ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

November 21, 2007

Mr. Jeffrey Stoltzfoos
Senior Advisor
Office of the Assistant Secretary for Financial Institutions
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Mr. Mario Ugoletti
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1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: TREAS-DO-2007-0018

Dear Sirs:

The Working Group on Better Regulation of the International Council of Securities Associations (ICSA) appreciates the opportunity to respond to the Treasury Department's request for comment regarding their review of the U.S. regulatory structure for financial institutions. ICSA is composed of the self-regulatory organization and trade associations for the capital market in a broad range of jurisdictions, as well as a number of international trade associations.[1] ICSA members represent and/or regulate the firms that carry out the bulk of the activity on the world's equity, bond and derivatives markets.

We would like to comment specifically on paragraphs 1.3.4 and 1.3.5 of the request for comments, which refer to the question of adopting more efficient regulation for U.S. financial markets, including increased reliance on a principles-based approach. This is an issue of considerable importance for ICSA members, who have endorsed a set of

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[1] A list of ICSA members and the organization's ongoing activities can be found at: www.icsa.bz.

principles for better regulation (which are enclosed with this letter). The ICSA document attempts to distill the lessons that have been generated over the past several years in those jurisdictions where regulators and others have identified and in some cases adopted a working philosophy of better regulation.[2]

The ICSA *Principles for Better Regulation* are based on the understanding that well-judged regulation is essential in promoting the proper functioning and integrity of financial markets, the prevention of financial crime and the appropriate protection of market users and investors. At the same time, since regulation typically imposes costs and inappropriate or excessive regulation distorts markets and harms the interests of consumers, it can only be worth undertaking if there is the risk of a market failure or a demonstrable market failure which is unlikely to be mitigated over a reasonable period of time by market forces or is explicitly needed for investor protection, other remedies are likely to be less effective, and the benefits of regulatory intervention are likely to outweigh the costs.[3]

The Principles also propose that regulation should be no more complex or wide-ranging than the risks that are to be mitigated. In order to achieve that objective, regulations should be targeted, proportionate and risk-based, should stimulate rather than restrict competition and, as far as practical, regulators should rely on stable, principles-based regulations. The Principles also propose that existing regulations should be reviewed from time to time to examine whether they and the market failure to which they were initially directed are still relevant. Finally, the Principles note that market participants and the general public should be able to influence the design and implementation of

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2 At the national and international level, a number of governments in Europe as well as the European Commission have adopted “better regulation” initiatives. In addition, national regulatory authorities for financial markets in Australia, France, Ireland, the Netherlands and the UK have all announced and in some cases implemented “better regulation” initiatives.

3 In financial markets there are three types of problems that may need to be regulated if market forces alone are unlikely to be successful in correcting those problems over a reasonable timeframe: (a) externalities that arise when the costs and benefits of engaging in particular activities do not accrue solely to the direct buyers and sellers; (b) insufficient competition that enables certain users to exert monopolistic or monopsonistic market power; and (c) information asymmetries that arise when one party to a transaction has an informational advantage over another party in that transaction.

regulatory policy through an effective and structured consultation process, that any regulations issued at extreme speed should have an automatic sunset clause and that regulatory agencies operating in the same jurisdiction should cooperate with one another in order to avoid duplicative and possibly contradictory regulations.

ICSA members consider that adherence to these fundamental principles will help to ensure that any regulations that are enacted or maintained will contribute to the efficiency of the market or markets for which they are intended. Increased market efficiency, in turn, affects the overall well-being of consumers through higher rates of economic growth and may, therefore, be as important for the general public as more explicitly focused investor protection measures.

We would like to comment specifically on the issue of a more principles-based approach to regulation, which is explicitly referenced in the Treasury's request for comment and has become a major focus of debate within the U.S. over the past few years. As is set forth in the attached document, ICSA members consider that a principles-based approach to regulation has advantages over a heavily rules-based approach because it can be more flexible and focused on the appropriate outcomes rather than on rote compliance with a long list of rules. This is particularly important in a world of rapid financial and technological innovation, where rules meant to address one set of issues may become outdated almost upon enactment. In such circumstances, a principles-based approach to regulation has the advantage of being flexible for both the regulated and regulator. Although the regulatory principles remain static over time, the means for achieving them can evolve over time in response to technological innovation and changing market conditions. Precisely because of this flexibility, a principles-based regulatory framework will help to offset some of the competitive disadvantages currently being experienced by the U.S. financial sector.[4]

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[4] These competitive disadvantages have been identified in a number of recent studies. See Financial Services Roundtable, "Blueprint for U.S. Financial Competitiveness" (Nov. 2007); Commission on the Regulation of U.S. Capital Markets in the 21st Century, U.S. Chamber of Commerce, "Report and Recommendations" (March 2006); Committee on Capital Markets Regulation, "Interim Report" (Nov. 20, 2006); and "Sustaining New York's and the U.S. Global Financial Services Leadership" (Bloomberg-Schumer Report, January 2007).

A second and extremely critical advantage of a principles-based approach to regulation is that it would provide a more effective basis for regulation in a world where financial markets and financial entities are increasingly globalized. A principles-based approach offers a flexible structure that focuses on specific outcomes while allowing for coordinated global oversight. A principles-based approach also could make it easier for U.S. regulators to work cooperatively with regulators based in other jurisdictions than is possible with a rules-based approach to regulation.

This specific advantage of a principles-based approach to regulation is particularly important in light of the ongoing discussions in the U.S. about mutual recognition, regulatory convergence and standardization. Whatever the modality or modalities which are ultimately adopted, reliance on a more principles-based approach to regulation would greatly improve the ability of U.S. financial market regulators to address cross-border issues with a community of like-minded regulators.

It should also be noted, however, that while in theory a more principles-based regulatory approach has much to offer, there are a number of issues that must be considered in the implementation of such an approach. From an industry perspective, an important consideration in a more principles-based regime is how regulators can ensure that supervision and enforcement actions are consistent and reasonably predictable by well managed firms. This is related to the more general point that the adoption of a principles-based approach does not imply that all rules are discarded. For example, the UK's FSA has not become a purely principles-based regulator and detailed rules will continue to be important in a number of areas, such as consumer protection. Similarly in the U.S., a move toward a more principles-based regulatory system will not mean that all existing rules are automatically eliminated. Instead, it is likely that such a system would need to be composed of a mixture of high level principles and detailed rules as appropriate.

Second, the move toward a more principles-based regulatory approach will require a cultural shift both within the regulatory agencies and within the financial firms that are being regulated. As the ICSA *Principles for Better Regulation* point out, a principles-based approach to regulation works best when regulators and market participants have trusting and constructive relationships with one another and the regulatory framework is able to evolve freely to produce the concrete guidance needed at any point in time.

For firms, the shift toward a more principles-based approach in the U.S. will require a move away from the legally driven process of compliance to a process that is oriented toward the delivery of specific outcomes. For regulators, the shift toward a more principles-based approach will be challenging for supervisors and enforcement staff who will need to be able to assess and accept that well managed firms may adopt different approaches to delivering the same outcomes. For both, the shift toward a more principles-based approach will require the effort to build more cooperative and constructive relationships with one another.

A number of other practical questions will also need to be resolved if the U.S. is to move toward a more principles-based approach to regulation. However, despite the effort that will be required, the ultimate benefits of such a move in the form of enhanced market efficiency and international competitiveness are likely to outweigh the costs.

In closing, once again we would like to express our appreciation for the opportunity to comment on the Treasury's review of the U.S. regulatory structure for financial institutions. We would be pleased to meet with Treasury officials to discuss any of the matters set forth in this letter, or to assist in any other way that will be helpful to its further consideration of this issue. Please do not hesitate to contact the undersigned or Dr. Marilyn Skiles, the Secretary General of ICSA, at mskiles@sifma.org.

Sincerely,

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