

## **20091009 SEC: Remarks at IOSCO Technical Committee Conference (by Chairman Mary L. Schapiro)**

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### **Introduction**

I am very pleased to be here with you today and I want to add my thanks to our hosts at FINMA for their hard work in organizing this conference. Over the next two days we will discuss efforts to reform our financial system and the regulatory framework that governs it. Most importantly, we will seek to identify and take steps to address the serious shortcomings in the system.

Even as the financial system as a whole begins to emerge from the worst downturn in more than half a century, we must not lose our focus or our will to reform the system.

As some of you may know, I have had a long and very gratifying relationship with IOSCO, dating back to 1988 when I first served at the SEC — and continuing through my chairmanship of the SRO Consultative Committee in the late 90's. So, I'm very pleased to once again have the opportunity to work with and through this important organization.

### **Basel and the Printing Press**

It is fitting that we are meeting in Basel — not just because of its connection to international banking and bank regulation, but also because of its historical role in advancing the dissemination of information. Although it is not widely recognized, Basel, since the invention of the printing press, has been the home to many well-known and influential printing houses — printing houses that spread the teachings of Renaissance humanists such as Erasmus and Thomas More and the philosophical and scientific treatises of the ages of Reason and Enlightenment.

With the invention of the printing press and establishment of publishing houses, the world witnessed a global information revolution — one that, in many ways, is comparable to the information revolution we have witnessed over the past decade. Along with an expansion of knowledge and culture, the information revolution facilitated by Basel printing houses helped to trigger an explosion of trade and the development of the first international financial markets.

### **Transparency**

Of course, that information also created a thirst for transparency in business relations that underlies the disclosure-based regime of the U.S. securities laws. And, it has guided the SEC since its inception 75 years ago. In my view, the financial crisis has, more than anything, only reinforced the importance of information disclosure and the necessity of transparency for the existence of vibrant, well-functioning capital markets and sound regulation.

If investors cannot obtain important and accurate information necessary for them to judge the financial soundness, management and prospects of an enterprise, they are more likely to make poor decisions — or perhaps choose not to invest at all. Indeed, during the crisis, investor confidence in the transparency of the markets, sufficiency and even the reliability of the information they were getting was shaken to the core.

In too many areas, investors could no longer be certain that they were getting clear, relevant, and reliable information about their investment options. Because investors could no longer discern a clear picture of the risks they were taking, many exited these markets.

Furthermore, we have seen that if markets are opaque and regulators are unable to monitor the positions taken by financial intermediaries, then regulators will be unable to do their jobs effectively. In such cases, we cannot fully enforce fraud and other business conduct standards vital for orderly markets, let alone assess the potential risks to the financial system or take effective

action if the need arises.

Of course, the SEC's philosophical emphasis on transparency is shared by securities regulators around the world, as well as by IOSCO as an organization. And, IOSCO has been instrumental in advocating and facilitating transparency throughout the world's capital markets, through the creation of numerous standards and principles promoting transparency in key aspects of the securities markets. One highlight is the International Disclosure Standards for Cross-Border Offerings and Listings by Foreign Issuers, issued in 1998, which continue to form the basis for disclosure by issuers around the world.

Similarly, the IOSCO Multilateral Memorandum of Understanding is a powerful tool for promoting transparency by allowing us to see beyond our borders when it comes to misconduct in the securities markets.

### **Regulatory Priorities**

My fellow SEC Commissioner, Kathy Casey, already has given an excellent overview of the work being done by IOSCO to increase market transparency. So, I thought I would focus my attention on some SEC regulatory priorities that are concurrently under consideration by IOSCO.

The SEC has taken significant steps to address issues relating to the financial crisis. In addition to our efforts to transform our own enforcement program and crack down on market abuse, the SEC has embarked on an aggressive rule reform agenda. Many of these reforms are aimed at enhancing disclosure in order to increase transparency. I cannot discuss all of the SEC's initiatives, but I want to focus on three areas of particular interest.

### **Accounting**

The first area of critical importance is accounting.

Increasing transparency in the market through a high-quality, global set of accounting standards has also long been high on IOSCO's agenda. We know that the Technical Committee's Standing Committee One works closely with the International Accounting Standards Board to provide useful input on standards, based on IOSCO members' experiences.

Financial reports prepared in accordance with high-quality, consistent accounting standards are one of the most effective tools for providing transparency to the markets and instilling confidence in investors. Yet the financial crisis demonstrated that some standards must be improved to provide investors with the critical information they need. That is why there is a great deal of support around the world for improving accounting standards and public disclosures.

Accounting standard setters, including the International Accounting Standards Board and the US Financial Accounting Standards Board, are both in the process of addressing important issues raised by the crisis. And at the same time, those standard setters are continuing to cooperate on the convergence of accounting standards. I applaud the quick reaction and ambitious timeline that accounting standard setters have laid out to revise the standards in question.

We must not lose sight of the fact that the purpose of accounting standards is to provide a clear and accurate picture of a company's financial condition, which is critical to providing investors a sound basis for relying on those disclosures, and making capital allocation decisions. We want to make sure accounting standards are "right" — and that those standards are the same when markets are going up, as when they are going down.

We all want confident investors, stable markets, and a sound financial system. And it is only by maintaining accounting standards whose overriding purpose is to provide accurate and transparent financial information to investors in public markets that we can expect investors to recover the confidence necessary to return to securities markets worldwide.

These objectives are true regardless of whether you are discussing accounting standards developed in Norwalk, London or anywhere else in the world.

The crisis has highlighted importance of implementing and enforcing high quality and consistent accounting standards around the world. The SEC has of course played a leadership role in fostering this ideal and I remain committed to the goal of a global set of high-quality accounting standards. I

also believe that there are issues that will be critical to address as we at the SEC consider the input we have received on last year's proposed roadmap on the role of international standards in the U.S. It is with the principles and ideas I just outlined in mind that I am committed to focusing our efforts this fall to following up with a work plan that expands upon the concepts proposed in the roadmap.

### **Credit Rating Agencies**

Another important area to which we have devoted significant attention is credit rating agencies — many of which did not perform as expected during the financial crisis. Despite this fact, many investors will continue to use ratings, given the sheer complexity and variety of investment instruments available to them.

With this in mind, the SEC has recently taken several important measures designed to improve the quality of ratings by fostering accountability, transparency, and competition in the credit rating industry.

Last month, we adopted rules requiring SEC-recognized credit rating agencies — known as NRSROs — to disclose their history of ratings actions — such as upgrades, downgrades, affirmations and withdrawals, on a delayed basis.

The Commission also adopted rules intended to encourage competition from other NRSROs, potentially resulting in better quality ratings. The rules would set up a process whereby an NRSRO that is paid to rate a structured finance product would have to disclose all information on the underlying assets to other NRSROs. Competitor NRSROs would then also have a chance to rate the product.

Additionally, the Commission has proposed new rules that would require additional disclosure, including information on what a credit rating covers, any material limitations on the scope of the rating, and whether any "preliminary ratings" were obtained from other rating agencies — in other words, whether the issuer engaged in "ratings shopping."

These reforms are intended to put credit ratings into context for investors, so that they can better determine whether ratings are worthy of their consideration or reliance. The reforms are also designed to promote increased competition in the credit rating industry and to provide investors with the data with which to compare the credit ratings performance of different raters.

This should give investors greater insight into a part of the capital markets that has long been opaque.

I think it is important to recognize IOSCO for its proactive work in the area of credit rating agencies — particularly as this was an area largely unregulated by any securities regulator until fairly recently. Long before most jurisdictions considered actively regulating them, IOSCO recognized credit rating agencies as a growing area of regulatory concern.

By 2004, IOSCO developed its Principles for Credit Rating Agencies, followed shortly by the CRA Code of Conduct which has since been incorporated into the codes of conduct of all major rating agencies and a significant number of smaller CRAs.

### **Dark Pools**

Finally, we — at the SEC — are also looking into dark pools of liquidity.

As you know, our markets are growing ever more sophisticated, with greater differentiation among the products and services offered. While this is a natural part of a dynamic market, regulators must be alert to whether, when niche products or services begin to take on larger market share, their effects on the broader market should raise concerns.

Dark pools generally refer to automated trading systems that do not display quotes in the public data stream. Although dark pools must promptly report their executed trades to the public, the trade reports do not identify the particular dark pool that executed the trade. As a result, it can be difficult for the public to assess the source of liquidity in a given stock.

Dark pools are intended to help market participants preserve anonymity and engage in

transactions without moving the market. There are legitimate reasons for market participants to seek these trading goals. Over time, however, the volume of trades executed through dark pools has increased, raising, in turn, the potential for dark pools to detract from the quality of public price discovery mechanisms.

As dark pools divert an increasing volume of order flow away from the public quoting markets, the potential for market fragmentation is a concern. Also, where there is less publicly-available information about the trading practices of significant markets, there may be more opportunities for information to be leaked only to favored market participants. For these reasons, the SEC is considering whether dark pools need more light.

For example, some so-called dark pools in the U.S. are not really dark for all market participants. Rather, they transmit electronic messages to selected market participants that convey valuable information about their available liquidity.

The widespread use of these messages, often referred to as "indications of interest," could create the potential for significant private markets to develop that exclude public investors. Such a two-tiered market would be inconsistent with the fundamental principles of fairness and efficiency that guide U.S. market structure policy.

We have recently begun an in-depth review of multiple market structure issues given the rapid advancements in technology. In addition to our recent actions with regard to flash orders and our current focus on dark pools, we will also examine high frequency trading, direct market access and co-location.

While we understand that there will always be trading and information asymmetries, we seek where possible, to eliminate inequities in the marketplace. Dark pools of course, are not a US phenomenon alone, and IOSCO has taken notice. As each jurisdiction considers whether and how to address dark pools and other market innovations, we will all benefit from understanding each other's views and experiences through IOSCO.

## **Conclusion**

Over the next two days we will discuss the actions that need to be taken to adjust to the new global financial environment. Our efforts to build a better regulatory system in each of our countries and to ensure the stability of the world's financial system will only be successful if we act together.

Our markets are global in every sense of the word and in every aspect — from the exchanges to the dealers to investors. IOSCO will continue to provide a unique forum for us to debate, collaborate and work together to ensure we build an enduring foundation for market integrity, systemic stability and investor protection as markets innovate and evolve.

**NovaRes Team**