Comments by Nicholas de Boursac, ASIFMA,

I have been asked to provide some industry views on the G-20 group 1 initiative. Of course much has happened over the course of the year and progress has been made so my comments will take these into account.

Generally the industry is very supportive of the broad thrust of the initiatives proposed and supports many of the reforms being discussed but we do have comments to make on certain aspects. However before I get started I would like to briefly introduce SIFMA and ASIFMA, as some of you may not know our organizations.

SIFMA stands for the Securities Industry and Financial Markets Association. SIFMA was created in November 2006 by the merger of The Bond Market Association (often know at TBMA) and the Securities Industry Association (often referred to as SIA).

SIFMA has about 600 members and a budget of about 100 million dollars. It has staff of about 175 in New York and Washington.

On November 1, the merger in London with LIBA the London Investment Bankers Association with SIFMA's London operations will be final and create a new organization: AFME with a staff of about 45.

SIFMA, AFME, ASIFMA will all be connected through a global body called the Global Financial Markets Association – GFMA. GFMA will be responsible for initiating global initiatives whilst the regional entities will implement global initiatives in the region and also set their own regional agendas.

In the US and Europe SIFMA has led the industry's response to the current financial crisis and has worked with regulators, central banks and law makers to provide the industry's input to the regulatory reform process. SIFMA has also created the forum for discussions to accelerate some of the industry's own initiatives to address the current crisis. Examples are the creation of databases with detailed information on existing securitization transactions and the development of principles on executive compensation.

ASIFMA is the Asian part of SIFMA but we are relatively new and much smaller. Our mandate covers Asia, excluding Japan and excluding Australia and New Zealand. We were created in October 2006, just three years ago and are funded by the industry though annual membership dues raised in Asia. We have over 40 members, led by the global banks. ASIFMA has its own board that sets priorities and direction. We have a staff of only five and a budget of less than one and a half million US dollars. As a result we need to be focused and are currently working on fixed income issues in China, Korea and India only. This explains why some of you operating in other countries may not have heard from us. Our colleagues in the US and Europe address issues in the equity markets as well as fixed income. We simply do not yet have the resources to do that.

The other major difference is that we are not working on the same type of issues. The Asian fixed income markets are generally not as developed or as liquid as the US and the larger European markets. We work on issues that will make Asian fixed income markets deeper, more liquid, more transparent and more efficient. We collect input from our members who, because of their experience in the global markets as well as their involvement in the local markets, can usefully contribute. They know what really matters to market participants and they are up-to-date. We share these views with the domestic regulators. We also provide regulators with information on how certain issues are addressed in other markets, which helps them build their case for their own recommendation. I like to think that we are seen as helpful partners by the regulators with whom we interact.

While our membership is currently made up of mostly foreign parties we are reaching out to and would welcome more participation from Asian institutions.

With regards to the G20 working group 1 approach to enhancing sound regulation and strengthening transparency, we are very supportive of the general thrust and objectives but I would like to make four points:

- We strongly support the creation of systemic risk regulators or systemic risk boards.

- It is imperative that there should be real international coordination between the regulators across the globe so the regulatory reforms are consistent.

- It is imperative that the reforms be carefully considered and implemented after broad consultation, including with market participants, so that the outcomes are thoroughly assessed.

- It is imperative that the balance between prudence and economic growth be evaluated and calibrated so that the aggregate impact of regulatory changes does not have the unintended consequence of delaying or hampering the economic recovery.

Let me take these points one by one:

<u>First the systemic risk regulator</u>

The debate is lively in the US and Europe, so my comments will largely refer to those markets.

SIFMA strongly supports the creation of systemic risk regulators with a mission to mitigate systemic risk, maintain financial stability and address any financial crisis.

A consensus has been developed on the need for a systemic risk regulator in the US. SIFMA has no view on what body should be the systemic risk regulator.

In Europe, the problem is more complex as there are 27 countries, hence the creation of the European Systemic Risk Board (ESRB) with representation for each country, plus two from the ECB and one from each of the three EU Supervisory Authorities and the creation of the European System of Financial Supervisors (ESFS) to address micro-prudential issues.

The systemic risk regulator or ESRB should monitor risk across firms and markets and identify regulatory gaps and asses practices or products that could increase systemic risk. They should also coordinate with regulators responsible for systemic risk in other countries.

They should also have authority over systemically important institutions and markets. These could include primary dealers, securities clearing agencies, derivative clearing agencies, payment system operators, hedge funds, private equity funds or whoever the systemic regulators deems to be a systemically important institution. It is likely that these will be subject to stricter prudential regulation. It will be a challenge to do this while maintaining a level playing field.

The systemic risk regulator or systemic risk board should be empowered to collect information from the broadest array of market participants, not only the regulated institutions. Otherwise, there is a chance that like generals some claim to be always preparing to fight the last war, regulators will be working to prevent the repeat of the last crisis. A good example in the US is the mortgage broking industry. Clearly some mortgage brokers contributed to the problems we are now facing, and in aggregate the change in practices in this industry also did, so the new systemic risk regulators needs to have the authority to seek data from mortgage brokers and/or whatever group they will consider could help them to anticipate and understand new systemic risks in the future.

The systemic regulators and board should have the broad and comprehensive authority to implement and enforce directly or indirectly consistent or uniform rules across different parts of the market to reduce systemic risk and regulatory arbitrage. An example here would be the different treatment of the insurance industry and the banking industry who might be offering economically similar products but with different capital requirements.

In addition, the systemic risk regulator and board should have the authority to appoint an administrator or receiver for winding down entities that were deemed systemically important but which have run into difficulty, so that the winding down has a little impact on the functioning of the market as possible. This should be done without “changing the rules of the game” in bankruptcy, so that customers, creditors and investors have *ex ante* legal certainty on the outcomes. One concept gaining traction is that of a “living will” whereby firms design a process for dismantling their firm should the firm fail.

In the US, depending on which entity is chosen, it may appropriate for the systemic risk regulator to also have the capacity to provide liquidity and emergency financial assistance and be a lender of last resort. In Europe the situation will inevitably be more complex.

The systemic regulator and systemic risk board will need to balance accountability with independence from the political process. They should be supported by experienced professionals who should have access to a wide array of data and be well equipped to understand the implications. They should have a track record of measured response to crisis and established credibility in domestic and international circles. This is a very demanding task.

Second: international coordination.

It is a truism that the financial markets are global, so too are the risks of contagion.

The new regulations developed as a result of the current review process must take into account this global nature. They must set high standards and a common set of principles, for both the prudential standards and the enforcement of the regulations. Both must be consistently applied across the major financial markets around the globe.

The new rules need to be applied as uniformly as possible and ideally in the same time frame. Otherwise, activity will quickly shift to the friendliest jurisdiction for a particular type of transaction, as issuers, investors and arrangers look for the lowest cost solution. A lack of coordination risks creating new regulatory arbitrage. This will have the effect of diminishing the positive impact of the new regulations and may lead to the development of a new form of financial protectionism. Policies that impede trade and investments create barriers to entry, or distort competition will threaten economic growth and job creation. The need for an internationally level playing field was recognized in the official statements following the G8 L'Aquila Summit.

This consistency across the globe in supervisory activity needs to be complemented by a consistent approach to accounting rules, definition of capital, disclosure requirements, valuation and reporting. Capital buffer rules are being viewed as important to lowering risk, but they need to be applied consistently, as do limits on remuneration and bonuses.

We are also concerned that care should be taken with the extra-territorial consequences of domestic regulations some of which might be intentional, some not, and some unwelcomed by other jurisdictions; the worst outcome would be two or more contradictory extra-territorial consequences affecting an innocent third country!

When addressing the issue of systemic risk, the systemic risk regulators need to coordinate and share information for the "careful oversight" of globally large and complex institutions and systemically important instruments and processes as well as their response to a perceived increase in risk. Again, consistency in terminology, accounting, definitions and prudential standards will ease this process for all concerned.

Another important area for global agreement is the management of liquidity risk. This needs a global approach with domestic provisions then aligned or we risk a beggar-my-neighbor situation.

This global coordination needs to be very thoughtful and sophisticated as well as well informed. The peer review process whereby regulators can nudge each other forward is likely to be helpful.

In recent months, the rules of global coordination seem to be changing. The European Union seems to be intent on becoming a global standard setter in certain areas. A good example is the approach to credit rating agencies. However, I expect the US and the UK to want to exert their influence. These political realities will impact the process of global coordination and may not be helpful.

The development of new rules will be complicated by the fact that politicians are getting involved in the complex somewhat technical areas, where the impacts of changes are not always immediately apparent. This is further complicated by the fact the politicians themselves are influenced by the different political timetables in different countries, often dictated by election timetables. In the UK, for example the Conservative Party, ahead of 2010 elections is promising to eliminate the FSA. In Europe, there are calls for a speedy action on certain issues and we are concerned that some of the drafting of new regulations has not taken into account all the consequences of the changes they are proposing. In the US, our current assessment is that reforms will likely slip in to 2010.

Despite these difficulties, it is critical that the relevant authorities make a wholehearted effort to facilitate communication between jurisdictions to ensure effective cross border supervisory coordination, cooperation and fully buy into the peer review process. To achieve this we do need the political will to effect change and the G 20 meetings will, we hope, keep the momentum. With this background we welcome and support the work being done to advance global coordination by such entities as the G20, the Financial Stability Board, IOSCO, the Basel Committee on Banking Supervision and IASB.

SIFMA and ASIFMA are keen to contribute positively to this coordination effort.

Third: Outcome focused, carefully considered legislation following broad consultation.

These global financial markets are complex and interrelated. It is easy to try to solve the problems piecemeal but this could exacerbate the problems because of the unintended consequences. We caution against speed at this time and encourage a comprehensive consultation process to collect input from various sources including from other jurisdictions and from market participants.

- It is better to get it right than to do it fast.
- It is important to stay focused on the desired outcome not on headlines.

In particular, care needs to be taken to assess what the cumulative impact of one requirement after another might have on the capacity of financial institutions to perform their role in the economy, as well as on the availability of capital and economic growth. For example if an increased capital buffer, a significant increase in capital requirements for certain activities are coupled with a redefinition of capital and a change in accounting rules that affect capital then the combined impact could make the transactions uneconomical. This might not have been the intention at the outset.

More specifically, we believe that securitization has an important role to play in the credit markets and should continue to contribute to the development of the retail and commercial mortgage markets and the general economic development. It is important that the combined effect of the regulations do not preclude this. Regulators should consult broadly and take measures after careful evaluation of the outcome and an analysis of their impact.

In addition we strongly believe that regulations should only become effective after an appropriate notice period that allows for comments and transitional adjustments and should not be retroactive. A track record of retroactive legislation, or legislation which does not give market participants enough time to adjust their business, will have a significant negative impact on markets, including investors.

<u>Fourth: The balance between prudence and economic growth must be carefully calibrated.</u>

A number of commentators have advanced the concept of pro-cyclicality whereby capital is retained during good times so that it is available during not so good times. When I was a young banker in Switzerland that was the accepted way to run a bank: at the cost of transparency, hidden reserves were built up in good years which would then be drawn down in lean years, so I am personally sympathetic to the idea but SIFMA has not formed an official position on this issue yet and as far as I am aware there is not yet an industry consensus.

The current discussions are about having changing prudential requirements that adjust to force the financial institutions to accumulate that additional capital when times are good.

My concern is that if the increased capital requirements from the pro-cyclicality regulations are added too early to the other constraints on risk taking resulting from the other regulatory changes, then it is possible that the expansion that will have just started will be nipped in the bud as credit availability is curtailed.

So the pro-cyclicality provision should be carefully evaluated and timed and should also be coordinated internationally to maintain the level playing field.

Those are my four main points.

- We strongly support the creation of systemic risk regulators

- We are keen to see real international cooperation between regulators as they develop new regulations.
- The new regulations should result from extensive consultation with a thorough evaluation of the consequences before implementation.
- The cumulative impact of new regulations should be carefully calibrated so that they do not impede the economic growth that will create jobs.

These are challenging times for all in our industry, not least for those working on developing new regulations. We have a golden opportunity to get it right. SIFMA and the financial services industry has already taken steps to contribute positively and constructively to this task and will continue to do so.