Ladies and gentlemen,

Let me first of all express my appreciation to Anthony Kronman for his kind invitation to this Yale Law school Symposium. It is an honour to address such an audience at this time of the day and a pleasure to share with you a few thoughts about major reforms affecting financial market structures and participants.

Reforms are required at a time of crisis, financial crisis as well as crisis of confidence, reflecting an improper balance of interests between investors, issuers, and intermediaries, and reflecting as well an improper functioning of financial markets.

Reforms are also pushed forward by the winds of change, change of technologies, product innovation, political and financial globalisation processes. In both cases, regulators are in charge and concerned, in so far as our missions and related powers, as stated for example in our brand new Financial Security Law, to ensure that investors are protected and that financial markets function correctly.

So the winds of change are felt by us also, and let me make a few remarks about these pending reforms, from my own perspective as a regulator and a former market participant.

Let me first say that I believe that one of the future challenges for regulators in charge of investors’ protection is related to the complexity of financial instruments and investment strategies.
Most investors can understand investment strategies like *buy and hold* equities or bonds. None of them can understand the strategy of a hedge fund, assuming that his manager would disclose his positions, which is never the case. Between these extremes, asset managers can make use of a large range of derivatives instruments, forex, interest rates, equities and credit derivatives. In so doing, they can constantly modify the risk profile of their portfolios, according to their investment strategies; returns finally are more or less decorrelated with the performance of underlying securities.

Today, a large majority of asset managers implement very clear investment strategies aiming at a performance correlated to indexes and benchmarks.

However we can also observe a growing volume of money managed by alternative asset managers or invested in guaranteed and structured products, both making a significant use of derivatives, and more recently, of credit derivatives. By using a fund of funds, asset managers can also mix different strategies to diversify their risks and obtain a more constant performance.

This evolutionary tendency could accelerate, if, as a result of becoming disappointed by poor performance of traditional strategies or frightened by the volatility of equity markets, investors decide to increasingly demand such (alternative ?) products. In the same direction, banks and companies might also be encouraged to externalise their credit and market risks to optimise their return on equity for banks and avoid volatile results generated by IASB rules for companies. Eventually, investors might become the final insurers and re-insurers of the market and credit risks of the market place. This would be excellent news for prudential regulators, as such an evolution would reduce potential banking failures and systemic risks. On the other side of the coin, securities market regulators might express some concern about investor protection.
In this perspective, regulators should take significant initiatives to adapt their regulation:

- Firstly, all asset managers, alternative or not, making use of sophisticated instruments and techniques should be registered with regulators. They should be obliged to prove that they have the necessary experience in such techniques and adequate resources and systems to measure and manage such risks.

- Secondly, asset managers should clearly inform investors of their strategies and their use of complex instruments. Funds should be audited regularly and publish their performance.

- Thirdly, banks and prime brokers should organise strong Chinese walls to isolate credit officers and traders from asset managers. Asset managers should also be free to buy derivatives from any market participant and be in a position to prove the best execution of their orders.

These recommendations are in line with initiatives already taken by the COB to accommodate indirect alternative asset management in French mutual funds. They are also mostly in line with the report of the SEC on hedge funds. However, we also know that such proposed regulation meets strong resistance even inside the board of SEC. My belief is that such steps are totally necessary for adequate investor protection, not only for hedge funds but also for any fund invested in derivatives, and especially credit derivatives.

Furthermore, I have the feeling that the balance between law and regulation on the one hand, and governance of professionals on the other might have to change in these activities as is actually the case for financial analysts, credit rating
agencies, and audit-consulting activities. In the not very distant future legislators
and regulators may feel that the conflicts of interests between investment
banking, commercial banking and asset management are not properly addressed
with disclosures and Chinese walls and that they should be more clearly
separated from each other. Let us hope that new scandals will not accelerate this
evolution which has all the hallmarks of La Belle Époque and Glass Steagall
act.

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My second remark is related to the new complexities of an effective market
surveillance.

The time when professionals were trading together plain forex and debt
instruments in OTC markets and when investors orders were executed on
regulated markets belongs to the past.

As I have just said, most complex derivatives are traded on OTC markets: it is
next to impossible to control bilateral transactions between banks and their
market counterparts. Regulators can make specific enquiries but they cannot
achieve permanent market surveillance. In OTC markets, caveat emptor (let the
buyer or beware) is the name of the game.

A regulated market associated with a concentration of orders provides regulators
with all the adequate information on all transactions necessary to track market
abuse and control best execution by intermediaries.

The result of the new Investment services directive will be that, very shortly,
concentration of orders will disappear. Regulated markets will offer their
services in competition with two other types of trading venue: banks will trade
on internal private systems with their customers and other selected market
participants; private platforms named MTF will also offer their trading services to the same market participants. A second major objective of the ISD is to enable every participant to trade on any venue across borders.

We all expect a better and cheaper service for investors from this organised competition.

As a former banker, I believe strongly that such a fragmented market cannot bring price improvement compared to a concentrated exchange, except for a small number of market participants enjoying a strong negotiating position. For other investors, it still remains to be seen whether internalisers can reduce overall costs of transactions as a result of smaller fees on clearing and settlement on their own books. That would be excellent news. In any event, it is essential that every trading venue competes on an equal footing. Furthermore, in such an open, private and competitive trading environment, self regulating powers are not to be granted to any exchange, even one which is regulated; this should be so in both the European Union and Wall Street. Even then, the task of regulators will be tough.

As a regulator, the difficulty in controlling a fragmented market of any instrument increases with the square of the number of trading venues and the cube of the number of countries involved. That’s a rough assumption…Assuming that the COB would like to maintain the same degree of market surveillance, we should have to organise new channels of daily data gathering from MTF and internalisers and collect significant data from regulators in other jurisdictions. In principle, this is far from impossible, but would certainly cost more money directly or indirectly to the market place. As a matter of fact, pending the second reading of the revised ISD by the Parliament, we still do not know the rules that will be applicable to market surveillance in
Europe: certain articles of the ISD relating to trading rules and the exchange of information between regulators are still being fiercely debated. Quite a few Members of the European Parliament are quickly learning the intricacies of pre-trade and post-trade transparency and the virtues of competition between intermediaries. I, for one, could forgive some of them for having doubts about the good governance of traders, at a time when they are being asked to legislate on financial analysts and auditors in a post Enron environment.

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My third and last remark is related to the single European regulator.

A single European regulator sounds like a splendidly French idea. It has the nice technocratic flavour of a *jardin à la française*, where a single regulator makes a simple and single regulation applicable to every one in every jurisdiction. Nice prospect, but to make it work, we need a magic stick or to bring back Napoléon Bonaparte.

The reality is that in every country, securities markets rules and practices are imbedded, rooted in national laws and regulations; they are also different from one country to another for good reasons, due to different cultures, economic and political structures, professional traditions, investors formation and information.

Between London and Paris, it takes more than Eurostar to link the two markets: a century ago, the City was trading and investing 70% of stocks and 30% in bonds. At the same in Paris, the proportion was exactly the reverse and still is. UK investors have at least a century of experience in investing mainly in stocks. In Paris, only 20 years ago, the nationalisation of most of Frances significant companies; at that time, a large majority of French voters did not care a penny. After such an excellent market economy training, do you really believe that a
French investor requires the same information and protection as a British pension fund?

Consequently, cultural, political, social reforms are a prerequisite to condition securities market reforms. No external constraint from a single securities regulator could impose rules which had not been first accepted by parliaments and market participants. A second consequence is that we should not aim at creating from scratch a single set of regulations: every country should keep some flexibility in order to accommodate local concerns and practices. Principle of subsidiarity is also required in securities regulation.

This is not so very different from our experience in creating a single currency. The Euro and its relative value was not decided upon from scratch by technocrats and imposed on 15 countries in a single day.

On the contrary, the Euro was the last step of a slow process of convergence of monetary and budget policies, leading to less volatile cross exchange rates, which finally enabled governments – and not all of them - to align their currencies without much economic and social risks.

Similarly, European governments and regulators should work together to progressively harmonise their regulations without imposing the regulatory system of one jurisdiction or another.

This is exactly the objective of the Lamfalussy process, which is proving to be an efficient process: level one measures are proposed by the European Commission and decided by the political authorities, European parliament and Council of Ministers. Comitology insures participation of CESR regulators, both in advising the Commission and consulting market participants. National parliaments and governments implement the directive through the necessary laws and decrees. At the level of regulators, CESR has the responsibility of...
implementing measures, and making sure that these measures make good sense; as it is the same regulators who will have to enforce them in their own jurisdiction.

One of these days, somewhere down the road, harmonised rules will reach a critical mass, market participants will trade easily across borders and will be familiar with the new regulation, and then, a new directive will decide without much fuss, that the name of CESR has been changed into the European SEC.

However there is no short cut in the integration process: just look at the difficulties of the take over directive: rules are clear and simple enough to efface, but 14 years are not enough to efface national differences in the management of companies, in the way they restructure their businesses, in the way they can accept a foreign leadership or in the way they protect minority shareholders. Despite tremendous efforts of convergence of budget policies, just look at the difficulties of French and German to comply with the rules they themselves imposed some years ago?

The need for an harmonised regulation in a global market is not limited to European Union.

Here again, regulators are working hard in this direction. IOSCO which groups more than 100 securities regulators, has been very instrumental in the harmonisation process: IOSCO has issued 30 key principles on securities regulation based on three objectives: protection of investors, ensuring that market are fair, efficient and transparent, and the reduction of systemic risks. More recently, ISOCO has published principles relating to the conflicts of interest of financial analysts and Credit rating agencies. The IOSCO governance rules provide that principles are decided on consensus and that every regulator is
committed to enforce them within his own jurisdiction. As these principles define very high standards and high quality regulation. This is indeed very good news for one and all.

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Ladies and gentlemen, my last remark is a shirt one and a conclusion. As we have seen together, investor’s protection and proper functioning of financial and securities markets are moving targets. Our regulatory task is never ever completed.

But we can proceed by looking backwards or forwards. LTCM, Enron, Worldcom have required backward looking regulation. I have the strong feeling that we would create value in forward looking regulation to avoid the next Enron.

Thank you for your attention.