

Eleven Actions for Balanced Reform Needed to Drive Global Financial Market Recovery

Orlando Declaration

The International Stock Exchange Executives Emeriti, a group of former and current international stock exchange executives with decades of extensive leadership experience in financial markets globally, met for their second annual meeting in Orlando, Florida recently to discuss international capital market developments and global reform initiatives.

The participants shared their experiences as capital market experts from twelve countries around the world and discussed the reasons for the current financial crisis and the actions which might be taken. The discussions led to a decision to issue the following Orlando Declaration which outlines eleven actions which should be taken to drive a global market recovery.

Action One: Improved Governance: At the heart of the endless cycle of boom and bust, greed and fear, in the 400 years of capital markets are failures of good governance at all levels – of government policy affecting markets, risk and costs to the public; of the implementation of financial regulation; and of systemically significant financial businesses. Extending regulation and oversight to all systemically significant financial entities will only extend prevailing inadequacies *unless* the governance concerns about the structuring, recruitment and retention, independence and integrity of oversight, administration and enforcement organizations are seriously addressed.

Action Two: Independence: Regulatory authorities should be independent, as the judiciary and auditors are expected to be.

Action Three: Remuneration and Incentives: Executive remuneration and incentives for financial Institutions and firms are correctly being addressed. Remuneration for directors and executives in control of deposit taking and credit creating institutions must not have any remuneration which positively incentivizes the taking of increased institutional risk.

Action Four: Regulators and Government Policy makers need to be challenged to:

- Ensure effective and independent supervision and enforcement. This requires regulators at least of the calibre of the people being regulated, and remuneration incentives should reflect that;
- Have ability to make rules and respond flexibly and quickly to rapidly changing market practices.

- Receive remuneration completely independent of any entity being regulated or products offered by that entity (this must be covered in appointment and conduct rules).
- Eliminate regulatory conflict: Regulators need to be smart, experienced and personally and professionally independent of the financial institutions they are regulating (as is expected of auditors in respect of the firms they audit) and of the political entities who currently appoint them (as is expected of the judiciary). This requires a review of appointment, recruitment and retention policies at regulators, and the publication of conflict of interest policies at those institutions. Young staff should not be motivated by a desire to seek future employment, and the prospect of large salaries and status, in the firms they are regulating, or with political parties. Consideration should be given to policies such as those required to encourage auditor independence (e.g rotation periods), or minimum stand-down periods for future employment by financial firms, of regulators and government officials engaged in financial sector policy.
- **Avoid new restrictions on development:** We do not wish to see financial innovation restricted. Current and new financial products (such as CDOs and CDSs) should be allowed to be used and developed within defined capital rules and regulations.
- Extend regulation and supervision to all *systemically significant entities*, whether public or private. This requires definitions, including a review of appropriate size limits on systemically significant entities – to avoid future concentrations of systemic risk.
- **Do not blame Accounting Standards:** The failures are not due to inadequate accounting standards – capital adequacy and liquid capital rules and regulations need to be set recognising how accounting standards measure and report values.
- **Review (inadequate) capital adequacy rules and avoid merely increasing regulation:** Policy makers and regulators need to review how the rules are framed, and provide the right risk based rules for capital requirements, leverage and liquidity of deposit taking and credit creating institutions, and other financial entities, treated separately including:
 - the capturing of off-balance sheet transactions in capital adequacy rules and the construction of required liquid capital in a way which does not encourage the transfer of risk to third parties – this allowed banks to notionally increase their capital base for risky lending;
 - the nature of tax incentives and how they are used and abused. (is it surely time to revisit the age old tax distinction between interest and dividends - where one is deductible and the other is not – and its traditional incentive to leverage);
 - making current regulations actually work by adjusting “haircuts” correctly, so firms provide “real” liquid capital at all times – including in the absence of markets for assets.

Action Five: Transparency: All systemically significant entities, private or public, licensed or not, should be required to provide sufficient full public transparency of their



operations, including publishing a risk profile policy statement and regularly assess their performance against it.

Action Six: Language: We do not think it helps the development of responsible and constructive solutions to use pejorative media language to describe things. What are “toxic assets”?

Action Seven: Complexity and Understanding: One of the governance failures was failure of policy makers, regulators and board directors to understand the complexity of today's financial markets and the instruments they use. To avoid unnecessary controls on useful financial instruments, we advocate significant and *continuous education and training* in capital markets for all those engaged in the governance of capital markets. This should be considered a potential appointment requirement for officials and regulators and a potential licensing requirement for directors of systemically significant firms.

Action Eight: Ratings: Rating agencies have proved inadequate and shown to have significant conflicts of interest - with companies paying them for ratings. Independent agencies are required urgently. One possibility is to have an industry subscription model to support independent agencies, in preference to government agencies to provide ratings.

Government Initiatives

Action Nine: Oversight: Paralleling the G20 initiative to extend the international risk oversight role of the Financial Stability Forum, national Governments should move to establish an office of financial risk oversight, to review all government policies which increase the risk of the government incurring liability for future bailouts, and require explicit funding for those risks. (this could alternatively be a function of the Office of a Regulatory Review Commissioner).

Action Ten: Deposit Protection: Governments should guarantee all deposits at banks, as deposit taking institutions – as they effectively will in such a crisis anyway - and ensure they are managed in a way which protects the assets of depositors (as for intermediaries) in the event of a liquidation of the bank. Banks have largely been exempt from prospectus requirements for deposits as an instrument to raise funds and must now publish more information on bank risk and use of funds.

Action Eleven: Open Government: Governments should make explicit all social policies which have significant implications and refrain from using indirect incentives to pursue them (i.e. not put the costs off government accounts and on to institutions or the public). The current example is policies employed to get citizens into their own homes – instead of encouraging the banks to take on more risky lending to people who cannot afford to pay their mortgages and reducing their prudent capital ratios on those loans, Governments who see this as important public policy should use direct tax and subsidy methods to fund needy citizens into their own homes.

We will monitor the progress made by governments and regulators to address these fundamental structural concerns in a balanced and globally sensitive way and review them again at next year's meeting.

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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 2009 Meeting was hosted by the Metro Orlando Economic Development Council and Jim Schnorf of Wall Street Management and Capital of Orlando www.wsmcapital.com and Dick Batchelor of the Dick Batchelor Management Group, Inc. www.dbmginc.com without whom the Meeting would not have been the success it was. They were not only gracious hosts but also sponsored or arranged for sponsors for the reception with members of the Orlando business community in Downtown Orlando and for the two business luncheons and dinners which were essential to the success of the meeting.