

Keynote speech at SESC 25th Anniversary International Conference

Mr Ashley Alder
Chief Executive Officer

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Mr Ashley Alder, Chief Executive Officer of the Securities and Futures Commission (SFC) and Chair of the IOSCO¹ Board, addressed current issues facing conduct regulators in a keynote speech at the Securities and Exchange Surveillance Commission (SESC) 25th Anniversary International Conference in Tokyo on 5 December.

Mr Alder began by congratulating the SESC on its anniversary and noting that the SFC and Japanese authorities had historically had a very close relationship through deep enforcement cooperation. As the latest example of significant cooperation between the two regulators, Mr Alder cited criminal charges filed in Japan in November 2017 for market manipulation.

Conduct and regulation after 2012

The 2012 LIBOR (London Interbank Offered Rate) scandal, together with the forex scandals which followed, marked a watershed for conduct regulators, Mr Alder remarked. While securities regulators in major markets continued to do what they had always done – supervising, detecting misconduct, punishing wrongdoing and remediating harm done to investors – prudential and other regulators have since focused on preventing misconduct ex-ante.

Specifically, this approach looked at the “culture” of firms. It also tied compensation incentives to conduct and in some cases called for the holding of capital against possible misconduct as a type of operational risk. Mr Alder said that much of this stemmed from concerns about big fines leading to prudential risk and loss of public trust in banks.

He then posed the question of the extent to which these ex-ante “preventative” approaches might be effective. He also remarked that ex-ante approaches could not supplant the critical role of “traditional” supervision (eg, inspections), surveillance and ex-post enforcement as the key regulatory responses to misconduct. Some other practical approaches to conduct risks might also be valuable, Mr Alder suggested.

Individual accountability regimes

For example, both the Senior Managers Regime in the UK and Manager-In-Charge (MIC) regime in Hong Kong aimed to increase the personal accountability of senior management in the financial services industry by identifying those with real responsibility and requiring firms to provide regulators with organisation charts detailing clear reporting lines and individual management responsibilities.

Hong Kong’s MIC regime covers eight core functions instrumental to the operations of licensed corporations including overall management oversight and key business line

¹ International Organization of Securities Commissions



functions, he added. Regional and global managers are included and they must report to the firm's local board.

Whistleblowing

Rewarding and protecting whistle-blowers has also achieved demonstrable results, Mr Alder said. Financial incentives to report bad behaviour make a difference, as they compensate for social and career risks.

Enhanced surveillance

The SFC was developing a cross-divisional market intelligence project which will use new technology to identify potential misconduct in licensed corporations and listed companies, explained Mr Alder. Pooling internal and external data (submitted by firms and sourced from the media and elsewhere) will help the SFC identify relevant information before, during and after its inquiries and investigations, while the use of data analytics will isolate patterns or connections between companies, firms, transactions and individuals indicating potential misconduct.

Industry codes

- IOSCO Task Force on Market Conduct

The report issued in June 2017 by the IOSCO Task Force on Market Conduct identified characteristics of wholesale markets which might give rise to misconduct risks. These markets were decentralised but not unregulated. However, although principles of conduct apply to wholesale markets, few specific rules were applicable to the activities of traders. Instead, "normalised deviance" could take hold, Mr Alder said.

- FICC Markets Standards Board

The Fixed Income, Currencies and Commodities (FICC) Markets Standards Board² is an interesting experiment in the UK in which the industry can agree on standards and best practices to fill the "conduct void" between principles and rules. However, it faces challenges such as the extent of international convergence around standards and best practices and how private counterparties police adherence to industry codes. Moreover, industry codes cannot be equivalent to binding regulation, Mr Alder added. Nonetheless, the FICC Markets Standards Board was worth watching as its member firms cover 80% of global activity in wholesale markets.

Meanwhile, the UK Financial Conduct Authority is consulting on whether to state publicly whether it considers an industry code to be a helpful explanation of a proper standard of market conduct under its Senior Managers Regime.

Cross-border cooperation

Cross-border cooperation between regulators is essential to proper regulation of globalised markets, Mr Alder emphasised. To align the IOSCO Multilateral Memorandum of Understanding (MMoU) with developments in rapidly evolving markets, the IOSCO Enhanced MMoU (EMMoU) was endorsed in 2016. It will facilitate greater enforcement cooperation and assistance to combat misconduct, particularly in compelling attendance for

² The FICC Markets Standards Board, with over 50 member firms, is practitioner-led and owned and operated by the major participants in wholesale markets.



testimony, freezing assets and obtaining and sharing audit work papers as well as telephone and Internet service provider (ISP) records.

One issue worth noting was the interaction between the IOSCO MMoU and the EU's General Data Protection Regulation (GDPR) which will take effect in May 2018. The GDPR will be extraterritorial in the sense that it will apply to the personal data of EU residents regardless of where it is held or processed. Data subjects' rights have the potential to conflict with enforcement and supervisory goals in several areas, including rights of access, erasure of data and notification of breaches. IOSCO is currently dealing with potential solutions to these conflicts. Mr Alder noted that as firms rely more and more on data and automation, securities regulators' interaction with data privacy laws will only increase, as will their need to address other issues arising from technology or Fintech such as outsourcing and cloud computing.

Conclusion

Mr Alder made the point that the financial industry still struggles to change its culture. In a recent survey by the UK Banking Standards Board, 13% of bankers said that they were prepared to flex ethical standards to get ahead.

He added that the FICC Markets Standards Board had examined 400 cases in 20 of the largest jurisdictions over two centuries and found 26 consistent root causes of illicit behaviour, including front running, spoofing and cornering. These practices occurred again and again across markets over time, and were immune to changes in markets and technology. This finding could have important implications when using "Regtech" as a more sophisticated supervisory tool.

In concluding, Mr Alder summarised some lessons for regulators when regulating conduct.

- Be aware of the limits of trying to regulate culture or trying to rely on ex-ante or preventive incentives.
- Emphasise enforcement outcomes focused on individual responsibility.
- Take advantage of technology to detect misconduct.
- Programmes that reward whistleblowers are effective.
- Focus on the unchanging root causes of misconduct and apply direct surveillance techniques to them.
- Take account of new risks in an environment increasingly driven by data, automation and Fintech.

Do not lose sight of the fact that sustainable markets are founded on confidence, which always depends on credible surveillance and enforcement.