

**Regulation - Mutual Recognition and Cross-border Issues  
from the Market Authorities' Perspective**

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***Introduction***

Shanghai – what better place to talk about bringing the markets of the world together. In this prosperous and beautiful city of Shanghai, signs of the impressive progress of the People's Republic of China are all around us. The Shanghai Stock Exchange too has been a model of rapid progress and growth, since its beginnings only 17 years ago. I was very impressed to see that it had registered gains in domestic market capitalization of 220% last year, well ahead of any other stock exchange globally. The Exchange also participates actively in the international arena with several international relationships and MOUs. It is an affiliate member of the International Organisation of Securities Commissions (IOSCO) for example and a member of the WFE of course, and I understand has some 28 MOUs with other exchanges outside China. Our congratulations to Chairman Geng Liang on the outstanding success of the Shanghai Stock Exchange, and for hosting this conference.

## *What We Mean by Globalisation in Securities Markets*

This afternoon's overarching theme is globalisation. More specifically I am referring to the regulatory implications of the evolving globalisation of market structures and the increased interest in cross –border transactions. A corresponding interest in seeing regulatory convergence becomes an important theme.

Globalisation encompasses the extraordinary growth rates of cross border capital flows and investment, and the increasing interdependence of markets in different national jurisdictions. In actual fact globalisation is not so new. We can track back as far as the letters of credit presented by Marco Polo on his trips to this part of the world in the thirteenth century for early evidence of cross border trading in financial services. Back in 1602 with the establishment of the first stock exchange in Amsterdam, promoters sold stock to investors outside Holland. Indeed a global outlook has truly characterized the entire history of trade and markets.

Historically markets have been in fixed national locations and the regulation and monitoring of these marketplaces has been undertaken by national governments, and in many parts of the world this remains true today. As Sir Callum McCarty, Chairman of the UK Financial Services Authority said in 2005, “Most regulation is rooted in national legislation. But the business of large firms is increasingly complex and global. Regulators are rightly under pressure to remove duplication or inconsistent regulatory requirements arising from firms having to deal with multiple regulators in the EU and worldwide.”

Existing legal and regulatory frameworks in relation to stock exchanges are deeply rooted in many countries as national institutions, and regulators in many cases are accountable to national political constituencies for the protection of their investors. Furthermore national markets are seen as relevant to national economies particularly in their capital formation role. The challenge that globalised market developments are highlighting relates to the fact that increasing portions of the marketplace are now beyond those national jurisdictions, and new marketplace structures challenge these traditional national notions.

What is changing with globalisation now is the very form of markets. I hardly need to observe to this particular audience that today market operators have the capacity through technology, as well as the financial incentives with demutualization of market ownership structures, to expand their global reach. Exchanges are now motivated by maximizing returns to shareholders, and thereby competing to capture the broadest customer base through various types of strategic alliances, host relationships, franchises and outright mergers. Exchanges are motivated to grow their own markets and to respond to the demand for ever more cost effective mechanisms for trading. Developments are driven by both changes in technology and pricing challenges.

As I look around the room, many of your organizations are testament to the global nature of today's capital markets. In fact the number of partnerships, alliances and mergers involving exchanges in separate countries has risen so rapidly that it is likely if your organization is not already, it will soon be involved in one of these alliances. Recent examples of this rapid consolidation across national borders include the New York Stock Exchange's combination with Euronext to form NYSE Euronext Inc and the very recent merger between the Borsa Italiana and London Stock Exchange. A number of other recent acquisition attempts have been evident across various markets.

But as we observe this phenomenon of rapid growth of cross border trade and consolidation and merging of market- places, where does this leave the role of the regulators, a role traditionally vested in national governments? This question is at the crux of the themes I wish to explore today.

### ***The Approach of Regulators in Today's Global Markets***

Indeed an important question we regulators might be asking both ourselves and key market players such as yourselves is: Are regulators keeping up with the play? Are we ahead of this rapid globalisation play, or are we lagging behind? Where should we be? More fundamentally what should our role be?

How does the national and regional regulatory framework manage in this globalised environment? If we accept the need to maintain national and regional regulatory authorities what can regulators do to protect investors, and maintain confidence in our markets as they become increasingly global?

Having defined the challenge that regulators are confronting in the current environment, I will use the remainder of my time to address these questions in a review of progress already underway.

### ***Co-operation Between Regulators***

I'd like to start with the premise that cooperation between regulators is at the core of any solution.

Charlie McCreevy, the European Commissioner for Internal Markets and Services noted this sentiment, and I quote from a speech he gave in New York in April 2005:

“International cooperation in a globalised world is imperative if we are to create level playing fields: if we are to avoid unnecessary, burdensome and costly duplication; and if we are to deliver higher and consistent standards that build confidence in capital markets. Cooperation between legislators and supervisors urgently needs to catch up with the markets and in the way they work together on a global scale. Increasingly globalisation and integration have changed the business landscape for good. Hand in hand with this development it is unavoidable that regulation in one jurisdiction spills over into others. We must therefore work together to minimize unnecessary regulatory duplication and legal friction.”

And echoed by Sharon Brown-Hruska, previous Acting Chairman of the US Commodity Futures Trading Commission, in May 2005: “It is time for regulators to catch up with the marketplace by removing undue barriers that limit the ability of a market participant or

intermediary to conduct business based solely on the particular jurisdiction in which that person or firm finds themselves. Our task as regulators should be to foster the conditions that allow markets to perform seamlessly, and allow individuals and firms to execute their preferences globally and maintain their preferred relationships with service providers. If we do so, markets can compete with one another and innovate in order to provide the highest level of services to their customers at the lowest possible cost.”

Possibly no organization promotes this theme of cooperation more effectively than does the International Organisation of Securities Commissions, known as IOSCO. At this point I would like to describe and introduce the organization, although I am sure most of you will be familiar with the work we do. IOSCO is the international standards setter for securities regulation and our members include 120 regulatory agencies in 109 jurisdictions and many other affiliate bodies. Members regulate more than 90% of the world’s securities markets. IOSCO has a clear vision of markets which operate across the world on sound principles and standards, and regulators who can cooperate and exchange information across borders. It aims to ensure that markets are fair, efficient and transparent; to protect investors; and to reduce systemic risk.

In support of its regulatory objectives IOSCO established 30 broad Principles for securities regulation to be implemented in the regulatory framework of every member jurisdiction. These principles are recognized as securities market benchmarks by the leading financial institutions globally, the Financial Stability Forum, the IMF and the World Bank. The principles are sufficiently high level to enable all jurisdictions to implement them in any institutional or legal setting. To help achieve implementation IOSCO provides technical assistance, advice and training to members. The aim is to lead to convergence and implementation of consistently high standards of regulation around the world.

But getting back to globalisation, here one of IOSCO’s main objectives is to contribute as much as possible to reducing the regulatory differences and regulatory burdens for firms

that trade across borders and to enhance market stability and investor protection in the global arena.

### ***Ways to Approach Cooperation***

Regulators and national governments have been keenly aware of the increasing globalisation of the financial services industry and have put in place a number of processes and mechanisms to ensure greater global cooperation. These mechanisms are proving extremely useful in the interface between regulators and industry in the globalised world. Some of these efforts have involved a convergence approach, while a number have adopted forms of mutual recognition.

With convergence the process is often as important as the target itself and frequently requires a “roadmap” with a timetable as well as clearly defined steps and agreed final objectives.

With mutual recognition one must agree on a common basis of principles to assess the effectiveness of foreign regulations and the work of the foreign regulator to ensure coordinated responses and consistent approaches to regulating cross- border transactions.

For today’s discussion I plan to illustrate that the basic infrastructure for solving the tension between the national framework and the globalised framework has to some extent already been put in place. Much more work needs to be done but some basic building blocks are in place.

Let’s start with a brief look at the convergence approach.

The adoption of the IOSCO Principles themselves is a very significant example of the convergence of standards globally.

More recently the work on common global accounting standards is another excellent example. We applaud the huge strides made by the International Accounting Standards Board under the leadership of Sir David Tweedie towards the goal of a single set of global accounting standards, known as the International Financial Reporting Standards (IFRS) regime. This is a major task. On another angle, we at IOSCO have welcomed for example the initiative taken by the US Securities and Exchange Commission in proposing a “Roadmap” for transition. In July this year the SEC issued for consultation a proposal to eliminate the current requirement for foreign private issuers to reconcile their financial statements with US Generally Accepted Accounting Principles (US GAAP) where those statements are prepared using IFRS-subject to certain conditions. In other words use of IFRS may become sufficient for private foreign issuers listing in the US.

Not all standards and norms lend themselves readily to convergence.

### ***Mutual Recognition***

Mutual recognition allows laws and regulations to reflect national imperatives whilst providing the capacity for cross border co-operation and enforcement.

Apart from initiatives in some European Union jurisdictions and some very promising steps by the US, a worldwide application of mutual recognition is still very far away. However the core requirement of mutual recognition, a clear and common set of globally recognized principles, has already been established by IOSCO. It provides, I believe, the foundation for the recognition of equivalence or comparable regulation. IOSCO’s 30 broad Principles for securities regulation that I mentioned earlier provide a primary set of building blocks on which jurisdictions should build mutual recognition arrangements in the future. The principles are sufficiently high level for all jurisdictions to implement them in any institutional or legal setting. Much more detailed work is needed of course, but compliance with IOSCO’s Principles is a critically important start. In fact the IOSCO Principles provide a fundamental base line on which mutual recognition can occur.

We have in recent times seen a number of steps taken by some jurisdictions along the way towards mutual recognition. The approach is still somewhat piecemeal, I have to acknowledge, but there has been positive progress. I would like to spend a little time now to take a look at some of these, and the various approaches underlying them.

### ***IOSCO MOU***

IOSCO itself has developed a very good example of a limited form of mutual recognition around enforcement of securities law. In 2002, IOSCO members adopted a *Multilateral Memorandum of Understanding on Consultation and Cooperation, and Exchange of Information* – the “IOSCO MOU”.

This defines the legal authority that regulators must have to cooperate and exchange information for enforcing securities laws. It also sets out conditions under which these information exchanges should occur. Under the IOSCO MOU, signatories in effect delegate the “recognition” to groups of IOSCO experts who audit a jurisdiction’s regulatory capacity and legal framework. It is an interesting and innovative model. IOSCO has a clear vision of effective cooperation between securities regulators for enforcement across jurisdictional borders. This is happening with increasing frequency under the IOSCO MOU, and it is imperative in today’s globalised securities markets. IOSCO has adopted a deadline of January 2010 for all member regulators to become full signatories to the IOSCO MOU or to have committed formally to doing so. To date, 41 members are signatories and 15 others are committed to addressing issues that prevent them from signing on to the IOSCO MOU. As Chairman of New Zealand’s regulator, the Securities Commission, I can attest to the effectiveness of this mechanism in cross border enforcement. We have made excellent use of the IOSCO MOU in recent enforcement cases.

### ***Other Examples of Mutual Recognition***

There have been a number of steps adopted in both bilateral and multilateral agreements recently which are edging towards a broader mutual recognition approach. As I have said



the IOSCO Principles provide a set of preconditions to enable mutual recognition to occur.

Many of you will be aware of the MOU of 2006 between the US Commodity Futures Trading Commission and the UK Financial Services Authority dealing with consultation and cooperation in relation to some US and UK exchanges.

Similarly you will be aware of the arrangement concluded in January this year by the US SEC with the five European authorities that oversee Euronext.

All these arrangements recognize the importance of local regulation applying to local markets and create mechanisms for consultation and cooperation between regulators.

I am sure you will agree that these examples highlight that regulators are making progress in keeping up with the rapid global developments of marketplaces. Of course as I have already mentioned we have not yet seen an all encompassing form of mutual recognition appear between the major capital markets of the world, but the aggregation of exchanges and increasing cross border capital flows, and the demand these developments put on regulators may accelerate this.

Some of you may be familiar with the article published by Ethiopis Tafara and Robert J Peterson of the US SEC earlier this year, setting out a blueprint for cross border access to US investors. In this they propose a new framework to apply to foreign financial service providers accessing the US capital market, by providing investment services and products not otherwise available on the US market. Effectively it's another mutual recognition approach based on "bilateral substituted compliance".

Rather than requiring such foreign stock exchanges and foreign broker dealers to register with the SEC as is currently the case, the proposed framework relies on a system of substituted compliance with SEC regulations. The paper proposes that the comparability finding would need to be complemented by an unambiguous arrangement between the

SEC and its foreign counterpart to share extensive enforcement-and supervisory-related information.

This is a bold initiative reflecting the spirit and intent of mutual recognition, and is to be commended.

All the examples I have discussed represent building blocks for frameworks which enable regulators to achieve greater levels of comfort with each other's national frameworks. What will be core to the effectiveness of arrangements based on mutual recognition is the level of trust in the capacity and willingness of the other regulator to enforce and cooperate. It requires a mutually acceptable legal framework, and a similar appetite to take action. The examples I have touched on set in place worthy frameworks on which to base cross border regulatory cooperation.

#### ***New Zealand –Australia Example of Mutual Recognition***

I'd also like to share with you a development in mutual recognition (albeit within an initially narrow ambit) in my part of the world which well illustrates this point. New Zealand and Australia signed a treaty for mutual recognition of securities offer documents between the two countries in February 2006 and are now in the final stages of putting the necessary legal frameworks and processes in place for this to become operative. This framework mutually recognizes the enforcement mechanisms and capacities of the two jurisdictions in relation to securities offerings. Neither has adopted the laws or regulations of the other. Each is sufficiently comfortable with the other's framework and has sufficient respect in the other's enforcement capabilities to allow cross-border securities offerings with few additional requirements.

Domestic regulators who wish to participate in mutual recognition arrangements will be compelled to look at their own regulatory arrangements and ensure that they have regulatory frameworks and enforcement capabilities in place that others would wish to mutually recognize. In my view as a prerequisite, adherence to the IOSCO Principles and

being a signatory to the IOSCO MOU should be the underpinning to mutual recognition considerations. If a jurisdiction in the future wants to participate in market developments of the future its domestic regulation and capacity will need to be world class. IOSCO's self –assessment tools and training can assist here.

### ***IOSCO More Operational - Industry Dialogue***

I have talked about IOSCO's 30 Principles for securities regulation. I also note that IOSCO is becoming more operational in its focus. Beyond the initial adoption of the Principles we are taking a stronger interest in the capacity and capability of jurisdictions to implement the Principles. When we look at members applying to become signatories to the IOSCO MOU for example we not only look at the jurisdiction's legal ability to comply with the requirements of the MOU but also whether they are fully capable of undertaking the cooperation and enforcement action envisaged in the spirit of the IOSCO MOU.

As we become more operational it is important that our dialogue with industry is increasingly effective. Through constant internal discussions between regulators and with systematic consultation with industry, we have stepped up our consultation with the securities industry. A starting point of this "industry dialogue" is IOSCO's launch of a consultative paper on the ongoing work of the Technical Committee. In it we give an overview of the issues we are working on and planning to work on. We are interested to hear market participants' views on our proposed technical work plans but also if they believe IOSCO should carry out or even refrain from work in other areas. We are pleased at the input that the WFE made through its response to our consultative paper, where the Federation noted the most pressing issues it believes IOSCO should focus on.

### ***Concluding Comments***

In summary, I believe that it is imperative that securities regulators respond to and keep up with the rapid developments occurring in today's globalizing capital markets.

It is indeed in all our interests for a number of reasons. We should be aiming to expand investors' choice and reduce transaction costs that investors will pay when investing overseas, while increasing investor protection and ensuring global market stability.

It is in our interests to facilitate the end of the current situation of often overlapping and duplicative registration and oversight requirements for certain stock exchanges and broker dealers.

We need to improve investor access to foreign investment opportunities, while guarding the integrity of domestic capital markets. And to better protect investors we need to enhance the ability of national regulators to combat breaches of securities law across borders.

In all developments it is important to discourage "regulatory arbitrage" that can undermine investor confidence.

I'd like to come back to my earlier questions about just how effectively regulators are able to achieve these and other objectives in the current environment. How well are regulators keeping up with the fast moving trends?

My conclusion is that I believe we have started to put the pieces of the puzzle in place. We have the building blocks for significant progress, starting with the establishment of the 30 IOSCO Principles. We have seen benefits in the adoption of a convergence approach to modern common global standards. The IOSCO MOU has provided an early example of effective mutual recognition around cooperation and information exchange in enforcement of securities law. We can be encouraged by the types of bilateral and multilateral approaches moving towards mutual recognition that I have outlined, and we can see the implementation of the IOSCO Principles forming the substantive basis for this. These are all positive stepping stones towards a more all-encompassing approach in the future.

Indeed, representing the largest market, the US through the SEC is starting to look at what it believes would be required to enable it to accept mutual recognition at a holistic level. What would the standards be if we approached this on a global basis? Clearly the IOSCO standards for a start. What the additional requirements would be are yet to be worked through - but this is work in progress!

We are at the cusp of a huge global adventure into new realms of mutual recognition and consistent standards around the world. We live in exciting times!

Thank you.