

NEWS RELEASE

January 21, 2009

MoneyVoices: ICI's Stevens Lists Needed Reforms

MoneyVoices: ICI's Stevens Lists Needed Reforms

by Paul Schott Stevens

(as published in the Money Voices column in Ignites on January 16, 2009)

With long experience as a regulator, President-elect Obama's pick for Securities and Exchange Commission chair, Mary Schapiro, understands what ails the troubled agency she will lead and has a golden opportunity to fix it. The SEC needs reform of a kind not seen in a generation or more. That should begin with the recognition that the nation's capital markets regulator faces a very different world today, one that requires new capabilities and techniques.

At the birth of the SEC 75 years ago, securities and exchanges were almost entirely domestic concerns. As the agency developed in the decades that followed, global forces driving relentless change in financial markets rarely had an equal impact on the agency's thinking, management or staffing. Our major federal securities laws, models of progressive legislation in their day, proved resilient but scarcely kept pace. Over time, serious gaps have emerged — both in the fabric of regulation and in the approach of the regulator. Sadly, although widely recognized both in and outside the agency, the growing need for reforms was ignored.

No one can ignore it today. Bernard Madoff's \$50 billion Ponzi scheme ultimately would have come apart no matter what. But it could not have gone on as long or grown as big except for the enormous resources on call in a globalized financial marketplace. And had the SEC itself been more efficient, more sophisticated and more knowledgeable about the rapidly evolving financial markets, the scam might have been detected well before it collapsed of its own weight.

Here is a list of reforms that incoming chair Schapiro, the Obama administration and the new Congress would do well to implement:

Establish a single U.S. capital markets regulator: When current SEC chairman Christopher Cox and Commodity Futures Trading Commission acting chair Walter Lukken signed an agreement last March to have their agencies work together more closely, they took a first step in adapting to a world in which futures aren't just for wheat farmers but are deeply incorporated into the operations of the global financial markets. Much more is needed. The

two commissions should be merged, working under a single set of commissioners and a single chair.

Update the securities laws: Congress started on this process in 2006 with new requirements for rating agencies, ones now being implemented by the SEC. In the past year, we also have learned the high price that other market participants may have to pay when even important and useful financial innovations — for example, new instruments like credit default swaps and unregulated pools of capital such as hedge funds — grow like Topsy, outstripping any semblance of oversight. Transparency is a fundamental principle of our regulatory system. At a minimum, America's capital markets regulator requires continual access to the kinds of data needed to identify developing dangers and help assure the orderly functioning of markets. It would greatly serve the interests of retail investors if Congress also harmonizes the laws that regulate brokers and investment advisors, intermediaries who perform similar roles but are subject to differing legal standards.

Enlarge the mission: As both issuers of securities and investors, mutual funds have benefited from strong regulation and vigorous securities law enforcement. Our industry believes that investor protection is a core SEC concern and must remain such. But after-the-fact remedies aren't enough. Tough enforcement of the securities laws must be part of a dual mandate that also includes smart oversight — the kind that doesn't just prosecute but seeks to prevent massive frauds like Madoff's. Remember that protecting investors also means making sure that markets work both accountably and well. Let's start by taking seriously Congress's 1996 mandate to the agency to promote efficiency, competition and capital formation.

Pay attention to agency management: For decades, despite the very best of intentions, SEC chairs appear to have focused on nothing so little or to so little purpose as management of the agency. That is understandable. Management improvements take time and serious attention, while the tenure of a typical SEC chair is relatively short. The commission needs to bridge that gap. Some have suggested formalizing a role for a chief operating officer, perhaps as a vice chairman. An enlarged complement of commissioners could promote a more robust internal dialogue on management issues, consistent with the Sunshine Act.

Further, a better mix of disciplines on the SEC staff, and better ways to bring different perspectives to bear on regulatory challenges, could be of great benefit. That requires a staff with more operations and technology expertise, a better grasp of industry economics and current developments in the marketplace, and more hands-on experience.

A thorough restructuring of staff offices could facilitate a better focus on the most important challenges for the agency. Bureaucratic walls between offices engaged in regulating and inspecting today impede even the most sensible measures. The road to better management starts with promoting a level of teamwork and coordination that's all too often lacking today. And while the all-in-one structure of the United Kingdom's Financial Services Authority may not work here, certainly there's something to be learned from the FSA's methodical approach to setting regulatory priorities, assessing progress, reevaluating its rulebook and consulting with stakeholders.

It's no exaggeration to say that the health of the entire global financial system depends on the effectiveness of our capital markets regulator. In short, the major reforms that are badly needed at the SEC include consolidating agencies, updating our laws, getting the mission right and paying attention so the parts work together and not at cross-purposes. We in political Washington, D.C., don't like to talk about such mundane matters. But any

attempt to rehabilitate our capital markets regulator doesn't have a prayer without them.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.