Financial Markets Regulation: Never a Dull Moment

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Regulating financial markets is not easy. It is a delicate balancing act in which related, but not always parallel, objectives such as maintaining easy and convenient market access, integrity of market participants and financial stability must be factored. The points are related in the sense that they are all essential preconditions to successful, effective and reliable financial markets.

However, when it comes to concrete legislation or policy measures, it is often a challenge to satisfy all such preconditions at the same time. Strict and detailed requirements as to customer due diligence, Chinese walls, internal policies on private investment transactions by insiders, employee screening, suspicious transaction reporting and risk management generally – only to name a few – can reduce integrity risks. Frequent and extensive reporting to regulators may help to identify systemic risks at an early stage. But the administrative burden and cost associated with such requirements may also scare off *bona fide* parties that are considering entering the market, or may lead to regulatory arbitrage. On the other hand, an all too liberal market access policy may present obvious dangers of its own.

The relative importance of issues such as eliminating barriers to entry, integrity of market participants and ensuring financial stability varies over time. Shifts in the relative weight of such issues are often triggered by external factors. This can be witnessed at the level of individual states, but also at the European level.

At the time the Financial Services Action Plan was launched in 1999, the attention of EU policymakers was dedicated primarily to eliminating capital market fragmentation, reducing the cost of capital raised on EU markets, and allowing users and providers of financial services to benefit from a single financial market to the fullest extent possible.

After the events of 11 September 2001, attention swung towards the prevention of terrorism financing. Existing customer due diligence and suspect transaction reporting requirements were improved and enforced around the world. States that did not play their part were dismissed as 'non-cooperative countries or territories'. Around that same time, the demise of Enron and the accounting scandals at Worldcom, Parmalat, Vivendi and Ahold dominated the business sections of newspapers. The US legislator responded immediately and forcefully by passing the well-known Sarbanes-Oxley Act, feared in boardrooms across the world. The EU followed suit, albeit in a more modest fashion, by expediting already existing initiatives regarding improved disclosure by listed companies, corporate governance and accounting reform.

We are now facing a profound and unprecedented money market crisis caused by defaulting sub prime housing loans in the United States. Lawmakers around the world are already taking action. Responses vary from allowing state aid to banks in distress, to identifying and eliminating vulnerabilities that the credit crisis revealed. An example includes the stronger call for the regulation and supervision of rating agencies. Rating agencies assign credit ratings to repackaged loans in the form of asset backed securities. Such securities are used to divide up, repackage and transfer credit risk, and play a key role in the current crisis. Other measures and initiatives, whether temporary or more fundamental, will undoubtedly follow.

These are interesting times for financial law specialists. But aren't they always?