REGULATION: TOO MUCH OR NOT ENOUGH?
Finding the Balance

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Introduction

Good afternoon ladies and gentlemen. I would like to thank the Jamaica Stock Exchange for inviting me to speak at this event and for providing me the opportunity to discuss one of the timeliest topics of the current regulatory environment - balancing growth and regulation; a goal shared internationally, regionally and in The Bahamas.

There is no doubt that weighing social benefits and the cost of regulation can be challenging at any point in an economic cycle, but it is, of course, more challenging during a global financial crisis. The potential loss of social benefit looms and the need to ensure confidence and stability in the markets is paramount. Examples of this include regulations introduced in the United States capital markets following the stock market crash of 1929 and in the midst of the Great Depression; and as recently as Sarbanes Oxley following the Enron and WorldCom scandals. Currently, addressing weaknesses in the regulatory systems that were exposed as a result of the global financial crisis has become a priority for many countries as they recognize the consequences that may not have been previously evident, such as the role of credit rating agencies, naked short-selling and disclosure of off-balance sheet arrangements. And in addressing these weaknesses is a call for more (effective) regulation; asking more questions and getting more answers.
I would like to discuss some of the more prevalent responses to the crisis as they relate to our topic of discussion today; and the pressure we in the Caribbean will feel to accept the increased costs of regulation. However, before I begin, I must use the Commission’s standard disclaimer: that the views expressed in this speech are my own and may not represent those of the Securities Commission, its members or staff.
Addressing the Regulatory Weaknesses

In an attempt to solve the problems associated with the kinds of risks that brought the economy to its current state, responses by the world’s more active financial centres have included: the closing of regulatory gaps; increasing statutory authority; consolidating regulatory agencies; and increasing transparency.

This call for increased regulation is rooted in the understanding that a stable, efficient financial sector reduces the cost and risk of investments; and of producing and trading goods and services. The critical contributions to economic performance that financial markets make - that is facilitating financial transactions, mobilizing savings and allocating capital across time and space – is a matter of public policy and nearly all national governments have chosen to regulate their financial sectors.

But beyond facilitating the efficient allocation of capital, securities regulations are meant to accomplish several objectives, which include:

1. The protection of investors
2. Ensuring that markets are fair, efficient and transparent; and
3. The reduction of systemic risk

The achievement of these objectives is meant to deter the events that disrupt the functioning of capital markets and institutions. In effect, “sound and effective regulation and, in turn, the confidence it brings is important for the integrity,
growth and development of securities markets"\(^1\). These are objectives that most of us support.

In response, regulatory measures have been developed and justified on grounds that they defend the financial markets from systemic risk, protect investors from opportunistic behaviour and, in so doing, provide the confidence necessary for greater participation in the markets. The question then is whether the regulatory measures developed match the regulatory objectives; more precisely, whether the costs of implementing regulatory measures outweigh the objectives.

Several studies have been carried out in an effort to address the cost and benefit analysis of financial regulation\(^2\). Whether the regulatory approach taken is based on broad principles of guidance or prescriptive regimes that rely heavily on enforcement to promote confidence, the attempts to quantify costs and benefits of securities regulation have been for well developed capital markets – greater in size and depth than the markets in which we participate either as regulators or market participants. However, regardless of any difference in market size, international regulatory measures are to be adhered to on the basis that the world’s markets and capital flows are interconnected and that standard regulation reduces systemic risk. Essentially\(^{\text{Nonetheless}}\), once the decision has been made to operate as an offshore financial centre (such as those attracting significant cross-border capital flow), abiding by international standards is mandatory. And, in the absence of being able to quantify benefits or cost of existing regulation, the move toward increased parameters of

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\(^1\) Objectives and Principles of Securities Regulation, IOSCO.
\(^2\) Reports such as those sponsored by the UK FSA and in the US by the Capital Markets Regulatory XXX.
regulation could be taken as indicative of the greater costs associated with a move in this direction.

Status of International Regulatory Standards

As national regulators respond to the financial crisis by reviewing the weaknesses in their respective regulatory frameworks, several international initiatives already in existence sought to guide the development of securities and financial market regulation. The primary objective of which was the maintenance of stability and avoidance of systemic risk. Some of these initiatives include the following:

• **Increasing principles of securities regulation (IOSCO)** - The International Organisation of Securities Commission’s (IOSCO) Objectives and Principles of Securities Regulation are the primary standard-setting rules for securities and capital markets globally. In addition to the standards of membership in IOSCO, the Multilateral Memorandum of Understanding on International Cooperation and Information Sharing requires members or those wishing to become members be in compliance with the terms of the agreement. Further, at a recent IOSCO meeting, discussion was had to the effect of reviewing the 30 principles with a view to increasing them.

• **Financial Stability Forum** – The FSF was convened in April 1999 to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to propagate from country to country, thus destabilizing the world economy. Capacity of regulatory regime (to deal with...)}
• **OECD** — The objective of the OECD’s efforts to eliminate harmful tax practices is to encourage an environment in which free and fair tax competition can contribute to economic growth and development worldwide. Jurisdictions operating offshore financial centres are asked to voluntarily make acceptable commitments to transparency and effective exchange of information to protect the global financial system. The alternative is publication on a “black-list” of uncooperative jurisdictions. Recently, talks of distinguishing between levels of cooperation have taken place with a proposal for a separate list for jurisdictions that have substantially implemented OECD standards.

• **Stop Tax Haven Abuse Bill**

These are but some of the initiatives underway. Others include the Stop Tax Haven Abuse Bill and a potential new role for the IMF in reducing risk to the global financial system, sitting above the FSF and issuing recommendations to the Bank for International Settlements (BIS), Basel Committee on Banking Supervision, IOSCO and the International Accounting Standards Board (IASB).

Given the current global financial crisis and the need to uphold confidence in the world’s financial markets, these initiatives will find greater support to implement their objectives. As these objectives grow, and although they remain shared principles, the shifting goal posts make adherence difficult; and costly. Caution must be taken in recognizing that regulation at the pace of that required for advanced more deep and liquid markets does not necessarily translate into greater benefit over than cost for all.
Social Objectives versus the Cost of Regulation

If the objectives of regulation are rationalised by increases in regulatory measures, how, then, does the benefit of standard regulation continue to outweigh the cost? Remaining competitive given the increased demands to comply with standards and, given the current financial crisis, we will be hard pressed by international organisations for information. More questions will be asked and more answers demanded. In the case of The Bahamas, in order to comply with increased demands, the Commission is refining its risk-based approach to oversight of the almost 900 investment funds, 66 investment fund administrators, 100 plus registered securities firms and broker-dealers, the securities exchange and all associated parties. Further, developments in the regulatory regime and legislation are taking place within the context of balancing growth and regulation.

Regulatory Regime in The Bahamas

During the year 2000, in response to developing trends in the international regulatory environment, external and internal reviews of The Bahamas’ regulation of its financial services sector resulted in changes to local legislation and institutional reform. A suite of legislation, enhanced and newly created, as well as the establishment of additional institutions addressed transparency, cooperation and information exchange. These changes to the regulatory regime were designed to further increase confidence in the jurisdiction.

Currently, The Bahamas’ regulatory regime includes five bodies:
The Central Bank of the Bahamas, which supervises banks and trust companies;

The Securities Commission of The Bahamas, responsible for securities, capital markets, and investment fund industries, in addition to being appointed the Inspector of Financial and Corporate Service Providers 1 January, 2008;

The Registrar of Insurance Companies;

The Compliance Commission; and

The Director of Cooperatives, who has responsibility for credit unions.

This revised regulatory framework meant that all financial services and products commercially available in or from The Bahamas were subject to regulation, with the exception of pension funds. However, further review of our regulatory regime determined a more efficient structure could be achieved through consolidation of institutions.

Significant progress has been made in this area through the transfer of all regulatory agencies to the portfolio of the Ministry of Finance, although credit unions remain outside of the regime. A further development has been the appointment of the Securities Commission of the Bahamas as Inspector of Financial and Corporate Service Providers, effective January 1, 2008. The FCSP Act ensures that in addition to corporate service providers, financial service activities that fall between the regulatory cracks of the Central Bank, Securities
Commission and Registrar of Insurance Companies are regulated. In addition, regulation of the pension industry is under review.

A move toward greater consolidation of the financial services regulatory regime, with an incremental move toward a super regulator is also underway. In the first instance, the Central Bank maintains supervision of banks and trust companies, while securities and investment funds, insurance, financial and corporate service providers and compliance merge to form a type of financial services commission. The objective of this move toward regulatory consolidation is to reduce the overall costs of regulation.

**Status of Regulation in Bahamian Securities, Capital Markets and Investment Funds Legislation**

In addition to a more streamlined regulatory structure, several regulatory developments are taking place with respect to maintaining competitive securities legislation in The Bahamas. Some of the regulatory developments taking place increase the level of regulation and others lighten regulation, as is required when balancing market development.

*Securities Industry Act, 1999*

A draft Securities Industry Act has been produced and the accompanying regulations are near completion. The primary objectives of the new Act were to move to a more flexible legislative structure that sets out the broad principles in the Act and more specific detail in subsidiary legislation; which was done to allow the Commission to respond quickly and effectively to market developments. One
of the other primary developments in this new Act is the change in the registration regime by title to function. This is done to clearly regulate activities being undertaken by licence type. The investigation, enforcement and disciplinary provisions have also been enhanced.

**Investment Funds Act, 2003**

Recent amendments to the Investment Funds Act, 2003 (IFA) have taken place with the objective of facilitating growth of the funds sector. These changes have included expanding the pool of eligible investors in professional funds, ensuring that most investment funds in recognized jurisdictions benefit from the lighter touch registration regime, and the extension of the filing period for financial statements from four to six months.

**Financial and Corporate Service Providers Act, 2000**

The Financial and Corporate Service Providers Act, 2000 (FCSPA) was developed to ensure that in addition to regulating corporate service providers, financial services not regulated by the Central Bank, Securities Commission or Registrar of Insurance were covered. In developing the legislation a definition of financial services was not provided and, as such, no clear distinction between the provision of corporate or financial services was designated to licensees. This regulatory gap meant that financial services regulated by the FCSPA had reduced prudential supervision compared to other entities regulated in financial services sector. Increasing regulation to address this gap is important in increases investor protection by enabling monitoring of financials to ensure segregated operational and customer accounts are maintained.
Conclusion
Remaining competitive and adhering to international regulatory standards is challenging. But complying with regulations that promote market confidence and the resulting efficiencies of growth and development of securities markets is what makes our markets stand or fall. Effective regulation must be accepted and balanced with the associated increase in costs. Given the current financial crisis, questions about the regulatory framework have been asked and solutions being designed as we speak.