Urgent Capital Market Reforms needed

Orlando Declaration 2011

The International Stock Exchange Executives Emeriti ("ISEEE") is a global non-profit organization of current and former senior executives from stock and derivatives exchanges. We are incorporated in the State of New York. The purpose of the ISEEE is educational in nature, enabling our members to share insights and trends on developments in the World's financial markets in areas including organization, operations, listing, trading, disclosure, clearing and settlement, access to the market, technical infrastructure, risk management, surveillance and enforcement, investor protection and foreign investment.

We held our 2011 Annual Meeting over three days from March 21 to March 23 where we discussed and reviewed international capital market developments, progress with recommendations in previous Declarations and global reform initiatives.

Participants in this year's Annual Meeting included exchange officials (many former CEOs) representing twenty-four exchanges across North America, Europe, Asia and South America. Present or past affiliations included the New York Stock Exchange, NASDAQ, American Stock Exchange, the National Stock Exchange and the Chicago Board of Options Exchange, the Philadephia Stock Exchange, Amsterdam Stock Exchange, Euronext, Istanbul Stock Exchange, Stockholm Exchange, OMX, Kuala Lumpur Stock Exchange and Hong Kong Exchanges and Clearing, the Toronto Stock Exchange, Sao Paulo Stock Exchange (Bovespa), New Zealand Stock Exchange, Eurex, Deutsche Börse, Zurich Stock Exchange, Abu Dhabi Securities Exchange, Frankfurt Stock Exchange, Australian Securities Exchange, European Options Exchange and the Berlin Stock Exchange. Nearly half the attendees had senior securities regulatory experience.

Progress on: the Eleven Actions for Balanced Global Reform; on reforming Market Structures; and on fixing Small Business Financing.

Participants felt little progress has been made on the 11 actions set out in our **2009 Orlando Declaration** and repeated in our **2010 Orlando Declaration.** These are still needed to strengthen market integrity and restore investor confidence and trust.

The Group discussed US and international regulatory reform initiatives to date in the wake of the GFC, and largely views the consequent market developments, including exchange mergers and acquisitions, as:

- Not principally in the interests of, or not delivering benefits to, the general public;
- Focused on process rather than purpose;
- Failing to deal with the potential for further crisis; and
- Failing to facilitate and encourage the much needed primary market role of job creation and economic growth.

Key points of the current environment were that:

- Current Exchange consolidations and M&As will further reduce market support for Small and Medium Enterprises.
- Growing use of leverage is again evident and portends future problems
- Lack of public listings and current regulatory structures are driving money to derivative and OTC markets and not new business formation
- The One-Size-Fits-All regulatory model no longer Fits-All.
- Markets are now more efficient for high Caps, but efficient markets and specialisation/ independence rules have made intermediation support for equity raising for small companies unprofitable.
- There is a wrong focus on Process and not Purpose in proposed Rule based responses to micro-market problems.
- Making more rules (e.g. to reduce volatility) is just interference and enhances moral hazard[1]
- SME IPOs are vitally needed for employment and growth
- Good market regulation now needs:
    - a full audit trail of data, analysis and publication of results
    - responsibility to judge conduct
    - authority to act and direct, and
    - independence and proper remuneration

Criticisms reflected concerns about the negative implications of the Dodd-Frank Act, knee jerk responses to the flash crash, and the continuing unwillingness of governments and regulators to provide adequate market transparency and information to allow proper monitoring and analysis by regulators to inform their regulatory decisions.

Participants felt regulators were wrongly trying to provide stability to markets by further restricting outlier activity and were yet to deal with the problems arising from the behaviour of participants incentivised by increasing regulation of inadequate current market structures[2].

The desire to avoid “blame” and reluctance of anyone to accept personal responsibility, after the event, for any aberrant or objectionable market conduct which causes significant losses to sufficient members of the public, together with the willingness of governments to burden the taxpayer with restitution in such situations, was seen as driving the rule based approach to controlling market conduct, incentivising market participants to become “too big to fail”, increasing moral hazard problems, increasing barriers to entry to public markets and killing the IPO market.

The discussions led to the following decisions by the group, as their Orlando Declaration of 2011:

[1] Instead, trading should be left to the market and made subject to responsible, tough and fair conduct regulation

[2] e.g. in the flash crash scenario, computers and electronic systems did not make any mistakes - the people that programed them and then relied on them did. Setting more circuit breakers encourages, not discourages, limit seeking behaviour and volatility within the limits (e.g. programming trading computers to assume all events are “normal” and to maximise returns within trading limits).

Balanced and Comprehensive Reform still Urgently Needed[3]

Action One: Improved Governance: the governance concerns about the structuring, recruitment and retention, independence and integrity of oversight, administration and enforcement organizations must be seriously addressed.
Action Two: Independence: Regulatory authorities should be independent, as the judiciary and auditors are expected to be.
Action Three: Remuneration and Incentives: Remuneration incentives should not positively encourage institutional risk taking with assets held for safekeeping.
Action Four: Regulators and Government Policy makers need to be challenged to:

- Improve incentives to ensure high calibre staff and effective and independent supervision and enforcement;
- Make rules and respond flexibly and quickly to rapidly changing market practices.
- Keep their remuneration completely independently of any regulated entity or product;
- Eliminate regulatory conflicts;
- Avoid new restrictions on innovation;
- Extend regulation and supervision to all ***systemically significant entities;***
- Not blame Accounting Standards; and
- Review (inadequate) capital adequacy rules and seek smarter and better, not more, regulation.

Action Five: Transparency: All systemically significant entities should provide full public transparency of their operations.
Action Six: Language: Encourage the media to avoid emotive language to describe products.
Action Seven: Complexity and Understanding: Ensure ***continuous education and training*** in capital markets, especially for officials and regulators and directors of systemically significant firms.
Action Eight: Ratings: Change the model to remove rating agency conflicts.
Action Nine: Oversight: Governments should establish agencies to review and oversee financial risk, and require explicit funding for those risks.
Action Ten: Deposit Protection: Governments should either restrict the size of deposit taking institutions and allow them to fail, or guarantee deposits and regulate the management of depositors assets. Transparency and certainty of Government policy is missing.
Action Eleven: Open Government: Governments should make all social policies explicit, fund them directly, and refrain from using indirect incentives or requirements to pursue them.

Equity Market Structure needs principled reform not patching

The ISEEE members commented on the US Securities and Exchange Commission's Concept Release on Equity Market Structure by the requested date of April 21, 2010. The ISEEE comment letter offered comments and recommendations in three areas which are summarised below; Capital Formation, Market Regulation and Market Quality. .

Many comments in the submission apply to most other equity markets worldwide:

[3] These 11 actions are set out more fully in our **2009 Orlando Declaration**

Capital Formation: The detrimental impact of current market structure.

1. **Recommendation**: Government authorities should focus on revitalizing the initial public offering (IPO) markets by improving the market structure to provide more support and liquidity for small and micro capitalization companies.
2. **Recommendation**: Government authorities should undertake a full analysis of the direct and indirect costs of going public and maintaining a public company to assure that the associated obligations are appropriate and reasonable for the size of the company.

Market Regulation: Oversight and Transparency need to be improved.

1. **Recommendation:** Countries must have a national (centralized) trading surveillance, data collection and enforcement system.
2. **Recommendation:** Countries should separate all regulation and enforcement from for-profit trading venues where there is a clear conflict of interest.
3. **Recommendation:** Markets and industry participants should move to a shorter (minimum) settlement period and require a "hard locate" system to minimize certain abusive practices, minimize systemic risk and increase investor confidence.
4. **Recommendation:** National Regulators should adopt and universally apply formal definitions of "liquidity" that incorporate tradable volume, the time period, and a limited variation in stock price.

Market Quality: Large and small capitalization stocks and investors are worlds apart.

1. **Recommendation:** Regulators should work jointly with the authorities of other markets to address the erosion of support for small and micro capitalization stocks and their investors.
2. R**ecommendation:** Regulators should develop appropriate metrics of market quality for different market capitalization segments.

The crisis for financing small enterprises: Controlling Mega market excess is sucking the life out of the IPO market: Urgent professional CPR is needed.

Participants discussed in detail the effects of the higher public and private debt levels, and the weakening of government and corporate balance sheets in many countries which is particularly affecting smaller enterprises, and encouraged governments and international institutions to focus even more on the present indebtedness. Research is showing that international capital market structures have progressively moved to provide better support for large companies and to reduce capital finance available for small and mid-cap enterprises. As a consequence, millions of jobs are not being created by these enterprises, which are vital to economic growth and the subsequent ability to pay off the sovereign debt.

Accordingly the Group resolved last year to formulate and suggest practical and positive steps to improve the way international market structures support the formation and capital raising of small and mid cap enterprises; recognizing the vital importance, globally, of the potential of this sector of the market.

The ***Small Business Financing Crisis (SBFC) Task Force***[4] created by the ISEEE has met with different groups concerned about the issue to fully understand its ramifications in developing its position. As immediate wholesale market structure reform is unlikely the TF has developed, with input from SME executives, legal and accounting experts, a "carve out" construct which recognizes that a "one-size-fits-all" approach to public market regulation is not working. This concept is designed to facilitate the raising of equity capital for financing small and medium sized enterprises to create jobs and stimulate the economies in countries worldwide, pending the introduction of more systemic structural reforms.

This work is currently progressing. The structure of any "carve out" will vary in each jurisdiction, however the TF is working to agree on the general principles which they consider should guide general criteria or thresholds for implementation.

ISEEE June, 2011

(For enquiries please contact William Foster, Vice Chairman ISEEE via the ISEEE website)

The Orlando Declarations of 2009 through 2011 and the ISEEE Comment Letter to the US Securities and Exchange Commission are on the ISEEE web site www.capitalmarketexperts.net along with a list and brief bios of the ISEEE Directors and Members.

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4 The SBFC Task Force ("TF") is Chaired by David Weild IV, Chairman Capital Markets Advisory Partners and Former Vice Chairman of NASDAQ, and Mr Donald Calvin, current Chairman of ISEEE, former Chairman of the National Stock Exchange and former Member of the Office of the Chairman NYSE, as Vice Chairman. Former CEOs of the New Zealand Stock Exchange (William Foster), the Sao Paulo Stock Exchange (Bovespa) (Gilberto de Souza Biojone Filho) and the Frankfurt Stock Exchange (Prof. Rudiger von Rosen), and the Former Deputy Minister of Finance of Kazakhstan (Daulet Saudabayev) are ISEEE members on the Task Force . A leading Washington, DC attorney and ISEEE member (David E. Franasiak) heads up the legal efforts and the CEO of Wall Street Management and Capital (Jim Schnorf) and the Managing Director of Corporate Finance Associates (Jim Zipursky) head up the interface with SME executives.

Background:

ISEEE (International Exchange Executives Emeriti Inc) is a not for profit corporation registered in the State of New York, organized for educational purposes to, inter alia, leverage the expertise of former senior executives from all major exchanges around the world to better understand and formulate opinions on the leading issues affecting the global exchange community.

The ISEEE 2011 Meeting was hosted by Jim Schnorf of Wall Street Management and Capital of Orlando www.wsmcapital.com, without whom the Meeting would not have been the success it was. They were not only gracious hosts but also sponsored the reception with members of the Orlando business community in Downtown Orlando, and arranged for the following sponsors for the business luncheons and dinners which were essential to the success of the Meeting: Standard & Poor's, Xtreme Oil & Gas, Inc., and Forex International Trading Corp.