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THE ROLE OF FINANCIAL REGULATORS IN THE CONTEXT OF THE GLOBAL FINANCIAL CRISIS

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Abstract: The financial sector is one of the main driving forces of a country's economic development and essentially important factor of its overall economic stability. However, when exposed to inadequate regulation, unstable market and underdeveloped institutions, the financial sector might become a root cause of financial crises and one of the main factors that contribute to destabilization of a national economy as a whole. As the global financial crisis set in, it became evident that a stronger role of the state and its institutions became necessity in order to restrain more efficiently the observed internal deficiencies in the market itself. In the aftermath of first wave of the financial crisis, many countries initiated legislative reforms, abandoning the then prevailing principle of financial deregulation. One of the main directions the reforms took was the establishment of new regulatory authorities and delegation of enhanced supervisory powers to existing market regulators.

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Without any doubt, the financial sector of every national economy is one of the main driving forces of a country's economic development and an essential factor of its economic stability. However, when exposed to inappropriate regulations, unstable market and underdeveloped institutions, the financial sector, instead of being one of the main pillars of stability, might even become the root cause of financial crises and one of the main factors undermining the national economy.

Maintaining stability and reinforcing performance of the financial system, i.e. financial markets as one of its most significant and at the same time most vulnerable parts, depend on a number of institutional factors and market participants. The legislator, regulators, licensed firms and investors – all have an important role to play in developing the financial market. Still, it is noteworthy that here the state has the essential function and role.

Ten years ago, the opinion of the economic experts was rather unanimous considering what the role of the state should be in the financial sector. The common belief was that the state and often its regulators posed a hindrance to the economic development, and that the direct government interference, primarily through state ownership of financial institutions and direct subsidies were the complete opposite of the idea of a free market economy. The general standpoint was that a market should rest on its own regularities and that in such conditions capital and risks are the most efficiently distributed. The proponents of the free market theory believe that any kind of state interference in the market is not only unnecessary, but, what is more, could have damaging and numerous adverse effects. When it comes to market economy it is on the state to ensure that the laissez-fair principle is applied. It should merely establish the general rules for economic activities and ensure efficient enforcement of laws. It would be impossible to dwell on the champions of this theory, without mentioning the originator of the free market theory, Milton Friedman. When assessing the optimal role of state in national economy, he was far blunter than his followers, later on. In the middle of the last century, he argued that any interference of the state and any attempt at control of the free market violated not only the natural, free development of capitalism, but resulted in restricting the freedom of citizens as well. The following quote from Friedman is a great example illustrating this standpoint: “If you put the federal government in charge of the Sahara desert, in five years there’d be a shortage of sand.” He identified the cause of the gravest economic crisis of the time as excessive government intervention in economy: “The Great Depression, like most other periods of severe unemployment, was produced by government mismanagement rather than by any inherent instability of private economy.”

However, the new century faced the economic thought with new challenges. To be more precise, at the beginning of the last century, a new financial crisis arose, showing all the weaknesses of financial markets. As a consequence, the then generally accepted principles and the prevailing standpoints of economic experts that a market should rest on its own regularities were to be re-examined. As the crisis set in, in addition to the climate of mistrust in the state which had generally stayed the same as before the crisis, the lack of confidence in the market itself appeared. The repercussions of such lack of confidence primarily among investors in the capital market brought about some acute problems seen foremost in the undermined market stability and stagnant development, especially bearing in mind that the mistrust was in the very foundations of the financial system. It became clear in such a situation that the former arrangement no longer provided a satisfactory framework that could efficiently respond to new challenges. A stronger role of the state and its institutions became a necessity in order to restrain more efficiently the observed deficiencies in the market. At the same time, it was of utmost importance to achieve the right balance between the need for creation of a stable financial system and the risks of simultaneously smothering the competitiveness and suboptimal allocation of capital, all of which are prerequisites for further growth of the market.

In this sense, it is of importance for the state to continuously and through various mechanisms promote and advance the development of its financial market, to build its financial infrastructure, educate market participants and to constantly follow, monitor and analyze impulses, reactions and practical experience feedback from the market, in order to react timely and reduce systemic risks, but also to simplify procedures, or at least reduce administrative obstacles.

When determining the scope and direction of government intervention, we should take into consideration the experience that we now have from seeing the consequences of different reactions of some states which responded to the challenges posed by the crisis of financial institutions and the crisis of global excessive indebtedness. They indicate that healthy competition, but only if paired with strong supervision by competent authorities, could boost efficiency and enhance access to financial services without undermining total stability, at the same time.

Still, it is important to distinguish between different functions of a state in the financial system and emphasize that when direct interference is not the case, new evidence keeps arising of how state participation (e.g. state banks) can really, at certain points, help mitigate the adverse effects of crises. However, in the long run, too much of state interference in this way might have significant negative effects on the financial sector and misplace allocation of resources. On the other hand, the role of a state as a regulator that lays down rules and enforces them efficiently is of equal importance in times of a financial crisis when investor confidence needs to be restored and in time of economic prosperity, when it should prevent any potential threats to financial stability.

Speaking about the role of the state in setting general business rules and conditions through a legislative framework that should provide the optimum conditions for further development, it is important to bear in mind that the financial sector is specific, due to its dynamics and varying conditions. Therefore, it is extremely important to balance between the state interference and deregulation, and also be quick in reacting when the measures applied start showing their weaknesses or deficiencies.

Once the legislation, governing behaviour of financial market participants is in force, it is necessary that the state carry out its supervisory function by establishing independent regulatory authorities that will apply capital market regulations with integrity and independently from the executive arm of government, in a consistent way.

Therefore, let us remind of the inception period of the first Commission – capital market regulator, and the then situation in the market, which was ripe for reforms. Before the Wall Street Crash[1] in 1929, the financial market state regulations practically did not even exist. In the period immediately following the First World War, at the time when the securities related activities were on the rise, all the attempts at introducing financial disclosure and preventing frauds involving securities were not taken seriously. After the Stock Market Crash of 1929, public confidence in the market fell sharply, with a far-reaching effect. One of the ramifications of the Great Depression[2] was that retail and institutional investors, including banks, lost large sums of money. In this situation, in order for the economy to recover, it was necessary to restore confidence in the capital market. Thus, the first securities commission was formed in the USA in 1934, with an aim to regain confidence in the capital market, providing investors and the market itself with more reliable information and straightforward rules. The main task of such newly-founded commission was to enforce the newly adopted regulations on the financial market, to promote stability and foremost – to safeguard investors. Moreover, the Glass-Steagall Act (The Banking Act, Pub. L. 73-66, 48 Stat. 162, enacted June 16, 1933) was adopted, introducing legislative reforms, in the wake of the Wall Street Crash of 1929. This act primarily separated the commercial from investment banking activities, and also established the Federal Deposit Insurance Corporation (FDIC). FDIC covers bank deposits, the deposit insurance coverage amount is set by the Act, requiring all banks insured by FDIC to be members of the Federal Reserve System. The introduction of this corporation was not only an attempt at restoring public confidence in banks, but also to facilitate the much needed flow of capital to banks, which were severely hit by the crisis and placed on the verge of bankruptcy. This is illustrated by the fact that only 6 months after the establishment of FDIC, in January 1934, the bank failures – characteristic of the early years of the Great Depression – came to a halt. Moreover, this piece of legislation contains a set of provisions governing prevention of speculative behaviour, especially speculative use of loans.

A similar conclusion was reached after the last global economic crisis that once more underscored the importance of the state and regulation in prevention of consequences and primarily averting new crises, by enacting laws and

[1] The Wall Street Crash of 1929 is also known as Black Tuesday and the Stock Market Crash of 1929.
[2] The Great Depression is the name used for the period of severe economic depression following the US Stock Market Crash of 1929.

stronger supervisory powers. In this respect, the states hit by the crisis introduced sweeping reforms.

One of the main directions the reforms took was to redefine the role of the state in the financial industry, abandoning the principle of deregulation, establishment of new regulatory authorities and the delegation of supervisory activities to the existing market regulators. Such concepts are to be found in all the countries that faced the great financial crisis, the end of which seems yet not to be seen. However, there is no general formula for overcoming or averting a crisis, especially bearing in mind the specific features of the financial system and the fact that different states have – in addition to differing degrees of development – different tradition of development of financial markets.

The key issue in adopting the new regulatory norms is determining the level at which the relations on the financial market should be governed by state regulations or left to the market competition and the principle of autonomy of the will of market participants. Obviously, the solution lies in finding the proper balance between the state regulation and the market. Over-regulation, of course, should be avoided because it slows down financial innovation and thereby undermines economic growth in the wider economy (Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25 February 2009). However, caution should be taken not to overburden market participants with regulations. Still, insufficient regulation also warrants caution, bearing in mind the example of the latest crisis – largely fuelled by insufficient regulation of the American financial system. It is of key importance that the enforcement of existing regulation, when adequate (or improving it, where necessary), and better supervision, can be as important as creating new regulation (Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25 February 2009).

The purpose of regulation of financial markets is in the creation of assumptions for safety and adherence to adequate standards, legal safety, transparency, fair competition, liquidity and low costs of transactions carried out in the financial market. In achieving these goals, it is necessary to balance them (for example, between the maximum transparency requirements and costs related to it), the understanding of the inherited and the existing degree of development of financial markets, with the simultaneous projecting and implementation of measures essential for attaining the standards of the World Trade Organization (WTO), European Union (EU), International Organization of Securities Commissions (IOSCO) and other relevant institutions in the area.

In the aftermath of the first wave of the financial crisis, many of the countries initiated legislative reforms aimed at abandoning the then prevailing principle of deregulation. The standpoint that a market should rest on its own regularities was abandoned and general legal reforms were initiated. As a result, it is evident even today that the degree of regulation has been significantly increased.

In addition, one of the main directions the reforms took was the establishment of new regulatory authorities and the delegation of supervisory activities to the existing market regulators. Namely, an efficient system of functioning of a capital market is based primarily on complying with the prescribed rules and procedures by the capital market and its participants, laying the foundations for building confidence in the capital market. In order to create such an environment, an independent capital market regulator is required to safeguard the integrity of the market itself. For this very reason, one of the key goals of capital market regulation is maintaining independence of the market regulator to ensure a fair, efficient and transparent capital market.

To create the foundations for the regulators to perform their primary function, it is necessary for them to hold a high level of political independence. This is primarily because of the specific and unique position regulators have on the capital market. Regulators oversee a sector which is the center of capital allocation in any society, and therefore attract avid interest of political centers of power and the industry itself as active or potential participants on the market.

The adequate level of independence of a regulator is necessary in order to deter any external pressures and lobbying. On the other hand, bearing in mind the competencies of a regulator, acquiring and strengthening independence will enable the regulator to perform all the activities within its remit.

The Dodd-Frank Act and the US Securities Commission

Maybe one of the most explicit examples of a state responding to the crisis with overregulation is the United States of America with the Dodd–Frank Act adopted on 21 July 2010 (The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, H.R. 4173). This Act introduced the most comprehensive changes in the US financial regulation since the regulatory reform that followed the Great Depression[3]. Four years after the great crash of the US stock exchange, the Banking Act, known as the Glass-Steagall Act was adopted. By comparison, it is 23 times shorter than the Dodd-Frank Act. The Dodd-Frank Act contains 1601 sections categorized in 16 titles, and requires that regulators create 243 rules, conduct 67 studies and issue 22 periodic reports. Only one section know as the Volcker Rule, is intended to restrict banks from making risky speculative investments, to reduce banks' ability to take excessive risks by restricting proprietary trading and investments in hedge funds and private equity, containing 383 questions and 1,420 sub-questions (The Economist, February 18-24, 2012, p. 8.). One of the main reasons for the

[3] The worldwide economic crisis that began 29 October 1929 with the US stock market crash.

adoption of this act was to ensure the stability of the financial market in its broad sense. With it, the American legislator tried to advance the regulatory process, enhance supervision over specific institutions and promote transparency in operations of financial intermediaries. The Dodd-Frank Act ended the "too big to fail" principle, also protecting the American taxpayer by ending bailouts. The provisions of this Act prevent banks from taking excessive risk, proprietary trading of banks is very limited, derivatives must be traded on stock exchanges and clearing and settlement is limited to clearing houses. These are only a few of the provisions of the Dodd-Frank Act reflecting its main goal – prevention of a new financial crisis.

The Act changes the regulatory infrastructure in force by introducing a large number of regulatory bodies, and by assigning additional competencies to the existing regulatory agencies.

The Dodd-Frank Act introduced, among others, the following new agencies:

- The Financial Stability Oversight Council (FSOC) – has broad authorities to identify and monitor excessive risks to the US financial system, to supervise the financial services market and issue general recommendations, to study bills and advise the Congress. FSOC has the authority to bring within the perimeter of prudential regulation any non-bank financial firm whose failure could be the source of systemic problems.
- The Office of Financial Research – provides administrative and technical support to FSOC.

The changes in powers and competencies affected almost all of the authorities that take part in the supervision of the financial system: Federal Deposit Insurance Corporation (FDIC), Securities and Exchange Commission (SEC), Office of the Comptroller of the Currency (OCC), Federal Reserve (the "Fed"), the Securities Investor Protection Corporation (SIPC), etc.

It is worth mentioning that in order to ensure that no firm is too big to fail, was the creation by Dodd-Frank of orderly liquidation authority. Under this authority, the FDIC can impose losses on a failed institution's shareholders and creditors and replace its management, while avoiding runs by short-term counterparties and preserving, to the degree feasible, the operations of sound, functioning parts of the firm.

When it comes to the SEC, the Dodd-Frank Act contains more than 90 provisions that require SEC rulemaking, and dozens of other provisions that give the SEC discretionary rulemaking authority. To date, the Commission has put in place a foundation for a framework that will support an entirely new regulatory regime designed to bring greater transparency and access to the securities-based swaps market, adopted rules that will result in increased oversight and transparency around hedge fund and other private fund advisers, gave investors a say-on-pay regarding executive compensation and established a whistleblower program which offers incentives for individuals with information regarding securities law violations to come forward. The SEC also has proposed a series of rules designed to improve the practices of credit rating agencies, including rules to limit the conflicts that may arise when NRSROs rely on client payments to drive profits and rules to monitor rating agency employees who move to new positions with rated entities.

The Dodd-Frank Act significantly reinforced and expanded the SEC powers, especially concerning its jurisdiction over hedge funds, credit rating agencies and governance of public companies. In order to enforce these powers in practice, the Act stipulates a comprehensive set of measures and options to be added to the already substantial range of SEC powers.

Law firm Gibson Dunn (http://www.gibsondunn.com/publications/pages/DoddFrankActReinforcesAndExpandsSECEnforcementPowers.aspx) points to the following changes and enhanced powers of the SEC, established by the Dodd-Frank Act:

1. New Rewards and Expanded Protection of Whistleblowers[4]

Whistleblowers who voluntarily provide information to the SEC that leads to a successful enforcement action resulting in over $1,000,000 of monetary sanctions may be awarded by the SEC an amount not less than 10% and not more than 30% of the monetary sanctions collected. The Act states that determination of the amount of the award shall be in the discretion of the SEC, taking into consideration the significance of the information provided, the degree of assistance provided, and the programmatic interest of the SEC in deterring violations of the securities laws by rewarding whistleblowers and other factors the SEC may establish (Sec. 922(a)).

2. Authority to Impose Administrative Fines on all Persons, not Merely Brokers, Investment Advisers etc.

The SEC first received broad authority to seek or impose civil money penalties in enforcement actions as a part of the Securities Remedies and Penny Stock Reform Act of 1990, perceiving that such quasi-criminal remedies should not be imposed on persons who did not voluntarily choose to subject themselves to the SEC's jurisdiction. The SEC's own authority to impose such remedies in administrative actions was limited to persons who were associated with regulated

[4] A "whistleblower" – any individual who provides, or two or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission. Sec 21F (a)(6).

enterprises - brokerage firms, investment advisers, investment companies and other registered entities. For all other persons, the SEC was required to seek an order from a federal district court in a civil action, triable by jury.

Dodd-Frank washes away this distinction and adopts the three-tiered penalty grid already contained in the Securities Exchange Act, but raises the penalty amounts by fifty percent.

In part, the new authority codifies existing regulatory practice and it could facilitate negotiated resolutions of SEC enforcement actions. Historically, the SEC has sought civil money penalties in most of its enforcement actions. With regard to settlements of matters regarding non-registered persons, it has frequently bifurcated its settled proceedings into two different proceedings – one an administrative action imposing prospective cease and desist orders and ancillary relief; the other a civil, district court action seeking only the imposition of a civil money penalty. Because many regulatory provisions of the securities laws, such as the reporting and internal control requirements imposed on public companies, are directly applicable only to issuers, the Commission had pursued its claims for civil penalties on a theory that an individual had "aided and abetted" the violation by the public company, a theory of violation that required allegations of scienter – either intentional or reckless misconduct. Now, persons seeking to settle actions can do so in one proceeding, and, if the settlement does not involve a claim of fraud, may do so in an administrative action asserting that the settling party was a "cause" of the violation, a claim which may be premised on negligence, rather than intentional or reckless misconduct.

On the other hand, this new authority also gives the SEC and its Enforcement Division a powerful incentive to bring more cases as administrative actions.

3. Broaden Standards for the Imposition of Secondary Liability

The SEC has long relied on theories of secondary liability to enforce the federal securities laws, particularly those provisions, such as the reporting and internal controls requirements applicable to public companies, and the rules governing brokerage firms and investment advisers that were not directly applicable to individuals. To apply these provisions to individuals, the Commission commonly filed complaints alleging that an individual "aided and abetted" the violation by a company.

The Dodd-Frank Act terminated such practice by stipulating that “aiding and abetting” which is "knowing or reckless" will be a basis for an action.

4. Extraterritorial Authorities

Bearing in mind that securities markets are increasingly global with multinational companies, Act conferred some extraterritorial authorities to the SEC and to the Public Company Accounting Oversight Board (PCAOB).

The Dodd-Frank Act which restored the authority of the SEC and of the Department of Justice and confer U.S. court jurisdiction over violations of the three anti-fraud provisions involving (i) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors, or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Also, the Act increased the authority of the Commission and the PCAOB to compel the production to them of audit work papers of foreign private accounting firms by making such firms subject to the jurisdiction of U.S. courts for purposes of enforcing such a request; requiring US registered public accounting firms to secure the agreement of any foreign accounting firm upon which it relies in its audit to produce the work papers of that firm, and making a failure to comply a violation of law. The Act permits a foreign public accounting firm to produce work papers through alternate means, such as through foreign securities regulators.

The Act adds confidentiality provisions that are intended to overcome objections by foreign authorities to inspections by the PCAOB and other US government data requests and permit the Commission to share documents with the PCAOB and other federal and state agencies without losing the protection from disclosure, to refuse to disclose privileged information obtained from foreign securities or law enforcement authorities, and also permits the PCAOB to share its data with foreign government regulators or authorities empowered by governments to regulate auditors.

5. Increase Collateral Consequences of Securities Law Violations

Historically, bars or limitations on association imposed under one provision of the securities laws, have not extended to association with another regulated entity registered under a different provision, such as investment advisers. The Dodd-Frank Act gives the SEC the authority to bar that person found to have violated one of the securities acts from associating with a range of SEC-regulated entities, and not just entities regulated by the specific title that was violated. Specifically, the Act permits the SEC to bar a violator from association with a "broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal adviser, or nationally recognized statistical rating organization" in each case.

6. Deadline for Completing Examinations, Inspections and Enforcement Actions

One recurring criticism of the SEC has been delay in the completion of enforcement investigations. The Act require the SEC staff to, within 180 days of providing a written Wells notification to any person, either file an action against such person or notify the Director of the Division of Enforcement of its intent not to file an action. This deadline can be extended for additional 180 day periods if the Director of the Division of Enforcement or a designee of the Director decides that it is necessary because of the complexity of the case and so notifies the Chairman of the SEC.

De Larosière Report

After the crisis spread in Europe, in November 2008, the European Commission mandated a High-Level Group chaired by Jacques de Larosière to make recommendations on how to strengthen European supervisory arrangements with a view to better protecting the citizen and rebuilding trust in the financial system. In its final report presented on 25 February 2009 (the 'de Larosière Report' - Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25. February 2009), which contains 31 recommendations, the High-Level Group recommended that the supervisory framework should be strengthened to reduce the risk and severity of future financial crises. It recommended reforms to the structure of supervision of the financial sector in the Union. The group also concluded that a European System of Financial Supervisors should be created, comprising three European Supervisory Authorities, one for the banking sector (EBA - European Banking Authority), one for the securities sector (ESMA – European Securities and Markets Authority) and one for the insurance and occupational pensions sector (EIOPA - European Insurance and Occupational Pensions Authority).

Even the "de Larosière Report" has pointed to the importance of supervision and sanctions imposed by supervisory authorities. It is emphasized in the introduction to the Report that „The Group believes that the world's monetary authorities and its regulatory and supervisory financial authorities can and must do much better in the future to reduce the chances of events like this happening again."

One of the causes of the crisis is found to be in the unregulated, or insufficiently regulated, mortgage lending and complex securitization financing techniques. Insufficient oversight over US government sponsored entities

(GSEs) like Fannie Mae and Freddie Mac and strong political pressure on these GSEs to promote home ownership for low-income households aggravated the situation. The whole Report points to the significance of regulation and especially supervision and primarily the strong supervisory and sanctioning regimes. A special chapter is dedicated to the Policy and Regulatory Repair (Chapter II), and the EU Supervisory Repair (Chapter III).

One of the recommendations in the report is that competent authorities in all Member States must have sufficient supervisory powers, including sanctions, to ensure the compliance of financial institutions with the applicable rules and that competent authorities should also be equipped with strong, equivalent and deterrent sanction regimes to counter all types of financial crime.

ESMA[5]

Based on the "de Larosière Report", and in response to the financial crisis, on 1 January 2011 ESMA replaced CESR.[6] Its establishment forms part of a wider initiative to overhaul the European financial regulatory system and establish the European System of Financial Supervision.

ESMA is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection. In particular, ESMA fosters supervisory convergence both amongst securities regulators and across financial sectors by working closely with the other European Supervisory Authorities.

As well as continuing the work that was formerly carried out by CESR (including, for example, monitoring market developments and issuing guidelines and recommendations on securities law issues), ESMA has new additional powers including enhanced enforcement powers and the power to draft new technical standards.

ESMA's work on securities legislation contributes to the development of a single rulebook in Europe. This serves two purposes: firstly, it ensures the consistent treatment of investors across the Union, enabling an adequate level of protection of investors through effective regulation and supervision; secondly, it promotes equal conditions of competition for financial service providers, as well as ensuring the effectiveness and cost efficiency of supervision for supervised companies. As part of its role in standard setting and reducing the scope of regulatory arbitrage, ESMA strengthens international supervisory co-operation. Where requested in European law, ESMA undertakes the supervision of certain entities with pan-European reach.

[5] The European Securities Markets Agency
[6] The Committee of European Securities Regulators

Finally, ESMA also contributes to the financial stability of the European Union, in the short, medium and long-term, through its contribution to the work of the European Systemic Risk Board, which identifies potential risks to the financial system and provides advice to diminish possible threats to the financial stability of the Union. ESMA is also responsible for coordinating actions of securities supervisors or adopting emergency measures when a crisis arises.

IOSCO[7]

In response to the crisis, IOSCO revised its Objectives and Principles, namely they added eight new principles.

IOSCO's Objectives and Principles were adopted in response to the Asian financial crisis in 1998, with an aim to establish a framework for regulation of securities markets, market intermediaries, issuers and investment schemes. IOSCO Principles deal with investor protection, providing conditions for fair, efficient and transparent markets and the reduction of systemic risk. Thirty-eight IOSCO principles are grouped into nine categories: regulators, self-regulation, securities regulation enforcement, cooperation in regulation, issuers, auditors, credit rating agencies and other information providers, collective investment schemes, market intermediaries and secondary markets. More than ten years after adoption, in June 2010, IOSCO added some new principles as a response to the new, but this time global financial crisis:

Principle 6 – The regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to a mandate;

Principle 7 - The regulator should have or contribute to a process to review the perimeter of regulation regularly;

Principle 27 – Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme;

Principle 28 - Regulation should ensure that hedge funds and/or hedge fund managers/advisers are subject to appropriate oversight;

Principle 30 – There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risk that the intermediaries undertake;

Principle 32 – There should be procedures for dealing with failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk;

Principle 37 – Regulation should aim to ensure the proper management of large exposures, default risk and market disruption;

[7] International Organization of Securities Regulators

> Principle 38 – Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

In addition to the revised Objectives and Principles, in February 2011, IOSCO also published a document entitled: Mitigating Systemic Risk: A Role for Securities Regulators. This document warns that the securities regulation has traditionally focused on disclosure and business conduct oversight instead of systemic risk. The IOSCO paper analyzed the sources and transmission of systemic risks as coming from size, interconnectedness, lack of substitutes and concentration, lack of transparency, leverage, market participant behaviour, and information asymmetry and moral hazard. The Technical Committee urged regulators to be mindful of regulatory gaps and explained how these gaps can contribute to the build-up of systemic risk. Most notably, exemptions for particular market elements from regulatory oversight and the policy considerations underlying these exemptions should be considered and evaluated on an ongoing basis. Similarly, regulators should address gaps that arise from activities that are currently lightly regulated, as well as new market activities for which there are not yet regulatory responses. To address regulatory gaps arising outside of its jurisdiction, a securities regulator should conduct regular reviews of the perimeter of its regulation, coordinate with other regulators who do have the supervisory authority, and cooperate with international regulators. This analysis might seem very general, but it pinpoints several of the causes of the financial meltdown: the failure to regulate swaps and credit derivatives; the failure to regulate mortgage brokers; the failure to regulate hedge funds or credit rating agencies; the inadequate regulation of securitized products; and U.S. Securities and Exchange Commission exemptions for sophisticated investors.

The IOSCO paper on mitigating systemic risk explains the tools available to securities regulators that can reinforce the stability of the financial system. These tools are "transparency and disclosure; business conduct oversight; organizational, prudential and governance requirements; prevention of risk transmission" through rules regarding trading infrastructure; and "emergency powers." In addition, IOSCO, as an international body of regulators, stressed "intra-jurisdictional communication and exchange of information among regulators about systemic risk to help prevent the emergence of gaps in oversight and identify possible transfers of risk or cross-sectoral risks." Regulators were asked to leverage the work of other regulators and call on self-regulatory organizations to help, when applicable. On the international level, securities regulators were encouraged to continue their collaboration "through IOSCO to improve transparency and disclosure in various international securities markets" and "be active participants in international supervisory colleges" (Mitigating Systemic Risk: A Role for Securities Regulators).

The first IOSCO general meeting after the financial crisis entered its second phase in September 2008 was held in Tel Aviv, in June 2009. Ms Jane Diplock, the then Chairman of the Executive Committee said at the meeting:

"Now more than ever, IOSCO must work towards reaffirming and building confidence in the world's financial markets, and explore new mechanisms for doing that. Some constants remain of course: reducing systemic risk; encouraging efficient, well-functioning markets; and continuing to protect investors. There essentials are the heart of our mission and always will be.

We need to understand what direction to take in order to reaffirm IOSCO`s pivotal role in the international financial architecture. To do that, we must take account of the lessons every country represented here has learned from the crisis. We need to focus more on identifying risks in financial markets and addressing stability issues within the purview of securities regulators. Recent work on credit rating agencies and hedge funds are good examples of this focus.

While recovery now seems inevitable, challenges remain. The ongoing crisis highlights the importance of addressing stability concerns and reducing systemic risk while continuing to protect investors and promote the fairness, efficiency and transparency of markets."

Serbia

When it comes to Serbia, it can be said that a response to the crisis came not earlier than 2011, when a package of new laws was adopted to govern the financial market: A new Law on the Capital Market (Official Gazette of RS, No 31/2011) was adopted, Law on Takeovers (The Law amending the Law on Takeovers of Joint Stock Companies, Official Gazette of RS, No 99/2011) and the Law on Investment Funds (The Law amending the Law on Investment Funds, Official Gazette of RS, No 31/2011) were amended. However, it should be noted that the laws were adopted also because of complying with Serbia's obligation to harmonize the national legislation with the acquis communautaire in the process of EU integration.

The fundamental goal of the Law on the Capital Market (the Law) is to ensure protection of investors and a fair, efficient and transparent capital market. These are the objectives which are enforced through a series of provisions, among which there are increased capital requirements for licensed participants and significantly wider content of prospectuses. Moreover, the Law has also introduced a new institution on the capital market of the Republic of Serbia - the Investor Protection Fund. By establishment of the Investor Protection Fund the client cash claims and financial instrument claims are protected to the maximum amount of EUR 20,000 per client. The introduction of the Investor Protection Fund represents, in addition to the harmonization with the European acquis, undoubtedly a leap forward towards greater investor protection and decreasing the systemic risks in the market. Also, with the introduction of mandatory membership for licensed participants in the financial market, the Law has created legal prerequisites for more responsible and sound operations of all participants. These provisions clearly show that the legislator is trying to restore confidence in the capital market and create conditions for safer conduct of business on our market.

There is no safety in the capital market without paying special attention to supervision. The efficient system of functioning of the capital market is based on complying with the prescribed rules and procedures. In this respect, the Law on the Capital Market significantly reinforced the powers of the Securities Commission, expanding the list of supervised entities and procedures and introducing risk based supervision. Moreover, the law significantly expands measures the Commission imposes in supervisory procedures, ensuring better and more efficient implementation of the necessary activities and contributing to the preservation of the Commission integrity as a supervisory authority. In this respect, the Commission may, independently of other imposed measures declare, a fine to a supervised entity, as well as to a member of the board of directors. A relatively wide range for levying a fine was prescribed, the Commission imposes a fine on the supervised entity which cannot be less than 1% or higher than 5% of the minimum capital, the supervised entity's capital, according to the last financial statement, and it cannot be lower than one salary nor higher than the total of twelve salaries the general manager or a director received in the period of twelve months preceding the day of adopting such decision. Bearing in mind that the Law prescribes the minimum capital of the investment firm amounting to EUR 125,000, the fine cannot be lower than EUR 1,250. In this way, in some situations, sanctions are being more adapted to their purpose and to the effects intended to be achieved by the sanction.

The Law introduces three new criminal offenses: market manipulation, the use, disclosure and recommendation of inside information and unauthorized provision of investment services. Very strict prison sentences and fines are stipulated for the violators. These are the preconditions for introducing orderly functioning of the capital market in Serbia, as sanctions have a strong deterrent effect.

The Securities Commission of the Republic of Serbia was established on 16 February 1990. From the inception of the Securities Commission to the day, the state of the financial market has changed considerably, as well as the importance and the role of the regulator. It is noteworthy, that the Securities Commission became an ordinary member of the International Organization of Securities Commissions (IOSCO) in May 2002, and a full signatory to the IOSCO Multilateral Memorandum of Understanding (MMoU), on 22 October 2009.

In this way, the Securities Commission has been validated as the regulator of the Serbian capital market that adheres to the rules and principles of the highest standard. To sum up the previous considerations about the Serbian market, it can be said that, maybe a little belatedly, we have obtained a modern law of good quality which not just declares for, but essentially contributes to better investor protection, providing conditions for a fair, efficient and transparent capital market and reducing systemic risk in the market. It certainly is necessary, but not the only precondition for the development of the Serbian financial market and tackling the current economic crisis.

Conclusion

Clearly, there are sound economic reasons that a state should play an active role in its financial system, but there are some very practical indicators showing that the state often does not interfere successfully, and that its capacities to balance the right measure and form of interference oscillate with time. Such insights tell us how complex it is to operate a successful financial policy. When determining the scope and direction of such policy, it is extremely important to take into consideration the experience obtained from seeing the consequences of different reactions of states to the challenges posed by the crisis of financial markets. They indicate that promoting healthy competition, but only paired with strong supervision by independent competent authorities could boost efficiency and provide grounds for the creation of sustainable economic development, without undermining stability at the same time.

The global economic crisis has given the best example of importance of the strong and comprehensive supervision over participants, procedures and institutions on the capital market. Many of the scientists studying the global economic crisis deducted that tightened supervision might be of the same importance as creation of the new regulations itself.

As a result, in the subsequent period, Serbia and other countries affected by the economic crisis as well are to restore confidence in the financial system, so that the capital could start returning to the financial market, and this takes much more than a sound piece of legislation which can only be a good start point.

John D. Rockefeller said that “these are days when many are discouraged. In the 93 years of my life, depressions have come and gone. Prosperity has always returned and will again.”

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ULOGA REGULATORA TRŽIŠTA KAPITALA U KONTEKSTU GLOBALNE FINANSIJSKE KRIZE

Rezime: *Finansijski sektor nacionalne ekonomije je jedan od glavnih zamajaca ekonomskog razvoja zemlje i suštinski važan faktor njene ukupne ekonomske stabilnosti. Međutim, kada je izložen neodgovarajućoj regulativi, nestabilnom tržištu i nedovoljno razvijenim institucijama, finansijski sektor, može postati glavni uzrok finansijskih kriza i jedan od bitnih faktora destabilizacije nacionalnih ekonomija u celini. Sa nastupanjem globalne finansijske krize, postalo je jasno da je neophodna jača uloga države i njenih institucija kako bi se na efikasniji način kontrolisali uočeni unutrašnji nedostaci samog tržišta. Nakon početnog talasa krize, mnoge države su započele zakonodavne reforme, usmerene pre svega u pravcu napuštanja do tada gotovo opšteusvojenog principa finansijske deregulacije. Jedan od glavnih pravaca u tim reformama bilo je formiranje novih nezavisnih regulatornih tela, kao i davanje pojačanih nadzornih ovlašćenja postojećim tržišnim regulatorima.*

Ključne reči: *finansijska kriza, finansijska tržišta, regulatori na tržištu kapitala, regulacija, post krizne reforme*