

**Testimony Concerning International Cooperation to Modernize Financial
Regulation**

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Chairman Bayh, Ranking Member Corker, and distinguished members of the Committee, thank you for inviting me to testify about the international cooperation to modernize financial regulation.

Why International Cooperation is Necessary

I am pleased to have the opportunity to testify on behalf of the Securities and Exchange Commission on this very important topic. International cooperation is critical for the effectiveness of financial regulatory reform efforts. In reaffirming their commitment to strengthening the global financial system, the G20 Finance Ministers and Bank Governors recently set forth a number of actions to “maintain momentum [and] make the system more resilient.” The G20 banking statement correctly recognizes that due to the mobility of capital in today’s world of interconnected financial markets, activity can easily shift from one market to another. Only collective regulatory action can be effective in fully addressing cross-border activity in our global financial system.

As an SEC Commissioner and Chairman of the Technical Committee of the International Organization of Securities Commissions (IOSCO), I bring the perspective of both a national securities market regulator and a member of the international organization charged with developing the global response to the challenges posed to securities markets by the financial crisis. I also represent the SEC and IOSCO in the Financial Stability Board (FSB), where the US financial regulatory policy representation is led by the

Department of Treasury, with the SEC and the Federal Reserve Board both serving as members.

The financial crisis has made it clear that we must address regulatory gaps and overlaps. The Commission has recently proposed action to this end in a number of different areas, recognizing, however, that some regulatory gaps and market issues cannot be fully addressed without legislative action. The Commission already is working to achieve consistency on the domestic and international levels, including through IOSCO and the FSB, with banking, insurance, futures, and other financial market regulators. In this vein, the Commission also is working to ensure respect in the global regulatory environment for the integrity of independent accounting and auditing standard-setting processes for the benefit of investors. The Commission looks forward to continuing and improving on this cooperation as part of a reformed regulatory landscape.

Mechanisms for International Cooperation in Securities Market Regulation

The Commission has actively worked to achieve consistency in regulatory policy and implementation on an international basis through multilateral, regional, and bilateral mechanisms for many years. The SEC was a founding member of IOSCO, and has maintained a leading role in the organization. The Commission's commitment to international cooperation has become increasingly important to its mission in recent years in response to the increasingly global nature of financial markets.

In addition to my chairmanship of IOSCO's Technical Committee, Commission staff leads or is very active in IOSCO's standing committees and taskforces. Commission staff also represents IOSCO in the Joint Forum on Financial Conglomerates, which was established by the Basel Committee on Banking Supervision, IOSCO and the International Association of Insurance Supervisors (IAIS) to deal with issues that cut across the banking, securities and insurance sectors. For example, SEC staff participates in the Joint Forum's Working Group on Risk Assessment and Capital, which has

undertaken a number of cross-sectoral initiatives that have arisen out of the financial crisis.

While IOSCO represents the primary vehicle for development of common international approaches to securities market regulation, the FSB is a key mechanism for the Commission to engage internationally on broader financial market issues. The FSB has a broader scope, with membership comprised of national regulatory and supervisory authorities, standard setting bodies and international financial institutions. In addition, its mission is to address vulnerabilities and to encourage the development of strong regulatory, supervisory and other policies in the interest of financial stability.

The Commission also is represented in oversight bodies charged with maintaining the public accountability of international accounting and auditing standard-setters. SEC Chairman Schapiro is a member of the Monitoring Board of the International Accounting Standards Committee Foundation. Through this Board, the SEC and other capital market authorities that permit, have proposed to permit, or require the use of International Financial Reporting Standards in their jurisdictions have a means to carry out more effectively their mandates regarding investor protection, market integrity, and capital formation. The Commission also is represented through IOSCO in the Monitoring Group for the Public Interest Oversight Board, which serves as a mechanism for promoting the public interest in the development of international standards for auditing by the International Federation of Accountants.

In addition to multilateral, global engagement, the Commission participates in regional and bilateral mechanisms for discussion and promotion of common approaches to regulation. SEC Commissioner Aguilar is the Commission's liaison to the Council of Securities Regulators of the Americas, or COSRA, which aims to develop high quality and compatible regulatory structures among authorities in the Western hemisphere. Commission staff, alongside staff of the Federal Reserve Board, the Commodity Futures Trading Commission, and other US government agencies, also participates in a number of Treasury-led financial regulatory dialogues, including with the European Commission,

Japan, China and India, as well as Australia and our North American partners, Canada and Mexico.

Securities-regulatory-focused bilateral dialogues between Commission staff and our counterpart securities regulators in these and other jurisdictions also complement the broader financial sector dialogues; we are engaged in such bilateral efforts with, among others, the UK Financial Services Authority and the Japan Financial Services Agency, the Committee of European Securities Regulators (CESR), and the China Securities Regulatory Commission, Securities and Exchange Board of India, and Korea Financial Supervisory Commission. Furthermore, the Commission and a number of other securities regulators have recently entered into bilateral “supervisory” memoranda of understanding that go well beyond sharing information on enforcement investigations. These supervisory MOUs, such as those the SEC has signed with the UK’s Financial Services Authority and the German consolidated financial services regulator (known as the “BaFin”), represent groundbreaking efforts by national securities regulators to work together to cooperate in their oversight of financial firms that increasingly operate across borders.

Thus, the infrastructure for international cooperation on securities regulatory policy is well-developed, and the Commission plays a key role in promoting rising levels of cooperation. These efforts build on the success the Commission has achieved in raising standards of cross-border enforcement cooperation. Over two decades ago, the Commission entered into its first bilateral memoranda of understanding for the sharing of information in securities enforcement matters. To date, the Commission has concluded bilateral agreements with 20 jurisdictions that remain in force today. These bilateral agreements were the impetus for the creation of the IOSCO Multilateral Memorandum of Understanding (MMoU) in 2002. Since then, authorities in 55 jurisdictions, including the SEC, have already implemented the principles for cross-border enforcement cooperation contained in the MMoU and another 27 jurisdictions have committed to do so. With each additional MMoU signatory, the scope and ability of the SEC to pursue wrongdoers

across borders significantly increases. This ability is increasingly important as more and more SEC investigations involve some international component.

In addition to continuing to work to increase the number of jurisdictions that share information pursuant to the MMoU, the Commission also is continually working to increase the level of enforcement cooperation that it provides foreign counterparts as well as the level of cooperation provided by our global counterparts. The SEC was among the first securities regulators to receive the legal authority to assist foreign counterparts in investigations of securities fraud. Today, the SEC has broad authority to share supervisory information as well as assist foreign securities authorities in their investigations using a variety of tools, including exercising the SEC's compulsory powers to obtain documents and testimony. To further facilitate international cooperation, the SEC supports the passage of HR 3346 that would give authority to the Public Company Accounting Oversight Board, which the SEC oversees, to share confidential supervisory information with foreign auditor oversight bodies. The Commission believes that granting this authority to the PCAOB would enhance auditor oversight, audit quality and, ultimately, investor protection.

Key Securities Regulatory Reform Issues and International Cooperation

The Commission has led or supported the development of a number of international securities market regulatory initiatives to support the strengthening of the global financial system in the wake of the financial crisis. These initiatives, developed through IOSCO, its joint working group with the Committee on Payment and Settlement Systems (CPSS), and the Joint Forum, have been developed in conjunction with calls from the G20 and FSB to ensure that all systemically important financial institutions, markets, and instruments are subject to an appropriate degree of regulation and oversight.

IOSCO

IOSCO's Subprime Task Force issued its report in 2008, examining the underlying causes of the financial crisis and the implications for international capital markets. IOSCO launched a number of ongoing projects in response to recommendations in this report, including in key areas such as issuer transparency and investor due diligence; firm risk management and prudential supervision; valuation and accounting issues. Last fall, following on concerns highlighted by the G20 Leaders, IOSCO also established task forces on unregulated entities, unregulated financial markets and products, and supervisory cooperation, each of which is discussed in greater depth below. The Commission has contributed significantly to these projects with a view to ensuring that global capital markets address issues relating to the current turmoil in a sound and aligned way.

Credit Rating Agencies

With regard to credit rating agencies, in February of this year, IOSCO established a permanent standing committee to continually evaluate and seek cross-border consensus for CRA regulation. IOSCO has built on the early work in this area that resulted in the IOSCO CRA Principles and Code of Conduct Fundamentals first adopted in 2003 and 2004. The Code Fundamentals, as amended in 2008 as a consequence of "lessons learned" during the early "subprime crisis," has already been substantially adopted by at least seven rating agencies, including the largest ones. Staff of the SEC chair this committee.

Unregulated Entities

With regard to unregulated entities, following extensive consultation, IOSCO agreed to a set of high-level principles for hedge fund regulation in June of this year. The six principles include requirements on mandatory registration for funds or their advisers, ongoing regulation and provision of information for systemic risk assessment purposes.

They also state that regulators should cooperate and share information to facilitate efficient and effective oversight of globally active hedge fund managers and hedge funds. Work continues in IOSCO on defining what type of information should be provided by the hedge fund sector (and their counterparties) to allow regulators to assess the systemic importance of individual actors and identify possible financial stability risks.

Unregulated Markets and Products

Earlier this month, IOSCO's Task Force on Unregulated Financial Markets and Products issued a number of recommendations concerning regulatory approaches that may be implemented with respect to the securitization and credit default swap (CDS) markets, as these two markets were key elements of the global financial crisis. The Task Force continues to consider whether additional work should be undertaken regarding implementation of the recommendations.

In addition, the Commission has worked closely over the past year with international regulators and central banks in gaining first-hand experience in applying the Recommendations for Central Counterparties (RCCPs) to proposed arrangements for OTC credit derivatives transactions. This has highlighted some challenges regarding the application of RCCPs to credit default swaps (CDSs), particularly with respect to valuation models. The CPSS, under the leadership of New York Federal Reserve Bank President William Dudley, and IOSCO have created a joint working group (co-chaired by the European Central Bank) to propose guidance on how central counterparties for OTC derivatives may meet the standards set out by the RCCP and will identify any areas in which the RCCP might be strengthened or expanded to better address risks associated with the central clearing of OTC derivatives. This working group will complete its report by the middle of 2010.

Supervisory Cooperation

As operations globalize, oversight and supervision require increased cross border cooperation. Supervisory cooperation is a critical tool in gathering information about risks and trends within institutions and across markets. To this end, IOSCO established a Task Force on Supervisory Cooperation this spring to develop principles on regulatory cooperation in the supervision and oversight of market participants, such as exchanges, funds, brokers, and advisers, whose operations cross international borders. Final principles are expected to be published in February 2010.

Commodity Futures Markets

IOSCO's Task Force on Commodity Futures Markets, which was formed following concerns relating to price and volatility increases in agricultural and energy commodities in 2008, focused on whether futures market regulators' supervisory approaches were appropriate in light of market developments. The Task Force issued its report in March 2009 with recommendations aimed at ensuring that regulators have the appropriate information and tools available to them to monitor futures markets effectively and act against any market manipulation. The Task Force was recently revived, with CFTC Chairman Gary Gensler and UK Financial Services Authority Chairman Adair Turner as co-chairs, to continue to address concerns about access to relevant information for effective market surveillance and to promote improvements to regulatory frameworks that may inhibit the ability to detect and enforce market manipulation cases.

Joint Forum Cross-Sectoral Projects

The Commission, participating through IOSCO in the Joint Forum, which is led by Comptroller of the Currency John Dugan, is taking part in a review of the scope of financial regulation, with a special emphasis on institutions, instruments, and markets that are currently unregulated. The group's focus is on the differentiated nature of regulation in the banking, securities and insurance sectors; current consolidated supervision and

unregulated entities or unregulated activities within a conglomerate structure; and the regulation of hedge funds; among other issues. The main deliverable of this workstream will be a report to the FSB and G20 Finance Ministers and Governors, and is expected by the end of this year.

In addition, the Joint Forum's Working Group on Risk Assessment and Capital (JFRAC) recently finalized its report examining the range of various Special Purpose Entities (SPEs) used by financial firms to transfer risk for capital and liquidity management purposes as well as derivatives vehicles and transformer vehicles. Finally, in recognition of the reality that prudential supervision is becoming increasingly risk-sensitive in the different sectors, JFRAC has also undertaken a project to consider methods for risk aggregation that incorporate a characterization and quantification of diversification effects within financial firms. The primary focus of this work will be on aggregation across different types of risk -- such as credit, market, insurance, and operational risk -- and on similarities and differences between the commercial banking, investment banking, and insurance sectors. A preliminary draft paper will be discussed at the October Joint Forum meeting.

FSB / G20 Participation and US Government Coordination

With regard to my role at the FSB, I represent both the Commission and the IOSCO Technical Committee alongside the other US government participants, namely Governor Tarullo of the Federal Reserve Board and the Under Secretary for International Affairs of the Department of Treasury. The Commission places a high priority on coordinating the US position with its fellow agencies and presenting a strong and unified position in policy discussions at the FSB level. This is accomplished through extensive and informal communication between the staffs of our agencies, including the Office of the Comptroller of the Currency (OCC), the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corporation (FDIC) and the National Association of Insurance Commissioners (NAIC), among others, and has been highly effective. In this regard, the work that Comptroller of Currency Dugan and I jointly led, under the

auspices of the Financial Stability Forum's efforts to reduce procyclicality of regulation, to explore possible improvements to the accounting for loan loss provisioning is particularly noteworthy.

Importance of the Role of Technical Experts and Independent, Consultative Rulemaking

The international financial regulatory architecture that I have just outlined has proven its robustness in the level of cooperation since the outbreak of the financial crisis. The G20 leaders' focus on financial regulation has provided more high-level and political attention to these ongoing efforts. With the conversion of the Financial Stability Forum into the FSB and expansion of its membership to the G20, the architecture is evolving to reflect the growing importance of emerging markets and international cooperation in light of the interconnectedness of the global financial system. While the Commission supports and participates in the work of all of these international organizations, I would like to take this opportunity to highlight the different roles that these international organizations should play as nations increasingly seek to cooperate with regard to international financial regulatory policy.

The FSB, for example, comprises officials from across the spectrum of financial regulation, and so is very useful as a discussion forum to determine broad trends in the financial system. Through FSB discussions, gaps in regulation can be more readily identified and prioritized. The G20 focus on these results also is helpful in ensuring that the pace of reform is maintained and that a clear international framework emerges.

Given the complexity of the financial markets, however, it is critical that technical regulatory bodies such as those represented in IOSCO, as well as statutorily mandated independent regulators, such as the Commission, have control over their agendas and the ultimate outcomes of their regulatory and standard-setting work. The regulators and supervisors of each financial sector have specific goals for regulation, which may differ slightly from sector to sector, but are all important. For example, a key goal of securities

regulators is investor protection; this goal is not the focus of bank or insurance supervisors, who have other priorities. Only by allowing the technical experts to develop regulatory approaches to address areas of concern in their sector can we ensure that all regulatory goals are being met. Moreover, implementation and enforcement depend on legal mechanisms and processes that vary jurisdiction by jurisdiction, and sector by sector.

One example where this approach has been successful is raising standards for international securities law enforcement cooperation. The development of the IOSCO MMoU, and the push to further expand the number of jurisdictions providing cooperation as well as deepen the level of cooperation they provide, has significantly raised standards of cooperation in the securities sector over the past decade. The FSB's effort to promote standards in non-cooperative jurisdictions will provide opportunities to raise the level of cooperation across a broad range of financial regulatory enforcement concerns.

The Commission looks forward to continuing the constructive dialogue with our colleagues at the Fed, Treasury, and other agencies, in continuing to develop the common US position in the future. For more specifics on the outcome of the recent G20 meeting, I defer to Mark Sobel of the Treasury Department, as the Commission did not directly participate in the Summit or the G20 process leading to Pittsburgh.

Conclusion

While the Commission's particular focus – and that of IOSCO – on investor protection and efficient and fair markets has remained constant and somewhat distinct from that of banking supervisors and regulators of other market segments, our recent collaborative work – both at home and internationally – has shown significant progress in strengthening the global financial regulatory system. It remains the case that investor protection and a focus on efforts to enhance investor confidence are vital to interests of financial stability on national and global levels.

In its June White Paper, the Administration named as one of its five key objectives of financial regulatory reform the raising of international regulatory standards and improvement of international cooperation. The Commission, through IOSCO, the FSB, other cross-border mechanisms, and coordinating domestically with fellow financial regulators, stands ready to continue its collaborative work with the aim of enhancing our ability to identify and address systemic risks early across the world's financial markets. International cooperation is essential to the success of any financial regulatory reform that we undertake.

Thank you for this opportunity to address such timely and relevant global regulatory issues.