tended to be based on those used by prudential supervisors. While they have worked for the banking sector, they won't necessarily work for market-based finance.

At IOSCO, we have grown increasingly concerned about these developments.

They don't fit comfortably with the way we look at the world and our responsibilities as markets regulators.

The markets we regulate are built on the idea of risk taking – risk taking which supports wealth creation and economic growth.

We see regulation as being about ensuring markets accurately and fairly price those risks and that market participants act with integrity.

- It's all about ensuring trust and confidence in these markets.

Regulation should be careful not to stifle risk taking – or make it prohibitively expensive.

The tools we develop and use should be tailored to the particular risks we think warrant regulation and supervision. In the markets space, they should be about conduct supervision and enforcement.

3. The current agenda

I would now like to outline how I think these concerns should be taken into account in charting a path forward in international work more specifically on asset management.

You will all be aware of the work which has now been underway for some 3 years on the designation of Non-Bank Non-Insurer Systemically Important Financial Institutions, or NBNISIFIs.

This work has extended into the asset management space. And, the FSB is now embarking on further work to understand – and address the risks – posed by this sector.

I want to touch on two issues – which IOSCO is flagging and will continue to flag through discussions with the FSB. These two issues are:

1. Judgements about risks in the asset management sector and the need to act; and
2. Actionable solutions we need in this sector.

3.1 Making judgements about the asset management sector

The first issue is being careful in jumping to conclusions about the nature and extent of risks in this space – and the need to act.

Our view is that we should only progress thinking about solutions once we are satisfied there is **strong evidence** that there is a problem. I want to make three points on this:

1. The first is about the quality of the evidence.
    - This should not be theoretical and drawn from academic papers based on what might have happened in the distant past.

- It should be based on what we are currently seeing and what we think might be happening in the markets we regulate – our real experience.

2. The second is making sure the evidence is collected jointly and collaboratively across all sectors and with industry.

    - The evidence here is not simply data – and how big fund managers are – but about industry practice in addressing risks and the effectiveness of conduct supervision and enforcement;

3. And, the third is how we go about deciding when a problem or risk is so important that it needs to be acted on.

    - This means being very clear about our objectives and the balance we want between financial stability and economic growth outcomes.

I am not convinced, for instance, that there is evidence that asset managers put financial stability at risk simply because they are large.

As yet, we do not have concrete evidence that this has been or might be the case.

- In this respect, I find industry's recent commentary compelling.

Even during the depths of the financial crisis net outflows from funds were small and certainly not of a scale to impact the broader market.

This reflects the fact that investors in mutual funds are – by nature and definition – in it for the long haul and take short term fluctuations in their stride.

- They do not rush to redeem.
- In the rare instance where they might, managers have tools in place to manage the flow of redemptions.

There is – however – scope to explore the extent to which some of the activities of asset managers might pose broader market risks.

I am encouraged by the fact that the FSB has now embarked on work to better understand these risks.

- Work that will inform further regulatory guidance in this area.
- I look forward to seeing the outcomes of this work.

3.2 Actionable solutions

My second issue is about implementing actionable solutions once we decide we need to act.

I am firmly of the view that we should not look to find new – and possibly inappropriate solutions – before we understand what we are already using and what refinements we may need to make to our current approach.

In the asset management space, markets regulators and asset managers already have toolkits at their disposal – toolkits based on conduct supervision and enforcement – which I believe have been effective in managing disruptions in these markets in many jurisdictions.

These include rules on:

- eligible assets;
- liquidity thresholds;
- restrictions on leverage;
- stress testing;
- know your investor requirements; and
- redemption restriction tools, including gates, fees, side pockets and suspensions.

IOSCO has described these tools in two previous reviews and provided guidance on when and how they might be used.

In 2012, we published *Principles on the Suspension of Redemptions in Collective Investment Schemes* which provided guidance on when and how managers of schemes should suspend redemptions.

- Our report also sets out alternative measures which could be used to deal with illiquidity based on real experiences – not just theoretical possibilities in member jurisdictions.

In 2013, we published *Principles of Liquidity Risk Management for Collective Investment Schemes* which include guidance about managing liquidity on a day-to-day basis.

We also published recommendations in 2012 on the use of these tools for money market funds.

If we decide there is an issue, this work should be our starting point.

We should **not** use tools developed in the banking and insurance space as our starting point.

- Those tools were developed to deal with firms which have different risk profiles to asset managers.
- It is like creating a square peg for a round hole.

At our meeting last week in London, the Board also discussed how we should be progressing work in this space.

Let me outline our decisions.

We decided three things:

1. The first was that a full review of asset management activities and products should be the immediate focus of work in identifying potential systemic risks and vulnerabilities in this space.

2. The second was that this review should take precedence over further work on methodologies for the designation of systemically important asset management entities.

3. The third was that once this review was completed, work on designation should be reassessed.

Our thinking was that the review should focus on four areas:

1. The first is about ensuring we have the data we need to monitor and understand risks in what is a dynamic space.

   - This is about collecting more and better data than we currently have.

2. The second is about liquidity management – particularly the extent of liquidity mismatches and how those mismatches are being dealt with.

   - Liquidity management is at the heart of asset management.

   - We need to be comfortable liquidity risks are being effectively managed.

3. The third is about leverage.

4. And, the fourth is about developing a better understanding of the risks posed by the transfer of investment mandates in times of stress.

Wherever we land after this work and whatever guidance we develop, we need to be sure we don't unduly stifle risk taking.

It is the core characteristic of the markets we regulate and the characteristic which delivers wealth and economic growth.

4. Conclusion

So – in conclusion – I want to flag the importance of being careful and cautious in driving regulatory work on market-based finance and in particular asset management.

We need to ensure our work is not just about ensuring the stability of our financial system – but recognising the role markets play in funding economic growth and facilitating that role.

We need to recognise that markets are all about taking risks and should be regulated in different ways to banks.

We need to make a very clear case for acting before we act.

We need to ensure the action we take recognizes the tools and approaches we currently have.

Conduct supervision and enforcement are a great starting point and should be the basis of any further regulation in this area.

I'd be happy to take any questions.