

Trinidad and Tobago Securities and Exchange Commission

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Kingston, Jamaica**

ADDRESS

US New Financial Regulatory Reforms: How will this realign the markets?

How will this Regulation Affect the Caribbean?

The recent global financial crisis has been described as one of the worst financial crises in the past century, second only to the Great Depression of the 1930's. This crisis was triggered by a liquidity shortfall in the United States banking system and has resulted in the collapse of several large international financial institutions, the bailout of banks by some national governments, and downturns in stock markets around the world. The financial crisis is said to have contributed to the failure of several businesses, declines in consumer wealth estimated in the trillions of U.S. dollars, substantial financial commitments and injections by governments, and a significant decline in economic activity globally.

The US housing market also suffered in the crisis, resulting in numerous evictions and foreclosures. We now know that before the burst of what has been called the housing bubble, banks appear to have indiscriminately extended credit to consumers many of whom, when the bubble burst, were unable to repay. These losses however were not only confined to the financial institutions extending the credit. Many other institutions were exposed to these losses as a result of investing in asset backed securities which relied on the

once steady streams of income generated from the mortgage payments. The term subprime is a word which is now etched in our minds.

Most of the world's financial markets have been exposed to the ravages of the crisis and, while some economies are slowly beginning to recover, several are still reeling from the effects of it. The US Government's regulatory response to the financial crisis was to draft legislation which is aimed at establishing stricter and tighter financial regulatory controls with a view to increasing regulatory oversight over complex financial products, increasing consumer protection and monitoring systemic risk.

In an effort to allay fears and to prevent similar occurrences in the future the Dodd-Frank Wall Street Reform & Consumer Protection Act ("the Dodd-Frank Act") was signed into law by President Obama on July 21, 2010. This legislative package comprises of approximately 15 major parts, 14 stand alone statutes and an array of amendments to the current banking, securities, derivatives and consumer finance laws.

The Act, which was 2 years in the making, is over 2300 pages long and contains at least 240 rule making provisions. The Act mandates that about 65 different studies be conducted and at least 20 periodic reports be done. The rulemaking period began almost immediately upon the Act coming into effect and is expected to last approximately 5 years. Most of the rules are to be implemented within 6 to 18 months of signing.

The Act is a framework type legislation which mandates that US financial regulators implement it by issuing rules and regulations over a period of time. Even though it was signed in July of last year only small parts of the Act were effective immediately.

As a result, the impact of the Dodd-Frank Act will not be felt for a while because it was only in the latter part of 2010, and now during 2011, that many of the rules will be proposed, finalized and implemented.

It is clear from reading the Act, that no part of the American financial landscape was left untouched. The areas which are addressed include the banking and insurance industries, securities regulation, hedge funds and private equities, consumer protection, systemic risk, derivatives including OTC swaps, corporate governance and executive compensation.

Mary L. Schapiro, Chairman of the U.S. Securities and Exchange Commission in her address in the USSEC's 2010 Annual Report describes the Dodd Frank Act as landmark legislation which "gives the SEC important tools to better protect investors, including new tools for our enforcement personnel and the authority to create a uniform fiduciary duty for broker-dealers and investment advisers. It provides important new sources of data and information to investors as well as to the SEC by bringing hedge funds under our oversight and over-the-counter derivatives into the sunlight.

And, it builds on priorities already embraced by the SEC, such as enhanced oversight of credit rating agencies. The Act presents the SEC with an opportunity to build on the accomplishments of the past year and to create an enduring structure for improved protection of investors and markets.”

It is indeed too early to assess the impact of the Act in the US as well as in the Caribbean because much of the rules and regulations which are necessary to implement the Act are still being drafted. In fact US regulators appear to have been given a wide berth with respect to how the provisions of the Dodd-Frank Act are to be transposed into rules. So until the final rules have been drafted and adopted one does not know the exact form, scope and rigidity of these rules.

I thought however that it would be useful to highlight some general areas that may in time be of importance to us in the Caribbean.

The areas that I have chosen to look at include:

- Investment Adviser Regulation**
- Credit Rating agencies**
- On-Exchange Trading Derivatives**
- Consumer Protection and**
- Non US financial Institutions**

How will the Dodd-Frank Act affect the Caribbean?

Investment Adviser Regulation

Prior to the passage of the Dodd-Frank Act many private investment fund managers, both US and non-US, could have relied upon certain private investment adviser exemptions to avoid registration with the US SEC on the basis that the US investment fund was one client.

The Dodd-Frank Act has repealed the private investment adviser exemption and now requires investment advisers of certain private funds to register under the Investment Advisers Act 1940.

The Act has now created 4 new categories of exemptions namely foreign private advisers, advisers with *de minimis* assets under management, venture capital advisers and family offices.

The repeal of the private investor adviser exemption, and the introduction of the new exemption categories, may indeed have some impact on the Caribbean. For instance, in order to qualify under the foreign private adviser exemption the investment adviser cannot have a place of business in the US.

Additionally, it must have:

- **fewer than 15 US clients and investors in private funds that it advises**
- **less than US\$25 million of assets under management attributable to investors in the US**
- **and not hold itself out generally to the US public as an investment adviser.**

The threshold which is now imposed may affect the scope for US participation in certain foreign funds and foreign sponsors may begin looking elsewhere for investors. The Caribbean may be one such area and in the coming years we may see an increase in investment fund activity in the region. It is too early to tell what the effects will be. However, we should also consider that our regulatory systems may have to be considerably enhanced to match any increased activity in this region.

Credit Rating Agencies

During the financial crisis, credit rating agencies were singled out as partly to blame for their role in issuing favorable credit ratings to asset backed securities that were ultimately based on sub-prime mortgages. The Dodd-Frank Act introduces a new regulatory scheme with respect to rating agencies. It seeks to improve existing regulations the aim of which is to hold rating agencies accountable for the credit ratings given and to enhance transparency with respect to the methods used to derive these credit ratings.

The securities regulators who are among us here today will be aware that in June 2010 the International Organization of Securities Commissions (IOSCO) introduced 8 new principles of securities regulation. Among these principles was principle 22 which mandated that credit rating agencies should be subject to adequate levels of oversight. Securities regulators around the world are now tasked with the job of ensuring that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.

For many of us in the region who do not as yet have the systems in place to regulate credit rating agencies this is not an easy task. In fact, the introduction of regulation of credit rating agencies in the Caribbean will involve legislative changes as well as the creation of new systems and regulatory requirements which will capture these credit rating agencies within the regulatory ambit.

The US has found itself among the leaders of the pack with respect to regulating credit rating agencies. The US implementing rules which express its policy solutions may provide us in the Caribbean with a guide in this area.

Whilst I do not advocate the blind copying of another territory's legislation I do believe that certain provisions in the Dodd-Frank legislation, as well as the implementing rules which are to come, can provide useful guidance with respect to the regulatory treatment of such agencies.

On-Exchange Trading Derivatives

During the height of the financial crisis it became apparent that a lack of transparency has hindered regulators in their efforts to make a proper assessment of the full impact of the crisis. This lack of transparency was evident in the derivatives market, for instance the swap market, which was conducted off-exchange, and which was virtually unregulated. This type of off-exchange, or over the counter, trading made it difficult to track these transactions to fully assess the risk of exposure because they did not pass through regular exchanges.

The Dodd-Frank Act now requires the centralized clearing for all swaps through a registered clearing house as determined by the Commodity Futures Trading Commission or the US SEC.

This legislation is attempting to do what previously had not been done before with swaps, i.e. regulate a previously unregulated derivative.

In order for this regulatory requirement to work it will be necessary for new and existing exchanges and clearing houses to step in so as to provide the necessary clearing facilities. The business opportunities that have now been created by the legislation are obvious.

Critics of this change maintain that on-exchange trading of swap products is unworkable because most swaps are unique and cannot be homogenized for trading on an exchange. However if the US is successful in this area, our exchanges may look to the US for models in the never-ending quest of expanding business which will facilitate or contribute to the growth of our capital markets. Once again we must bear in mind that whilst we know that the landscape in the US with respect to these over the counter products has changed, the full extent and consequences of these changes will not be evident until the implementing rules have been drafted, adopted and more importantly, tested.

Consumer Protection

I thought it important to note that a significant area of the Dodd-Frank Act, Title XIV of the Mortgage Reform and Anti-Predatory Lending Act, focused on consumer protection in the banking sector.

As I pointed out earlier it was the burst of the housing bubble and the related sub-prime mortgage fiasco which was the most likely catalyst of the financial crisis. These sub-prime mortgages were termed sub-prime because credit was extended to customers who may not have possessed the full ability to re-pay their loans at the time that the credit was extended.

The Dodd-Frank Act establishes a Bureau of Consumer Financial Protection which is tasked with the responsibility of regulating consumer financial products and services. Among the protections, the Dodd-Frank Act sets minimum under-writing standards for mortgages by requiring lenders to verify that consumer borrowers have a reasonable ability to repay at the time that the mortgage contract is entered into.

The Act would eventually lead to sweeping changes to the American domestic banking landscape. Again it is not clear at this point what effects these changes will have on us in the Caribbean. What is clear however is that in seeking to change a flawed financial system US legislators have attempted to consider all the interested parties and stakeholders in the regulatory process.

Non U.S. Financial Institutions

Finally, one significant consequence of the 2008 financial crisis is that the U.S. is more aggressively asserting jurisdiction over non-governmental financial institutions even when the activities of such companies take place outside the U.S.

Non U.S. financial institutions should be very cognizant of the severe financial penalties for violation of these laws and the extraterritorial reach of the Act.

Since these firms are in the same position as U.S. financial services firms, the activities of all of them by virtue of the Act have become or will soon become subject to additional capital requirements, prudential regulation or general oversight by the USSEC, the Federal Reserve Board or the Commodity Futures Trading Commission.

It is too early to determine the Act's impact on Foreign Financial Firms whose 'offshore' activities involve:

- (i) Contact with US investors**
- (ii) Activities in the U.S. dollar denominated financial markets that are settled in the US or transactions with the US financial institutions generally or**
- (iii) Any other non-US "financial" activities if such activities are deemed to have a "substantial impact on the US financial system".**

It will be some time before the implementing regulations are finalized and the full scope of the extraterritorial reach of some of the provisions of the Act become clear.

I wish to reiterate that, apart from these general observations, the effects and impact of the new US financial regulatory reforms cannot be fully assessed at present.

As explained earlier the Dodd- Frank legislation is over 2300 pages and only a very few of the new statutory provisions, for example certain repeals, came into effect immediately. The greater number of the Dodd- Frank provisions depend upon US regulatory agencies to draft, finalize and implement the same.

Until this is done we cannot assess the effects of these provisions on us in the region. I do advise however that we continue to monitor the regulations and their full impact in the USA and examine how we treat with this in the region.

Thank you.

