



U.S. Securities and Exchange Commission

Speech by SEC Chairman: 'Learning from the Shogun — Toward IOSCO's Vision of A Global Market'

by

Chairman Christopher Cox

U.S. Securities and Exchange Commission

International Organization of Securities Commissions
Technical Committee Conference
Hotel Okura Tokyo
Tokyo, Japan
November 8, 2007

Thank you, Junichi [Maruyama, Deputy Commissioner for International Affairs of the Japan Financial Services Agency] for your kind words, and for being such a wonderful host to IOSCO. I hope all of you will join in a round of applause for Commissioner Maruyama, Minister [Yoshimi] Watanabe [Japanese Minister for Financial Services], and Commissioner [Takafumi] Sato [Commissioner of the Japan Financial Services Agency] for the exceptionally warm hospitality that they have extended to all of us in the IOSCO family.

It is also an honor to follow Michel [Prada, Chairman of the French Autorité des Marchés], who has been an extraordinary leader as Chairman of the IOSCO Technical Committee. Chairman Prada has been a pillar of IOSCO as it has grown to become the world's most important forum for securities regulatory cooperation.

All of us from around the world are fortunate that this year's conference is being held in such a beautiful and historic city as Tokyo. Today, of course, Tokyo isn't just one of the world's financial capitals, but also one of the world's truly great international cities. And to match its high technology and 21st century innovations, Tokyo has a rich and remarkable history.

This city — which was originally known as Edo — hasn't always been the nation's capital. Instead, it was a castle city and once the headquarters of the shogun, Tokugawa Ieyasu. You might recall that the history of his rise to power was fictionalized in James Clavell's novel *Shogun*. Tokugawa is a fascinating historical figure: He came to power after years of civil war, and

established a system that led to centuries of peace, and the flowering of culture and art. But his was also an odd system, by modern standards, that included strict rules governing virtually every aspect of life.

Some of his rules had unintended consequences. For example, at a time when Japanese gunsmiths were producing some of the finest muskets in the world, Tokugawa centralized all firearms production in a single city. That effectively destroyed the firearms industry — which is probably what Tokugawa intended, because it had the direct consequence of keeping other feudal lords from acquiring the weapons to overthrow his rule. But it also ended up doing something he didn't intend: putting a crimp on technical innovation in Japan. That's because Japanese gunsmiths had developed very sophisticated metal working and mechanical techniques with potentially broad application.

That wasn't the only thing Tokugawa did that had unintended consequences. In order to protect Japan from the aggression of foreign colonial powers, he cut off Japan from almost all foreign contact, including prohibiting Japanese citizens from traveling abroad. That policy was successful in what it was intended to accomplish; but it also had the indirect effect of cutting off Japan from the explosion of economic and technological development that we now call the Industrial Revolution.

Tokugawa's policies offer many lessons for securities regulators today.

Of course, we don't live in the same world. Thankfully, 21st century financial regulators aren't besieged by constant war among samurai and feudal lords. But we do live in a world of constant change and uncertainty. The men and women who lived in 1600 witnessed astonishing changes in technology. And the world was shrinking all around them in ways that had never before seemed possible. To them, not all of this seemed benign.

We, too, live in an environment of fast-changing technology, where the world seems to be shrinking every day, and the level of international contact is greater than ever before. We might think of ourselves as more open to this kind of change than our 16th century forebears. But we'd be kidding ourselves to think that in our modern context, the meaning of all of this change isn't often just as obscure, and occasionally just as frightening.

We all know that new technology and financial innovation offer investors and our economies untold benefits. Like many of you, I'm a strong advocate of tapping the power of modern technology to improve the quality, and reduce the cost, of regulation. But recent events have also underscored for us that some silver linings come equipped with their very own clouds.

Just as Tokugawa recognized that the guns his industry was producing could also be used by other feudal lords to overthrow his regime, we've got to recognize that the same technology that's improving the lives of investors, companies, and even regulators is also making criminals more productive. Today's securities swindlers use technology to devise ever-more

sophisticated means of robbing investors of their savings, and to make it harder for regulators and prosecutors to catch them.

We've all learned to be wary of identity theft, and of so-called "phishing" scams, and spam emails offering us unsolicited stock tips. These are problems that were virtually unheard of just 15 years ago. Our growing reliance on electronics is also making us vulnerable to network outages — both accidental and malicious. And as the world saw when America's markets closed on 9-11, our growing interconnectedness can result in problems in one country causing customers and institutions around the world to question their own markets' reliability. The potential for a loss in market confidence to spread instantly, and worldwide, is another byproduct of instant global communication.

Other modern innovations, such as the sophisticated securities and synthetics of structured finance, hold out the possibility of enhancing liquidity and reducing risk, but also raise new questions of investor protection that these days keep us regulators up at night. The problem that we're all wrestling with now is the way that securitized bank debt and other products designed to diversify financial risk have helped spark a credit crisis in markets around the world. A lack of transparency in some of these same types of securities, and perhaps a lack of due diligence on the part of those who analyzed them and bought them, provide only the latest example that the lesson of history is to learn the lessons of history.

Technology and globalization present both great opportunity and increasingly complex threats. There is no better way to confront those threats, and to work to ensure that our citizens obtain all the benefits of technology and modern global finance, than to put our heads together here at IOSCO. The national leaders here represent the vast majority of the world's population. There is a great deal of good we can do together.

Our legislative mandates all differ. But as financial regulators, we've all been charged with protecting investors, ensuring that our markets are fair, efficient and transparent, and reducing systemic risk. Those are the words of IOSCO's core principles that bind us together.

The truth is, despite its mind-bending complexity, today's global market is just like any domestic market in one fundamental respect: when the risk of fraud is high, investors lose confidence, and they demand a premium for their money. That's one reason, in the wake of Enron and Worldcom, that not only America but every major market on earth increased its investor protections — because once investor confidence is lost, it is very hard to get back.

When we look at history, we might infer that on balance, Tokugawa's decisions were wise. It is true that in the long run his policies certainly had unintended consequences, but they also led to several centuries of peace where in the past there had been war. But for modern securities regulators, I believe following in Tokugawa's footsteps may not be the wiser course.

Like him, we may be tempted to seal ourselves off from the rest of the world, regardless of the benefits that global markets offer to investors. After all, the world can be a scary place, and the threats to our own regulatory systems from integration with the rest of the world may appear to us to be just too great. We might be tempted to clamp down on new technology and financial innovation, because we're worried the risks we can't foresee may haunt us down the road.

We could follow that course, but it would be a mistake.

But the opposite policy — indiscriminately exposing investors to every financial pathology the world has to offer, and making "buyer beware" the only rule in global finance — would be equally mistaken.

Investors want a global market. We can see that all around the world. For evidence, we need look no further than the Tokyo Stock Exchange here in Japan. In recent years, over half the trading volume on the Tokyo Stock Exchange has originated overseas. The same global interest exists in Europe. By some estimates, between 30% and 50% of all European stocks are held by foreign investors. And in the United States, where for so long the sheer size of our market meant retail investors didn't need to look abroad, today roughly two-thirds of American investors own securities of non-U.S. companies. That's a 30% increase from just five years ago.

But while investors undoubtedly appreciate a global market, more than anything they want an honest market. So for all of us as regulators, the question is: How do we best protect investors and promote efficient, honest markets while ensuring that our nation's investors and economies enjoy the benefits of integrated cross-border trading, global financial diversification, and the latest innovations in both technology and finance? And how do we do this knowing that not every jurisdiction is likely to agree on exactly how regulators should go about it?

Because these problems are daunting, and because we've got to address them on a global scale, the solution is going to be found not in a particular regulation, or a foreordained "right" way to do things. Rather, the answer lies in a process that helps us to peel back the layers of complexity that make us different, and to focus on what we truly care about — and eventually, to make the kinds of mutual adjustments in our systems that will achieve all of our most important objectives, while bringing us closer together.

In short, we need to harmonize, recognize, and standardize.

We should begin by harmonizing our regulatory principles and focusing on our mutual objectives.

As that exercise helps us to discover other like-minded regulators, we should recognize that fact — by deepening our bilateral relations, and the extent to which we rely upon one another's systems.

And finally, when enough jurisdictions have established a way to address a particular issue, we should work to standardize our rules wherever possible. That will help to reduce friction between our domestic markets, and to reduce costs for investors and every marketplace participant.

The U.S. Securities and Exchange Commission has long been a proponent of international regulatory harmonization, such as the IASB's International Financial Reporting Standards, and IOSCO's own International Disclosure Standards. When international standards are of sufficiently high quality, they can be critically important pillars of integrity in our global capital markets. International accounting standards, for example, can serve as a universal language for investors to help them better compare their investment options. And international disclosure norms can help establish a universal expectation for market participants around the world.

Of course, no regulatory standard is perfect; and international standards are no exception. But often the value of a universal language outweighs the potential cost and confusion from many different standards — even though each may have its own reasonable claim to superiority. It is for just this reason that the SEC is getting ready next week to consider a final rule that would allow issuers who use International Financial Reporting Standards in their home countries to also use IFRS in their filings with the SEC, without any longer having to reconcile that to U.S. Generally Accepted Accounting Principles. And it's why we're considering the concept of offering that same option to U.S. domestic issuers. Our long standing support for international regulatory harmonization was also the reason that, seven years ago, the SEC conformed our prospectus disclosure requirements for foreign issuers to IOSCO's International Disclosure Standards.

Still, as important as international standards are, they've got to begin somewhere. In order for them to work, there's got to be an international consensus. And there must be quality. In reality, achieving that combination can be difficult — particularly where different jurisdictions have different regulatory philosophies.

That's why in areas where no international standard exists, it often makes sense to start out by looking for the commonalities in our general approaches. By tackling more modest, immediate objectives, such as the development of international principles and regulatory best practices, we often learn that despite our different legal systems, we're really not quite so different as we might have thought.

The opportunity to do this is one of the most valuable things we gain from our participation in IOSCO. Thanks to this organization, we've learned that most of the world's securities regulators share important fundamental goals, and that we have similar ideas about how to achieve those goals.

For example, we're now all committed to the view that an issuer's external audit function should be independent of management. And we all share the

conviction that some types of market participants, such as securities analysts, should be on particular guard against conflicts of interest. We've made this progress toward harmonized regulatory principles without having to sacrifice our national concerns and responsibilities, and without having to submit to a regime of universal regulation.

In fact, we've learned through our cooperation that regulatory differences can often be quite beneficial as a means of regulatory experimentation from which all of us can learn. At the same time, we've come to recognize the difference between experimentation and regulatory arbitrage. We all gain from experimentation because it can help us discover how to make regulation simultaneously more effective and less costly. And we all lose when regulation is used for anti-competitive purposes, or to undermine the legitimate objectives of regulation elsewhere.

So whenever we see regulators who share similar regulatory philosophies and powers, and who also share a passion for investor protection and market integrity, we can conclude that if their only real difference is that they're achieving the same ends through different means, mutual recognition makes eminent good sense. The only challenge for such countries is to find ways to make their oversight and enforcement systems seamless, so that they can increase opportunities for investors while maintaining their accustomed high levels of investor protection.

Beyond giving a nation's investors access to broader choices and perhaps reducing the cost of investing, mutual recognition may well offer like-minded securities regulators a laboratory to find out which ways of regulating work best. And when a superior approach is identified, I strongly suspect that our markets — and all of us as regulators — will work to see to it that this better way becomes the international standard. In fact, we're seeing this happen right now with the convergence project for U.S. GAAP and IFRS. This undertaking has offered us several examples of how two different approaches to the same problem can converge around a single best answer. Indeed, perhaps the best example of this phenomenon is the IOSCO Multilateral Memorandum of Understanding.

I believe IOSCO is destined to play an exceptionally important role in building a seamless global market. IOSCO has chalked up some very impressive achievements over the past few years, including the Multilateral Memorandum of Understanding, and our principles in areas such as auditor independence and oversight, issuer disclosure, and credit rating agencies.

Of course, those very successes have led some people who may be less familiar with this organization to suggest that IOSCO take on the role of international regulator. Clearly this is something IOSCO cannot do. Market regulation will remain a national affair for the foreseeable future — if for no other reason than that our legislative mandates require as much. For the same reason, in the area of mutual recognition, the early heavy lifting is likely to be done on a bilateral basis — or possibly, as the European example suggests, on a multilateral basis among a select group of regulators who are

tied together by a common legal framework.

But I believe IOSCO's true strength lies in its role as a think tank of the world's securities regulators. This is a place where we develop the international consensus on regulatory ideas and philosophies that form the necessary prerequisite to mutual recognition among not just two or three, but scores of countries. IOSCO is really the crucible in which these alliances of like-minded partners can be forged.

Through IOSCO, we're constantly learning that we have far more opportunities for cooperation than we might ever have imagined. We've also learned from each other's experiences about what works, and what hasn't. Although the process at times can seem difficult and plodding — after all, it's a big world, and there are a lot of people to talk to — if we look back on all that's been accomplished, we can only conclude that it is remarkable the way IOSCO has been able to do such prodigious work in developing consensus over a whole host of regulatory issues.

In many cases, IOSCO's work has encouraged other international organizations to develop technical areas within their own competencies into a true, international standard. We see this happening today with the International Accounting Standards Board, which IOSCO has supported for many years. And in a few cases, IOSCO has even shepherded a concept from initial philosophical consensus — for example, that regulators should be able to share enforcement information — to watching as its principles were adopted through bilateral arrangements among individual IOSCO members. And ultimately the result has been that, through the Multilateral Memorandum of Understanding, what began as consensus building has resulted in a truly international standard.

This is a vision for our markets and for IOSCO that I believe we are on the verge of realizing.

So as we gather here in Japan, in a place endowed with so much history and legend, perhaps we can draw inspiration from the example of legendary leaders like Tokugawa, who earned his place in history because he had a sweeping vision and never lost sight of it. He didn't win all of his battles, but he won the ones that counted. And he had the ability to pursue a difficult objective the way a master of Go might win a game — slowly but steadily, and with no doubt in the outcome.

I have no doubt that if we keep waging battle in favor of investors and markets — if we never lose sight of our objective of high-quality, truly global standards — we'll succeed in making the lives of every one of our citizens better, and we'll make the world a better place.

That's a sweeping vision, indeed — worthy of a shogun, certainly, but more than that, worthy of the world's preeminent organization of securities standard setters.

The challenges we face in today's market are daunting, while the opportunities at hand are dazzling. This is truly an exciting time to be a part of IOSCO. So on behalf of the thousands of men and women of the SEC, thank you for what you do every day. We're proud to be your partners.

<http://www.sec.gov/news/speech/2007/spch110807cc.htm>

[Home](#) | [Previous Page](#)

Modified: 11/08/2007