IOSCO Technical Committee Conference
Concluding Panel
Remarks by Manuel Conthe, Chairman of Spain´s CNMV

(London, November 16-17, 2006)

I will make a few remarks on the **increasing complexity and internationalisation** of securities markets and the challenges this entails for IOSCO and other international regulators. My comments will be a mixed bag of opinions as a member of IOSCO´s Technical Committee and Chairman of Spain´s Securities Commission, flavoured with some strictly personal views.

The growing complexity and internationalization of securities markets has at least four dimensions, which I will consider in turn:

- Financial products;
- Trading venues;
- Cross-border chains and holding patterns of securities; and
- Corporate structures of market participants, most notably issuers, intermediaries and beneficial owners.

1. The complexity of financial products and the challenge of protecting investors

- Investor protection has always been a key priority for IOSCO, as enshrined most notably in its Principle 23. This is not surprising, since conduct of business rules are a higher priority for (pure) security supervisors than for prudential & banking supervisors.

  In my view, this difference has a bearing on the ideal model of organization of financial supervision: while we are all very familiar with the model of "integrated financial supervision" whose epitome is the UK´s FSA, less attention has been paid to the so-called "Twin Peaks model", whose classical illustration is Australias´ASIC.

- There is an acute "market asymmetry" in the market for (retail) financial services: providers of services are rather strong and concentrated while their clients are dispersed and unorganized. In this context, John K.Galbraith's Theory of Countervailing Power[1] applies: there is a strong case for securities supervisors, acting in an enlightened, sensible way, to defend vigorously the interests of investors.

- There is an ongoing effort by financial regulators to ensure cross-sectoral consistency of banking, insurance and securities regulations on customers´ protection. At the international level, this effort is being led by the so-called Joint Forum. Within the EU, it is the remit of the so-called 3 L3 Committees (i.e. CESR & CEBS & CEIOPS).

[1] "American Capitalism", Chapter 7, 1952.

Within the EU there are indeed significant differences across sectors in this respect, since MIFID´ s provisions on investor protection are not mirrored in any similar Directive on banking or insurance services. .

There is not even full consistency within securities regulations, since provisions on Collective Investment Schemes (i.e. mutual or trust funds) are more detailed and specific that the more general MIFID´s rules on investor protection. This is at the origin of recent claims by the industry that the latter rather than the former rules should apply to the retail marketing of hedge funds.

- Finally, a word on the debate whether regulations should be rules- or principles-based. As one fellow member of IOSCO Technical Committee said in a recent conference, the industry seems to have a preference for principles-based regulations…provided supervisors do not attempt to enforce them! In my view, the critical issue should be to have standards and regulations which are enforceable, and are actually enforced. In those jurisdictions where principles-based regulations can be legally enforced and lead to the application of penalties in case of breach –this is probably the case in countries in the Common Law tradition- principles may be preferable to detailed rules. But in those countries where only detailed rules can be legally enforced and lead to disciplinary action –like is probably the case in most countries in the Napoleonic Law tradition-, rules-based regulations will be inevitable. Thus, whatever the merits of either approach, the actual choice by an individual jurisdiction should be based on its legal framework.

- The key issues & priorities in this domain for IOSCO´s two relevant Standing Committees (i.e. Standing Committees 3 and 5) currently are:

  - Information for investors at point of sale
  - Actual enforcement practices of conduct of business rules
  - Governance of Collective Investment Schemes (CIS)
  - Rules on order handling and execution

2. The complexity & growing choice of trading venues

Two key issues stand out in this area:

- The need to establish a level playing field among competing venues (e.g. Stock Exchanges and regulated markets, MTFs and internalizers), including on pre-trade & post-trade transparency, and on reporting obligations

- The need for a "best execution" policy by financial intermediaries, to ensure that investors benefit from competition among trading venues.

Before I move to the third dimension of complexity, let me recap briefly and point out what may amount to a paradox: in spite of the growing internationalization and choice of financial products, there remains a well-documented tendency for investors to invest in domestic assets (this is the so-called "*home bias*").

I wonder: Might this "home bias" be just a manifestation in the securities area of the more general paradox which behavioural economists have labelled the "paradox of

choice" (i.e. a large array of options may discourage consumers and lead them not to make any choice)? Might too much choice be de-motivating? [2]

3. The complexity of chains and holding patterns of securities

Besides the growing complexity choice of available securities and venues where they can be traded, there is additional complexity stemming from the way in which investors own, have an interest in, or hold securities across jurisdictions.

Two separate issues can be identified:

- The alternative legal approaches to the concept of "security interest" and ownership of "intermediated securities", including the degree of transparency of the holding pattern between the Central Security Depositary (CSD) and the final account holder or beneficial owner.

  This is a legally complex matter in which UNIDROIT (i.e. the International Institute for the Unification of Private Law) has taken the lead and is currently working on a draft Convention on Substantive Rules regarding Intermediated Securities. After its technical meeting in Rome earlier this month, there is a good chance that next year the draft Convention might be ready for discussion, or even adoption, at diplomatic, intergovernmental level.

- The jurisdiction where the final beneficial owner or investor is actually located, a decision which may affect the ability of foreign supervisors to obtain information about the investment.

  This is an area where IOSCO, acting through its Standing Committee 4 under the aegis of the Financial Stability Forum, is playing an essential role by keeping a dialogue with, and exerting moral suasion on, uncooperative or unregulated jurisdictions.

Concerning both issues, the objective is to ensure full transparency, for supervisory purposes, of holding patterns and the identity of final beneficial owners, something essential to enforce securities regulations, not only in the area of market abuse –e.g. insider trading or market manipulation-, but also concerning rules on mandatory take-over bids, where they exist.

SEC Chairman Mr. Cox yesterday described cooperation among securities supervisors as a Rousseaunian "stag hunt" game –where the first best for all players is achieved when they all cooperate-. I would be slightly less optimistic, since the relation between competing capital markets shows often distinct elements of a Hobessian "prisoner´s dilemma", where the individual first best is achieved when one is allowed to defect and free-ride on all the other cooperating players. For this reason there is a need in the international financial arena for a strong Leviathan –e.g. Standing Committee 4- imposing discipline on un-cooperative jurisdictions.

This brings me to the forth and final dimension of financial complexity .

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[2] See, for instance, an entertaining summary in *The Paradox of Choice. Why More is Less*, by Barry Schwartz, Harpers Collings, 2004.

4. The complexity of corporate structures of issuers & intermediaries& beneficial owners

The 2005 IOSCO Report on "Strengthening Capital Markets Against Financial Fraud" highlighted the various risks of fraud stemming from the use by issuers and listed companies of unconsolidated, or poorly audited, Special Purpose Entities (SPE).

When one considers, in historical perspective, how the recognition of legal entities has evolved, one gets the feelling that the pendulum has swung from one extreme to the opposite one, i.e. from the extremely restrictive and regimented regime which prevailed in many countries until well into XIX century –when the incorporation of a private undertaking as a legal entity had to be authorized specifically, case by case, by Parliament or by the Government-, to the current flexibility in the creation of corporate entities and its potential for abuse, as illustrated by the quip of a former Minister of Finance in Spain:

> "*At my age, most of my friends are already legal entities*".

Unfortunately, abuses with SPEs have not been limited to the private domain and many Governments, most notably those in the European Union attempting to meet the budgetary criteria established by the Maastricht Treaty, have frequently resorted to "budgetary gimmickry" involving of SPEs.

As a follow-up to the concerns expressed in its 2005 Report, IOSCO´s Standing Committee 1 is currently surveying the practices of its members on accounting and non-financial statement disclosure requirements for unconsolidated SPEs.

The Basel Committee of bank supervisors made a key contribution in this area earlier this year by enshrining in its Recommendations on "Enhancing Corporate Governance for Banking Organizations" the so-called Principle 8 ("Know-your-structure"), under which

> "*The board and senior management should understand the bank´s operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparency*"

The document notes that, in addition to the direct risk arising from operating in jurisdictions, or conducting business through structures, that lack or impair transparency, banks may also be exposed to risk indirectly when they perform certain services or establish opaque structures on behalf of customers.

In Spain we felt that this Principle had to apply not only to banks, but to all listed companies. And thus, Recommendation 8 of the so-called Unified Good Governance Code of listed companies, approved last May, reads:

> "*The board of directors should authorize the creation of, or acquisition of shares in, special purpose vehicles or entities resident in jurisdictions considered tax havens, and any other transaction or operations of a comparable nature whose complexity might impair the transparency of the group*".