Orlando Declaration 2012

Capital Market Reforms needed to facilitate Job Creation and Economic Growth

Background

The International Stock Exchange Executives Emeriti Inc ("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 2012 Annual Meeting over three days from March 26 to March 28 where we discussed and reviewed international capital market developments, progress with recommendations in previous Declarations, and reform initiatives being proposed or proceeding.

This year's Annual Meeting was attended by a record number of twenty-four ISEEE Members and Special Guests from fourteen countries including Austria, Australia, Canada, Egypt, Germany, Russia, Turkey, Peru, Israel, Luxembourg, Kazakhstan, New Zealand, Switzerland and the United States, each of whom have been or are currently officials of some fifty stock and derivative exchanges worldwide. Many attendees also have senior securities regulatory experience.

A summary of the Meeting and a List of ISEEE Members with brief bios is on the website www.capitalmarketexperts.org

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

Participants discussed progress on the 11 actions set out in our **2009 Orlando Declaration**, including the US and international regulatory reform initiatives since last year, and noted that:

- Government regulators took the position in several cases that cross border exchange mergers and acquisitions were not principally in the interests of, or not delivering benefits to, the general public;
- There is a recognition of the need to facilitate and encourage the much needed primary market role of job creation and economic growth (as in the US "JOBS" Bill); and
- There is a continuing need to deal with the potential for further crisis, and to develop the whole market framework needed to support small business.

Key points of the current environment were revisited and confirmed including:

- That International paradigms for market regulation are seen by Governments and regulators as easier to justify implementing in response to local problems. These are replacing thoughtful analysis and benefit evaluation at the national level in the extension and development of market regulation.
- Lack of public listings and current regulatory structures are still driving money to derivative and OTC markets and not to new business formation
- Growing use of leverage continues to portend future problems
- The One-Size-Fits-All regulatory model does not in fact Fit-All.
- Markets are now more efficient for high Caps, but efficient markets, more extensive licensing, and specialisation/independence rules have made intermediation support for equity raising for small and medium enterprises unprofitable.
- Regulatory micromanagement of markets can have unintended and adverse consequences.
- SME IPOs are still 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
  - independence and proper remuneration, and
  - restoration of incentives and profitability to support small businesses

Balanced and Comprehensive Reform Needed, as originally outlined in the prior Orlando Declarations

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 independent 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: Everyone involved with the financial sector should 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 were pleased at the response to the progressive and extended decline in the US IPO market in the form of the US JOBS Bill (enacted in March 2012 in the US Congress).

While members saw this as a credible first step towards the restoration of the US IPO market, its focus on reducing costs for issuers was only part of the structural problem arising from the combination of regulatory developments and market responses, and more was now needed to provide suitable structures for markets to support small business IPOs.

Members saw the developments as relevant worldwide with similar trends in most developed markets, and difficulties for small markets in Europe, but recognised that many emerging markets were still seeing substantial organic growth and were yet to see the impact of traditional overregulation on low or no growth economies.

The concerns previously raised by members remain:

Capital Formation: The detrimental impact of current market structure.

1. **Recommendation**: Government authorities should focus on revitalizing the initial public offering (IPO) markets by working with the private sector to improve 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:** 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.

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 continues to strangle the IPO markets: More Professional Responsibility and less red tape is needed.

Participants discussed in detail the effects of the high public and private debt levels internationally, and steps being taken to attempt to resolve the European debt crisis which are particularly affecting smaller enterprises. 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 and North American 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*** created by the ISEEE has met with different groups concerned about the issue to fully understand its ramifications in developing its position. While efforts to amend laws and regulations to improve access for small issuers to public equity capital are encouraging, immediate wholesale market structure reform is unlikely. The TF is continuing to develop, with input from SME executives and 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 being further refined in discussions amongst members 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.

The issues are complex and this work is still in progress. 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 May, 2012

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

The Orlando Declarations of 2009 through 2011 are on the ISEEE web site www.capitalmarketexperts.org along with a list and brief bios of the ISEEE Directors and Members.