Mitigating systemic risk: a role for Securities Regulators. March 2011

In June 2010 the Technical Committee of IOSCO agreed to create a working group to examine the role that securities regulators and supervisors should play with respect to systemic risk. The creation of this working group had a direct consequence on the agreement adopted by the organisation to amend the IOSCO Objectives and Principles, adding two new Principles on this matter: the regulator should have or contribute to a process to monitor, mitigate and manage systemic risk (Principle 6) and, additionally, the regulator should have or contribute to a process to review the perimeter of regulation regularly (Principle 7).
In February 2011 this working group published a document titled: "Mitigating Systemic Risk: A Role for Securities Regulators". This document aims to promote discussion among securities regulators from the point of view of the direct relationship of systemic risk with its work programmes.

The working document builds on the above-mentioned Principles and initiates the development of a methodology for the identification, analysis, monitoring and mitigation of systemic risk, as well as for the promotion of financial system stability.

The document gives context to the role of securities regulators with respect to systemic risk: the primary ways in which it can develop in securities markets, the approaches and indicators that securities regulators may use in seeking to identify sources of systemic risk, and guidance on how securities regulators can act, both to reduce the opportunity for systemic risk to arise and to reduce its impact. A summary of the preliminary findings of the document are:

1. Transparency and disclosure of information are critical to identifying the development of systemic risk and to arming regulators with the information needed to take action to address it.
2. A strict regulatory control of business conduct is essential to managing conflicts of interest and to avoiding the build-up of undesirable incentive structures within the financial system.
3. Financial innovation and its implications for financial stability should be a continuous concern. Innovation which involves opacity or improper risk management should be carefully monitored.
4. Given the central role of markets in the overall financial system and their capability to generate and/or transmit risks, securities regulators should work with other supervisors to improve the overall understanding of the economics of the securities markets, their vulnerabilities and interconnections with the financial sector and the real economy.
5. It is important for securities regulators to develop risks measurements which are key to assess systemic risk arising within securities markets, and improve their understanding and the application of tangible measures to mitigate identified systemic risk.

IOSCO considers that securities regulators have a key role to play in identifying and mitigating systemic risk, which involves incorporating a greater emphasis on reducing systemic risk into their everyday processes and tasks. Each IOSCO member will need to determine its own response in relation to its mandate and scope of regulation, as well as to the relative size and characteristic of its securities market taking advance, in particular, of other members experience.

IOSCO recognises that securities regulators share responsibility for dealing with systemic risks with central banks and prudential regulators and for promoting cooperation through bodies such as the FSB, the Basel Committee, the International Association of Insurance Supervisors and IOSCO itself.

If you are interested in obtaining more details about the report, you can click on the following link to the IOSCO document: Mitigating Systemic Risk – A Role for Securities Regulators
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf