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MS. LEONG: Welcome to Capital Ideas 2009. I want to thank you all for taking time from your busy schedules to be with us this morning. On behalf of the British Columbia Securities Commission, I would like to express my sincere appreciation to the panellists for travelling near and far to participate in this important discussion.

Our panellists come from Vancouver, New York and Madrid. I am, as I'm sure you are, looking forward to a lively and informative discussion about the many challenges facing our capital markets.

The theme of today's conference is how regulators should respond to the international credit market crisis and its fallout on our broader capital markets. It's a topic that's widely debated and discussed in many circles, both here in Canada and abroad.

Knowing what we have learned over the past couple of years, there are loud cries for systemic risk regulation. But who should be responsible for that? Some say we need a super single financial system risk regulator. Others say maybe the responsible regulators need to do a better job of identifying and managing risks. Financial regulators are debating and grappling with these difficult issues around transparency, disclosure and how to measure fair value, particularly in volatile markets.

So to set the stage for today's discussion, it's worth reminding ourselves of some key events that happened over the last couple of years. By early summer of 2007, the U.S. sub-prime market was showing serious signs of increasing defaults. This triggered the collapse in the value of many securitized products and, in the case of non-ABCP in Canada, a freeze-up of the market in August of 2007.

Banks worldwide started to report write-downs and credit losses related to residential mortgage holdings, securitizations and leveraged loans. In March 2008, J.P. Morgan acquired Bear Stearns for $2.00 a share. In the course of two months, starting September 2008, historic events happened in rapid succession. Fannie Mae and Freddie Mac was taken

over by the U.S. government. Lehman Brothers filed for bankruptcy, the largest bankruptcy in U.S. history. The next day, the U.S. Federal Reserve announced an $85 billion rescue package for insurer AIG. The U.S. Treasury Department issued a temporary guarantee on money market fund holdings.

The U.S. and the U.K. rescued key banks such as Citigroup, Bank of America, RBS and Lloyds. Central banks made a historic coordinated rate cut on October 8th of 2008. Inter-bank lending rates spiked sharply after the Lehmann bankruptcy and peaked the day of the G7 finance ministers' meeting in October.

We are all still recovering from that rollercoaster ride. While we see some positive effects coming from the government's stimulus packages, we know that economic growth will continue to be slow in most of the world over the next year. Investors have been hit hard by the loss in the value of their investments and they continue to be wary of the markets and, for some, they may have difficulty fully recovering.

So the financial turmoil has called into question a number of practices in some major areas of the market. On a global level, we learned that banks were reducing their capital requirements by offloading credit risk to third parties that were not able to meet all of their commitments. Credit rating agencies gave AAA ratings to complex and opaque sub-prime loan securitizations. The consequence? Investors did not know what they owned when the ABCP market froze up. Losses from abusive business risks undertaken has translated into taxpayer losses as firms thought too big to fail were rescued by American and European governments.

This leads to the question about how regulators should respond to what has happened. Today we will hear from our panellists about the lessons learned and their views on whether we need more regulations or systemic-wide changes to deal with the failings that caused the financial crisis. On the other hand, perhaps rather than focusing on what has already

happened, we should look at ways to better identify developing risks and work collectively to minimize unintended consequences.

In Canada, as regulators, we need to be asking whether we should adopt all of the reforms being agreed to in the G-20 summits and by global regulators in IOSCO or whether we should adopt a Canadian-made solution to the problems that most plagued our financial markets. These are all good questions that our panellists will undoubtedly have views on.

Now, I'm pleased to introduce our moderator for this morning, Ian Hanomansing. Ian has skilfully guided us through three years of Capital Ideas and I'm absolutely delighted that he agreed to continue on in that role. Ian has a wealth of experience as a journalist and, for most of you here, I'm sure you all know him as the host of CBC News. You will undoubtedly remember his coverage of the Beijing Summer Olympics and, for all of us Vancouverites, we'd be very proud to have Ian cover the Vancouver 2010 Olympics.

Please welcome Ian Hanomansing.

MR. HANOMANSING: Good morning, everybody. So it's my pleasure to once again be moderating this panel. My role once we get started really is going to be not to be speaking very much and really playing the role of a traffic cop and hearing from our four panellists. I invite all four of you to come up now. I had the pleasure last night at dinner and again this morning at breakfast to hear all four of them speak. Some of them perhaps you haven't heard from yet, but as you can imagine, they have a lot of interesting things to say.

The resumés of each of our four panellists are in the program that you've either seen now or will see throughout the course of the morning so I invite you to look through those. As you can imagine, all four of these panellists have very distinguished resumés. When I call on them to answer the first question, I'll ask them also to begin with maybe a sentence or two about who they are and what about them is germane to this conversation.

As I mentioned, we'll have six areas of discussion. I'm sure there will be some overlap, but we'll try to focus on each of those in their segment, questions at the end of each of those, and after the first three, we'll have a break of about a half an hour and then come back for the last three.

Greg, you get the honour of being the first -- and challenge, I guess -- of our panellists to speak. You're the head of IOSCO. You are the former head of Consumer Protection and International at ASIC in Australia. Lot of acronyms I've learned, and so I'll work through those. It's like the military, the financial world, in terms of acronyms. And so let's start with you for a global prospective on systemic risk. What is it, and what's unique about it and why is there so much discussion about adding systemic risk as a mandate for financial regulators.

MR. TANZER: Thanks, Ian. I suspect that the reason that I've been asked to speak first is that I'm the guy with the funny accent on the panel. For some of you who have travelled widely, you might recognize my accent as from Australia. Many people who come across Australians for the first time are somewhat surprised to learn that English is, in fact, our first language, because we tend to mangle the language so badly. So I hope that you can understand me.

I am, to take Ian's military analogy a little further, I am the generalissimo of IOSCO. I'm the Secretary-General of the International Organization of Securities Commissions, which is an international grouping of commissions just like the B.C. Securities Commission from all over the world, from over 110 jurisdictions.

Most recently, our work has been very much focused on trying to improve standards of regulation, specifically in the securities regulation field rather than banking and insurance, specifically on securities markets, but looking at ways that we can improve regulation to try to help deal with this crisis.

Ian, as you mentioned in the question, one of the key issues here has been about systemic risk. And I guess when we normally think of systemic risk we think of the failure of an institution, typically a banking or insurance institution that feeds through to be a problem, not just for that institution and not just for shareholders and employees of that particular firm, but feeds through into the whole of the financial system because of the inter-linkages between these institutions and/or the size of the particular institution involved. That has been very firmly part of our regulatory framework and thinking, especially for banks and insurance companies, and it's very much part of the role and mandate of national and international banking regulators and, indeed, central banks.

From an IOSCO perspective, I guess what we've been working a lot on over the last little while is - particularly in light of this current crisis - what's the role of markets in transmitting systemic risk? What's the appropriate role for securities regulators in attempting to mitigate or manage systemic risk?

Now, there's parts of the regulatory framework for which securities regulators are clearly responsible which do pose potential systemic risks in the traditional sense of that. I'm thinking of things like clearing houses, for example, which perform a key role in making sure that securities transactions are cleared and settled in a sensible way. But beyond that, I think we also need to think about the role that market transparency and business conduct rules can play in assuring that systemic risks are recognized and are mitigated.

And just the last point I'll make at this point is that I think we also need to think more generally when we're thinking about systemic risk about what we're really trying to do here, because I think it's very easy to understand that, in light of the huge cash injections and the disruption to everybody's sort of ordinary lives, and particularly to our long-term wealth that we're feeling, right at the moment -- especially if you're close to pension age, you're feeling that very, very deeply and that's important --it's easy to think of systemic risk as something that we need to remove risk from the financial sector. I think most people in this audience,

or people who are involved in finance, understand that really there is no finance without some risk. So, the issue is actually how you appropriately manage risk rather than removing it altogether.

I'll just pause here.

MR. HANOMANSING: Sure, thank you. Let's turn to Malcolm, now. You're the Vice-Chairman of Deutsche Bank. You were the head of the Bank for International Settlements and Deputy Governor of the Bank of Canada. From a government and corporate viewpoint, you've seen it from both sides of that fence. What issues arise as governments name specific institutions as contributors to systemic risk?

MR. KNIGHT: Well, I think that's a very interesting question, Ian. As you've said, I've had experience in the public sector as CEO of the Bank for International Settlements which is, of course, in Basel, Switzerland, the central banker's bank. I'm very glad to be back in the mountains here today. I'm not going to try to emulate a Swiss accent, but it's very good to be here. I've also had some experience in the past as Senior Deputy Governor of the Bank of Canada on the monetary policy side.

So this issue of systemic risk I think is very important. I'd like to say first that one of the things that this crisis really showed us is that private market participants have difficulty recognizing and pricing systemic-wide risks. We didn't see it in the market-based measures. And even when they see system-wide risks, it's actually not so easy for the private sector to adjust to system-wide risk because if you're a good CEO and you see it coming and you build a war chest and nobody else does, you may be out before you get a chance to prove that you were right.

So this is what we call an externality in economics. It's an area where there is a rationale for regulatory intervention to identify systemic risk and then mitigate it. Two key jurisdictions, the European Union and the U.S. have, in their proposals, policy proposals --

the Obama White Paper, June the 17th of this year and the European Commission proposals for the reform of financial regulation in the European Union -- have called for a systemic-risk regulator. As you say, this is going to be -- and as Greg said, this is a major issue.

I believe it's important that there is a government agency that has the job of identifying systemic risk and mitigating it when it sees it happening, but that is not going to be an easy job. This is a new -- really a new recognition of a responsibility in an individual government agency. It's difficult to recognize risks and so there are going to be some major challenges here.

I think that there are really challenges on two sides. Identifying institutions as systemically important is going to be politically and economically a challenging job, particularly if the institutions that are judged to be systemically important are subjected to more rigorous regulatory requirements, higher capital and liquidity ratios and so on. There's going to be a lot of pushback from the industry, and of course there's going to be the possibility of intervention, or even one might say meddling, from governments as well.

So this agency will have to be clearly professional. It'll have to be in some sense non-political. It will have to be independent both of regulatory capture by the private sector and of meddling by the government, but it will have to be accountable for its decisions. This is going to be a huge challenge. It needs to be done, but it isn't going to be easy. Thank you.

MR. HANOMANSING: In Brenda's introduction, she talked about institutions that are perceived as being too big to fail. And, Doug, let's bring you into this now, and based on your experiences as a securities regulator for more than 22 years -- your current position as Chair and CEO of the Canadian Securities Transition Office. How do you feel about an institution being too big to fail?

MR. HYNDMAN: Well, thanks, Ian. I won't spend a lot of time talking about my history since most of the people in the room have seen me in a different role at these types of

conferences. But I did have 22 years at the BCSC and I'm now looking at things from a national perspective.

I'm also an economist by education, so I tend to look at things from an economic perspective. When I hear things like "too big to fail", in talking about private sector entities, it does cause me concern because I think business failure is a very important discipline in a market economy. Failure of an enterprise is the way that the market responds to institutions that take inappropriate risks. It allows assets to be redeployed and industry to move on.

If you end up with a situation where an institution knows or expects that the government will bail it out if it takes an imprudent risk and gets itself in too deep, and if its shareholders have that view and its customers have that view, that essentially blunts the market discipline that causes people to shy away from institutions that are over-reaching and thereby reins them in. If we're going to do that, if we're going to send out the signal that some institutions are too big to fail, we need something else. Malcolm talked about regulation or some way of replacing the market discipline.

Governments do have legitimate concerns that if big institutions that have multiple linkages throughout the financial sector fail, that the knock-on effects will cause the kind of thing that we saw when Lehman Brothers went down.

My view is that we shouldn't be guaranteeing perpetual life to these institutions but should be structuring things in a way that they can fail without causing that much damage and I don't think that's easy to do either, but certainly just a guaranteed life (government guarantee) is a formula for increasing risk in the system if it's not managed properly.

MS. WALTERS: Both of you seem to have taken the view that there are -- or we can't do anything about "institutions too big to fail", so one of the questions that I would ask you is certainly larger institutions have synergies from size, but is -- would one aspect of regulation be that you don't allow companies to get to the point where they're too big to fail?

That if we can have regulations that prevent anti-trust situations, shouldn't we look at regulation that would prevent institutions from reaching the point where individually they present systemic risk?

MR. KNIGHT: Can I just come in there? I certainly never said that I believe that institutions should be treated as too big to fail. I think the practice, actually, of regulators - particularly in the United States - really right from the failure -- the situation with Continental Illinois in 1982 was that in practice, institutions were too big to fail.

"Too big to fail" is just a catch-all. We have institutions that are too big to fail under current regulatory systems, too inter-connected to fail. No one would have said the Northern Rock or even Lehman Brothers was really too big to fail. They were too inter-connected to be allowed to fail under the existing regulatory system.

We have to have a new regulatory system where institutions can fail without bringing the financial system down with them, without impairing other institutions that would otherwise be healthy. This is a major challenge, which has to be addressed in a number of dimensions, not just the systemic regulator but also building up the structure of the securities markets.

MR. HANOMANSING: Does anybody else want to jump in?

MR. HYNDMAN: Yeah, no, I don't disagree with any of that. I mean, I think we do need a process that allows a more orderly failure and managing the inter-connectedness and the counter-party risks and so forth. I don't pretend that that's an easy thing to do.

I would be reluctant to say that government or regulators would artificially prevent institutions from growing too big. Anti-trust, yes, but that's a competition policy. Obviously if competition is substantially lessened, there's a role for anti-trust, but purely

size? I don't think so, because I think that creates other kinds of inappropriate incentives in the market if you start artificially doing that.

Companies should be allowed to grow to an economic size that works for the sector that they're in, and I think, over time, technology dictates different sizes as being optimal. I wouldn't want to muck around with that too much.

MR. TANZER: I must say, just to add to the point, I think you make a very good point. One of the difficulties right at the moment is just about everything is going to be seen as too big to fail. No one wants to see anything fail at the moment.

I can remember when Bear Stearns first was dissolved and then when Lehmans was dissolved, there was a lot of commentary saying, well, that was a good thing because it was showing that, yes, institutions can fail and there can be sort of an orderly workout. There's a lot of criticism now of the authorities for allowing Lehmans, in particular, to fail and Malcolm used a great example in Northern Rock too. I don't think anyone would suggest that systemically, by itself, it was too big. But the issue was really that the failure of that firm had a substantial impact on investor and public confidence and, more particularly, on business confidence and banking confidence. That led to a lot of problems.

MR. HANOMANSING: How did they do?

MS. WALTERS: I think they did pretty well. I probably should say who is this woman? My name is Pat Walters and I am -- effectively I'm an investor advocate and most of my career has been advocating for improved market transparency through financial reporting, and currently, I bring that particular perspective when I teach people accounting, either at the university -- people who are going to be either preparers or auditors, it's nice for them to know what an investor might actually want from their financial statements, or when I do workshop for executives on international reporting standards. So that's who I am.

Sometimes I'm going to ask a question - it just happens to be my nature - that I don't necessarily agree with what it seems like I'm presenting out there, but I just like to be a contrarian in that sense, stir things up a little bit.

I would like to ask another question, because institutions are sort of separate, right, corporate persons, but they're run by people. So what to extent do you think a firm that becomes a systemic risk and comes under this umbrella "too big to fail", whatever that means, to what extent should it continue to be managed by the people who caused it to get into that situation in the first place, fully knowing that not everybody in a firm is responsible for the decision of top management or certain departments, but to what extent do you think regulators should be involved in those kinds of decisions when a company reaches, like AIG, for example, reaches that place in life where we want the firm to continue, but somehow something internally needs to shift.

MR. HYNDMAN: My first answer would be that if there's a business failure with no misconduct in the legal or regulatory sense, then it's really up to the owners of the business, the shareholders and the Board of Directors, to decide whether to get rid of management if it's their fault and replace them with new management.

If there's misconduct in the sense of inappropriate disclosure or inappropriate use of corporate assets, then I think there's a role for regulators to get in and take disciplinary action not only against the company, but against the individuals running it. We probably have, in the past, been more reluctant than we should be to do that.

MR. HANOMANSING: I do encourage you to jump in and ask questions, and even if you don't necessarily agree with the point of view expressed in the question -- and of course you'll have a chance to ask some questions as well. But before we take that first break, let's pick up a few more of the threads on the systemic risk part of the discussion.

Nick Le Pan, who is the former head of the Office of Superintendent of Financial Institutions - he's the current Chair of the Canadian Public Accountability Board - wrote on the issue of systemic risk last month, and the C.D. Howe Institute commentary entitled "Look Before You Leap, a sceptical view of proposals to meld macro and micro prudential regulation." Just rolls off the tongue, that title.

He says [as read]:

The federal government should not extend a safety and soundness mandate to the shadow-banking system.

So, Greg, do you agree? Should banking style prudential regulations apply to these types of institutions?

MR. TANZER: Actually, I don't agree with him. I think it's difficult to resist the conclusion that we should extend regulation into the shadow-banking system. But I need to explain a little bit what that means.

Shadow banking can mean all sorts of things. I mean when you hear it, you think of something that's a group of shadowy grey-looking figures

I think that often when we talk about the shadow-banking system, there are things that actually are within the banking system, but the bank was treating it as kind of off its books. So there are instruments that banks -- or activities that banks -- as regulated institutions were getting into, that, for whatever reason, were treated as unregulated activities or unregulated products or whatever. I think it's very hard to resist the conclusion that if this is happening within the bank structure as a whole, it's difficult to see how you kind of compartmentalize that and say, well, that's outside regulation and this is the stuff that's in.

I think that is a change,. Part of prudential regulation has been about ring-fencing. There's certain things that we're protecting and really worried about, and there's certain

things that are not. But I kind of sense at the moment that the institution and the name of the institution is so important from a public confidence point of view that it's really difficult to make those sorts of distinctions, especially when you're talking about a large institution, and expect people, the public investors and politicians to kind of understand or accept that.

Then there are other parts. Sometimes people talk about the shadow-banking system being entities that do things a little bit like banks, and that gets really murky because then you get in the very difficult questions of definition.

A hedge fund, for example - it's hard to define them to start with - but if you start with a hedge fund, a hedge fund typically is not a bank. A hedge fund typically does not take deposits. It doesn't make any guarantee about holding your deposits and returning them. Typically they're not connected to the payment system. I mean there's a whole range of things that make them different from a bank.

But a hedge fund can assume systemic importance these days, I think. Firstly, they can get really, really big, or collectively, as a group of private pools of capital, they can get really, really big. They can become systemically important players in particular markets. They might be the key market maker in a key credit default derivative or something of that nature which makes them important by themselves.

I think acting collectively, a group of funds can adopt strategies or tactics which are aimed at making a profit, but can cause certain distortions or asset bubbles to grow that we need to think a little bit about. Now, how exactly you would do that is another question, but I think that we need to think of this problem of systemic risk and what we need to think about as the sources of risk as being a little bit broader than just traditional banking and insurance activity these days.

MR. HANOMANSING: Thanks. I'm going to jump ahead a little bit in our program and, Doug, go to you. In that paper by Nick Le Pan, he refers to a tongue-in-cheek commentary,

saying that the trouble with early warning is that it's early and it's only a warning. What ability do regulators have to act when they see a risk like an asset bubble?

MR. HYNDMAN: Well, in order to act in a situation like that, you have to not only see the bubble, but you have to figure out what to do about it. These things are always a lot easier to see in retrospect than they are at the time. At the time the bubble is building up, you're getting all kinds of signals from the market of things going on, and the things that later on look blindingly obvious are buried in a lot of different data and conflicting signals. So, saying that you can spot a bubble and deal with it is much easier said than done.

But even when you're pretty sure as a regulator that there is a bubble or market irrationality or whatever you want to call it, it's not always immediately obvious how you should deal with this, and I guess the example I hark back to is the tech bubble in late '90s, early 2000s when certainly our view at the time was these technology stocks have gotten way out of line with reality. The valuations just didn't make any sense.

Of course, the joke I used to make was that here you've got a company with no sales and no assets and it has a market value bigger than General Motors -- maybe that's not the right comparison anymore. Everybody has a market value bigger than General Motors.

But the point is that the value should be based on an expected stream of future earnings and a lot of these companies, there was no indication where any future earnings might come from, and yet they had market values of billions of dollars. We can say that, but as a regulator what do you do about it?

Certainly as a securities regulator, we can do some investor education to try and warn people that they should look at the fundamentals before investing in these things. That doesn't seem to have a macro-economic effect in deflating a bubble. I suppose you could run in and say, well, we're going to stop trading in these things because we think they're out of line, but that's a pretty dangerous path for a regulator to get on. There are lots of people

who seem respectable and intelligent who would argue the contrary and say, no, these make sense.

I think as securities regulators participating in discussions among a group of regulators, probably the best we can do is identify those kinds of situations and bring them to the attention of the fiscal and monetary authorities who are really the ones that are in the position to do something about it, to deflate a bubble, to take the pressure off, and I guess I hark back to when I was studying economics. There was a saying that the job of a central banker was to take away the punch bowl just when the party started to get going.

I think the last couple of cycles, the central bankers may be -- particularly the Federal Reserve -- kind of forgot that lesson and didn't take away the punch bowl. Again, it's tricky for them to manage because they're seeing conflicting signals. Nobody likes a spoilsport who takes away the bunch bowl, but it is something that we have to have more discipline and we have to deal with these bubbles when they get out of line.

MR. HANOMANSING: All right. Pat, what do you think about a regulator's ability to act when they see risk?

MS. WALTERS: Well, I think there's two aspects to that question. One is do they have the authority to act? And I think often if it hasn't been an issue in the past, they may not have the authority and hence they have to go to the politicians to get the authority with all that that entails.

And then even if they do have the authority, I think some of the issues that Doug brought up come into play is to what extent should the regulator say, "I know better than 'the market mechanism'." Now, obviously there are certain circumstances where that's true. The point is, can you almost market-time it in intervention? I mean that really is what the intervention is. It's a timing issue. Do I do it too soon and hence nobody really knows

whether the intervention was necessary or not? Or do I wait too late, where whatever intervention I take can't be enough, can't correct the mechanism?

I do think there's another constraint that regulators have. Maybe there's two constraints, one that sort of came up from what Doug was saying. The first is they don't necessarily have the resources to do the work that's necessary to identify the problems. I'd like to sort of contrast that with the Central Intelligence Agency in the U.S. has a whole raft of people who are analyzing data trying to determine where the next problem is going to arise. They have the money to do that and they have the people who get the training.

I'm not sure it's the regulators themselves, but certainly the politicians that create the regulator needs to understand that if the regulator is going to be effective, they need to have the right people and they need to have enough of them with enough knowledge about the way the market works to do that kind of grunt-level work to identify the problems.

So if you think about why didn't, say, the U.S. Securities and Exchange Commission catch some of the major problems recently, I think part of the problem was that the people that they have available to them don't have the level of knowledge about the market that they would have needed to know, to understand what the companies were doing or the individuals were doing. They may not even have the ability to go to their boss and say, look, I don't really understand this. The simple fact of not understanding it could be an indication that some intervention might be appropriate.

So I think resources for -- setting up a regulator is great, but if you don't give it the resources necessary to do its job, then it's just window dressing, in my view.

The other thing that I wanted to say has to do with when should the regulator start talking to the general public, and would they get a spot on Ian's nightly program? Because regulators are usually not thought of as sexy enough potentially to be on the six o'clock

news to sort of give their views in a way that gets communicated to a wide variety of people.

We're certainly going to have people from Bloomberg, and you're going to have people from the major investment banks are all going to get on the news. But when was the last time you actually [saw] somebody from a securities commission be asked about a particular issue in the market. Part of it has to do that they are going to be the spoilsports; otherwise you wouldn't be inviting them, right? But how they get their message across, if it isn't simply to the people that already know, is, I think, a real issue.

MR. KNIGHT: Could I just add one thing to what Pat said? I think the fact of the matter is that in the run-up to the crisis that started in 2007, neither the policy-makers nor the regulators acted in a sufficiently pro-active way with the powers that they had. Yes, there were some new things about this crisis, but a lot of these things were not new. The U.S. authorities had the power to strengthen underwriting standards. They existed at both the state and the federal level.

Two governors of fed, Susan Bies and Ned Gramlich, warned about the deterioration in underwriting standards, but the authorities were concerned actually about the overlap of responsibilities between them.

In the case of central banks, because inflation rates were low, they took the view that the financial system should be stable in those conditions when, in fact, as Doug said when he referred to taking the punch bowl away, traditionally central banks have acted when they saw rapid credit growth leading to rapid increases in asset prices. So there are a lot of aspects of these things that I think were quite recognizable at the time.

Of course, we warned about it at the BIS and were very much involved in that process. But I think that that doesn't necessarily mean that now we tip the boat on the other side and introduce a whole bunch of new regulations. What is really important, I think, is to

clarify the mandates of the various regulators and to improve the disclosure in a lot of areas where it has been weak before. I think that that can lead to a much more stable financial system.

MR. TANZER: I was actually going to ask about whether you think there's any responsibility -- or maybe "responsibility" is the wrong word -- whether there is any incentive for an investor, actually, to try to take action on a bubble, other than continue to bid it up and try to get out just before the top. You can take away the punch bowl, but often before you take away the punch bowl actually what people tend to do is add a whole lot of water and lemonade and stuff to that by making statements about, "We're worried about this -- an asset price bubble arising." But if investors continue to kind of ignore that advice, then maybe you've got to do something more drastic.

Can we have any confidence that investors acting as a group might actually see value in tempering bubbles rather than just kind of driving it up.

MS. WALTERS: Well, I think the answer to your question is sort of yes and no, because investors are not a cohesive group any more than preparers or anyone else is a cohesive group. And certainly they're greedy as much as anybody else is greedy, and they're going to say this is not my problem. My problem is to make as much money for my client as I can, and I know better than anybody else so I'm going to be able to get out.

In some sense, when I talk about investors, I'm going to have to talk about what I would normally say are professional investors, so someone who's either a fund manager or an investment advisor versus your grandmother who happens to decide she wants to buy some stocks today.

There certainly were people, professional investors, who took the risk in terms of losing clients who refused to put clients in various types of instruments because they didn't feel they were appropriate. I think one of the issues we're going to get to a little bit later has

to do with this whole concept of suitability and who has the responsibility to make sure that a particular investment or a particular borrowing is suitable for the person that's sitting across the table from you, particularly when neither the country south of the border, where I happen to be from, or this country, in my view, really does include financial education as part of its overall educational system. I think in today's day and age, we should be teaching kids in kindergarten about proper use of money.

Because certainly if I looked at an ad for a loan, for a mortgage loan, say five or ten years ago, I would look at this ad and I would say what rational person would take out this kind of loan? I mean you pay eventually. But there are plenty of people who would not have understood that and would have taken the view of the person sitting across the table from them who had no concern about whether or not that person would lose that house or not.

So I do think that there should be requirements of people to have a certain code of conduct in order for them to participate in advising investors who may not know the intricacies of any particular instrument that they're looking at.

MR. KNIGHT: I think, though, in terms of systemic risk, we've got to be very careful not to confuse two very different situations. If you look at the Black Monday of 1987 or even the dot.com bubble, these caused very large losses for certain investors, but they did not impair the financial system.

Now we've had an episode where we've had a set of bubbles breaking in asset prices which has severely impaired the operation of the financial system which is supposed to transfer savings efficiently from savers to investors, and that's caused a global recession. This is what we have to avoid.

The fact that we have a bubble in the equities market is not necessarily a serious problem. Why is that? Well, because the products are standardized, there's much more disclosure, the regulatory system works better.

In the other assets that we're talking about, which are essentially structured credit products, there's a tremendous amount of leverage, and therefore when the system burst, the system had to de-leverage, and that led to shortages of capital which had to be funded by the taxpayer. That's a serious problem.

I think one of the things that we need to do, and why securities regulation is so important to financial stability, is that we need to build into these structured credit products some of the disclosure, consistency, standardization rules which have worked so well in the equities market.

MR. HANOMANSING: And I think this is a good opportunity for people to jump in and ask questions or make comments, so we have people -- you can see them, the shadowy figures with the microphone who are all set. I guess we'll -- so if you have a question, put up your hand or identify yourself and we'll get a microphone to you.

Okay, hi.

MR. RUSSELL: Yes. My name is Ian Russell. I'm with the Investment Industry Association and very interested in the discussion. I'd like to just ask a question about the reform process itself. You're talking about the need to deal with issues of systemic risk and transparency of the markets, regulation of credit rating agencies. There's a wide range of reforms that seem to be taking place.

But it seems to me, in looking back, that the heart of this financial crisis essentially was the failure of four large institutions in the market place, which were mentioned in Brenda's remarks at the beginning, that made grotesque miscalculations of risk, leveraged

their balance sheets enormously, and loaded up with securities in which they didn't understand the risk.

I have two questions. It strikes me as there was a failure of regulation. It was something that should have been detected earlier than it was. Further, with the SEC, of course, and it's a point that Patricia made, that the Madoff and Stanford scandals were not uncovered. Those Ponzi schemes weren't uncovered until the market crashed.

So I guess my concern about all of this is it seems to me that the reform process should really be focused on -- and you did touch on it, but you didn't focus on it in much detail -- how we can improve banking regulations, particularly in the U.S. and the U.K., and a related concern is that a focus on the wide scale of reforms, in a sense, can lead to perhaps externalities in the sense that we could end up with some over-regulation in this part of that process.

It's kind of a long question.

MR. HANOMANSING: No, it's great. And so just before we hear the answer, again, if you want to ask the next question or make a comment, just identify yourself and we'll be able to go smoothly to that after this answer.

Who'd like to jump in? Yeah, go ahead.

MS. WALTERS: Those banks wouldn't have been able to get to the point that they were unless people were buying those instruments, people all over the world who, in my view, I would label the unsophisticated investor. So small towns might have said, “Oh, I'm going to get a much better return on my investment because, one, this is an insured investment vehicle.” If they hadn't purchased those, then there wouldn't have been this appetite for more, and hence the whole cycle that caused more and more people to be borrowing bigger and bigger sums of money when they couldn't afford to borrow those kinds of monies.

So it's not just the institutions themselves. There had to be this much wider distribution network in order to get to some small town in Australia who happens to own securities that were issued by Citibank for U.S. mortgages. So I think it's more complicated -- it's a much, much more complicated system than you're making sound by your question.

I think the same thinking that caused the equity bubbles, the same thinking about "this is never going to end, I'm going to become a billionaire, I'm just going to keep doing this," is what caused this. So it may be a difference in magnitude or a difference in kind, but the same thinking went into this bubble that went into those other bubbles. It just has a much bigger impact.

MR. HYNDMAN: But I think what happened this time was that the risk was kind of diffused through the system and hidden, so that there were a lot of people who had a little piece of the pipeline as these products went from the initial mortgages to the securitization to the conversion into CDOs, all this stuff. Nobody saw the whole picture. They saw something coming in, they sent something out. They might have had a little bit of uneasiness about the risks, but they were passing it off so they didn't really worry about it all that much, with the result that you had a big hidden risk in the system.

I guess what worries me about saying we're going to fix this with regulation. I think we do need to pay attention to it and look for risks but the CIA had all kinds of people on staff in the 1980s studying the Soviet Union and they didn't spot the fact that the Soviet Union was about to fail any more than the SEC spotted the fact that the market was about to collapse. Things are that complex. It's not an easy task to get in and understand all the dynamics.

MR. KNIGHT: I would just like to say that a lot of us look on this crisis as though it began last September, and it didn't. This financial crisis began in August of 2007 with severe disruption in the uncollateralized international inter-bank market, which is the core of the

whole global financial system. That market where the spread from the risk-free rated then 12-and-a-half basis points, eventually went to 350 basis points after Lehman Brothers. So as soon as that market became distorted and ceased to function efficiently, the other dominoes were -- admittedly there were problems in management, but -- there would have been other failures as well, if it hadn't been for those specific firms.

So the distortions that began in 2007 were really very severe and we didn't figure out how to fix them for months after those distortions started. We now know that the recession in the United States started in November of 2007, and the global recession began in the first quarter of 2008. So that was long before the crisis really became exacerbated. This is why I think it's so important that we now establish hopefully an internationally harmonized regulatory system which will never prevent these periods of euphoria when everybody says, "This time is different, I really know that tulips are going to go," and so forth, but can somehow reduce the contagion and stress that it creates in the markets that are supposed to transfer saving to fixed capital formation.

MR. HANOMANSING: Let me see. There's a question, yes, over to my left.

MR. BANDEEN: Ian -- Ian -- I'll keep the trend going. It's Ian Bandeen. Actually, I'm here in my capacity as the CEO of a stock exchange in Canada, but in my past life, I was one of the guys who created securitization in Canada. What I find really interesting here, when you discuss systemic risk, I agree with you. Spotting a tulip bubble, it's always easy in hindsight, and there's always the motivations that go into it and, Doug, with respect to transparency or accountability for the products that we put in the public domain, transparency would have been a much better idea. I agree.

But there are certain elements to what we went through that were systemic that we could have solved. It was very interesting, in May I was at the British/North America Committee where it's equal parts Brits, Canucks and Yanks, and we were discussing what

went wrong in the three countries, particularly with respect to residential mortgages 'cause that was what underlay it all.

When you get right down to it, there are some fundamental differences. The American banks were allowed, including the investment banks, to go and strap on leverage, 30, 40, 50 times, whereas in Canada, we held them back to around 12, 14 so that when the bubble burst, we were in much better shape. The Americans were allowing them to go and have extended loan-to-value ratios of 140, 160 percent. As a lender, that's foolish. You're now into unsecured credit, and if it's being supported by gambling, which is essentially what it is in a bubble, you're going to have a systemic crash come down.

In Canada, we forced the maximum of 80 percent loan to value, and a real value, not a fictitious one.

And last but not least, and I think the real reason it kicked off in the States, is that they created an incentive politically to go and allow interest deductibility. So you had people who were incented to take the single biggest asset most of them are ever going to have in their lives, lever it 100-plus percent so they could get interest deductibility. They were collectively, as a community, riding a one-way option on a continuous buoyant market.

Now, that should never have been allowed and those are systemic issues that, with proper regulation, we should not have allowed to occur, and those you can anticipate. So there is room for prudential -- macro prudential intelligence, smart regulation. There was a great example and it failed in America. That would be my observation, at least.

MR. HYNDMAN: I think the point there really is that the crisis didn't begin in August of 2007. It began, some have argued in the 1960s, but at least in the 1990s, *Community Re-investment Act*, and efforts to allow more people to buy houses with higher-ratio mortgages and so forth, and that kind of built that psychology of the ever-rising real estate market that led people to a false sense of security.

MR. HANOMANSING: Let me take one more question before we move on to our next segment.

MR. DE GELDER: My name is Neil de Gelder. I'm here to learn and I've just got a question as somebody who, in my professional life is an investor and has banks as a counter-partners to our transactions. One of the things, we're not that smart, but we knew enough not to buy General Motors because there was a lot of disclosure and there's a lot of ways to assess it. We also knew that there was a lot of craziness going on in the U.S. sub-prime market. That didn't take a genius to spot either.

What we couldn't figure out is who was exposed to that and how. And the suddenness of it made it impossible to deal with. We had investment-grade banks declaring bankruptcy over the weekend. We had no way to see things coming. We had no way to know that UBS was levered 40 or 50 to 1 on this stuff, and Royal Bank was 12 to 1.

My question is why are these financial institutions which, by their very nature, have risks that are realized very suddenly because they're fundamentally in a confidence game as opposed to making cars, why are those risks assessed on 'what is' as opposed to 'what if'? When we do investment analysis for our own investments, we always do sensitivity analysis. What if this happens? What if that happens? What if it happens in a day? What if it happens in a month?

From my perspective, you can't -- maybe you, as regulators, can, but we in the market can't -- see that and you worry about regulators acting. The market acts way faster than you can. But they need information in order to be able to do that.

So I guess my question is what are you doing to be able to get information about systemic and individual institutional risk out into the marketplace where people were transacting with banks and shadow banks?

MR. TANZER: Well, maybe I can put in a couple of things here. One is at the level of structured finance itself, there has been a lot of work that's been done to improve the standards of disclosure of the selling of those products and the construction of those products.

Now, some of that at the moment is a little bit moot because, no one's going to buy a structured finance product right at this moment. But the reality is that it's getting back to the fundamentals that say you need to understand the underlying assets in all of this, and not just accept the word of the originator or the credit-rating agency that the spread is so well contained and this thing is so cleverly put together that the risk really is disbursed or the risk really has moved on and you can be confident in the investment grade.

It's getting back to the fundamentals that say you need the basic information at the level of that product.

I think you make a really point too in terms of general market transparency and things like leverage ratios and this sort of thing. I think there's an interesting question for us as regulators, as securities regulators and banking regulators in international organizations here which is the role that market transparency can play in assuring systemic stability and financial system stability as a whole.

If you look back, say, two or three years, -- Malcolm knows what the Basel Committee says in terms of what's a good leverage ratio or what's a good capital ratio, but -- that wasn't kind of well known. Not even what the global standard was, wasn't well known within the market. I think you're quite right; people wouldn't have known what Royal Bank of Canada's leverage ratio was or DBS's was or whatever else.

But they do now because the market demands it, and the market's getting it. In fact, banks are telling them voluntarily what it is because that's really important, because it's

important for investor confidence, right? So to a degree, I think you're quite right. We, as regulators, have got a bit of a job to do to kind of force that.

But what was kind of seen as something that was really quite important from a prudential perspective wasn't really seen -- I don't think it was seen within the market as necessarily all that important from a market perspective, and I think that's one of the things that we learned.

So I agree absolutely with your point. I think market transparency can be a very great aid here. I think it's going to continue to cause challenges for us as securities regulators who have a natural sort of orientation or bias towards disclosure.

With banks, and with banking regulators who have a natural concern that if you get too much disclosure about, kind of fundamental things about the heart of the financing in the bank, you can actually cause a lot more problems, the panic that you're actually trying to avoid. I think that is a very difficult question for us, actually, that it's going to take a while to resolve and you can only resolve in an individual case.

MS. WALTERS: I have two responses to you. One is information about the instrument that somebody is trying to buy out there, and then information about the risks that are associated with the institution issuing it.

Back in the late '90s, I had a committee of people who invested on behalf of the firms that they worked for, either banks or insurance companies who purchased CDOs. We were asked by the Securities and Exchange Commission to tell them what kind of information we weren't getting in order to do an adequate evaluation of the price we were willing to pay for those.

Months of work, send off our list of questions that we would expect the sensitivity analysis to address. Nothing happens. You call up, the person that worked there no longer

works there anymore. They don't have another person to put on this project and hence, what, it's ten years later and there's nothing. There still is nothing on that particular issue in terms of an investor who is a professional investor, works for a financial institution, who basically says we do not get either sufficient time or information to make a good decision about whether to buy a particular instrument, but it's our job to buy it so we will buy them based on whatever information we get.

So if we're talking about transparency and disclosure, one of the first places that that needs to happen is at the instrument level.

Then the whole issue of what gets moved off balance sheet. So what actually would you, as an investor, get to see about a financial institution in terms of what does it own and what does it owe? What's its assets? What is in theory its assets, and what is in reality its obligations with respect to these various vehicles?

Certainly under U.S. GAAP and under Canadian GAAP, in my personal view here, all one needed was an attorney -- and I understand there might be one or two out in the audience -- who would say, ‘yes, you are protected from the risk of this vehicle. You can move all of this stuff off balance sheet’ when, in reality, the institution's reputation would not have survived if they permitted that vehicle to fail, and therefore miraculously, all of these "toxic assets", which is certainly an oxymoron if there ever was one, move back on balance sheet.

Hopefully in the next round of ‘how are we going to account for financial instruments’, we will have better principles for keeping things on balance sheet which are, in essence, risks to the entity.

So I think there were really two things working against you in terms of being an investor, both you couldn't understand the instrument themselves, and then you didn't understand what the relationship was between these separate entities that were created to

hold those instruments. There needs to be improvement in both of those areas in order for us to have better market transparency.

MR. HANOMANSING: All right, thank you. We have 20 minutes before our break, and two topics to go through. So I'll compact these two topics from our original plan. The next one is cooperation and harmonization. Malcolm, let me start with you because you actually did touch on this in one of your responses to one of the questions, and it's about the importance -- and clearly there is a great importance, but assess that for us of international cooperation and harmonization.

MR. KNIGHT: Well, I think that one of the factors which has been an element of financial crises, really, throughout history - at least since the second World War - is the fact that there are very big differences in regulatory structures between and among jurisdictions. There are overlaps, and there are major gaps.

That creates a huge incentive and capacity to undertake regulatory arbitrage. The regulatory arbitrage can be from the bank itself to an unconsolidated vehicle within a jurisdiction, but it can also seek jurisdictions that look as though they have light-touch regulation and lower capital requirements and so on.

Now, we have a global financial system and I believe a very simple point, that if we're going to have an integrated global financial system, we need harmonized regulation of that system.

We could go back to a system where the large banks were just holding companies for totally independent operational units in each country, regulated by OSFI here in Canada, or the various bank regulators in the United States. But I think that really would lead to some quite significant inefficiencies, so we have to go one way or the other, either to the Lord Turner approach of fragmented -- breaking up the institutions, or to one in which regulation follows the process of innovation in the financial system, and minimizes the degree to

which financial innovation is just regulatory arbitrage, and avoiding rules, rather than the creation of instruments that are genuinely useful to ultimate savers and investors.

So, to me, harmonization across jurisdictions is absolutely crucial. Greg is working toward it in the Financial Stability Board, which is a very important element of that. The G-20 has given impetus to it. But down on the ground I'm not sure I see enough work being done in this area, particularly in the area that was mentioned by the last questioner. I think everybody is agreed now that regulators have to have a lot more information about the transactions in the over-the-counter derivatives markets, for example.

But a question nobody seems to be addressing is how much of that additional information should actually be publicly disclosed, and probably a lot.

MR. HANOMANSING: Doug, I'll just go to you. Even if there is cooperation or agreement on the international level, changes at the national level might not be the same. So what are the challenges in harmonizing the response of individual countries?

MR. HYNDMAN: I think we do have to be realistic that each country has its own institutional and regulatory structure, so each country is going to design its responses to fit its circumstances, and you see this in the international harmonization efforts where countries agree at a fairly general and high level on some standards, and then they go back and implement it in their own way.

And they have different philosophies in countries as to approaches to different aspects of the financial market. How much should we rely on government versus market forces to discipline activity, different structures of regulators and so forth.

On top of that, countries also have competitive interests. So while they all agree at the G-20 or one of these forums, the Financial Stability Board, to all impose certain

standards, they're also saying, well, I don't want to do it in a way that's going to drive business out of my country into your country, so all of that is kind of in the mix.

We've got to be therefore realistic about how far you can get down the harmonization road. Certainly we should be able to and we have to be able to get countries to agree not to do stupid and counter-productive things that will make the crisis worse, the kinds of things that happened in the 1930s that turned a market downturn into a world recession. And hopefully you can even go a step beyond that and get them to agree that if we all do this, this will make the market work more efficiently internationally and have a system to monitor whether people are in fact doing that.

Beyond that, I think you have to allow for a certain amount of innovation and local variation as long as it doesn't get too far away from the general global standards. And I guess the most important thing is to have a forum, which I think we have now in the G-20 and in the various international organizations, where countries have to show up and be accountable to their peers for what they're doing to kind of live up to what they've agreed to do collectively.

MR. TANZER: And can I just add to that? I think Doug's covered that really well. It's a little bit of a pipe dream to think that we can harmonize everything internationally all the time. Firstly, I don't think it makes sense. But secondly, it's not practical because there are differences between market structures. There's pretty basic differences between legal frameworks and certainly there's differences between the way investors, market players and so on interact in different jurisdictions.

So I think what's important when you think about harmonization is that you want to define what you are trying to really harmonize, and what is important in each area. Because more specificity is good in some areas and probably not so good or practical to achieve in others.

The Basel Committee has done a hell of a lot of work on raising capital standards recently. That's a really good area where you want pretty detailed rules and you want that to be a common standard.

Pat knows we're doing a lot of work at the moment on harmonizing international accounting standards. That's an area where I'd like to see pretty complete harmonization at a pretty detailed level, because the arbitrage opportunity that arises is pretty significant there.

But even for that, we certainly support the whole idea of a convergence towards a single set of accounting standards. That would make things a whole lot easier for everybody, provided it's clear what the differences are between different jurisdictions. Then the market can assess that, but I would rather see complete convergence.

And then I think of something like short selling where what we set out to do in IOSCO is to set a framework for the regulation of short selling, but we didn't set out to get down to the detail of what percentage reporting threshold are you going to have? Is it going to be two percent? Is it going to be one-and-a-half? What is it going to be? What we agreed on was reporting of short positions was a really good idea to the regulator and, in appropriate cases, to the market. Individual jurisdictions come up with their own thresholds, and then we need to work, like Doug was saying, we need to work on whether or not they're actually implementing that and achieving the outcome that you want which, in short selling, was to have a little bit more transparency around what was actually happening to the kind of put a light on things.

So I think it's important to define what level of harmonization you want. I think it's important that you work on implementation of the standard that you've agreed.

And then Malcolm touched on it earlier, what's really, really important then is for things that really are cross-border and so on, you need fantastic cooperation arrangements to

both assess what's really happening in the totality, and be able to take the day-to-day regulatory decisions that you have to take to deal with that.

You don't change an investment firm's risk culture overnight just by the Chairman of the FSA and the Chairman of the Fed, or the Chairman of the SEC and someone from the European Commission or whatever, agreeing -- that comes down to a whole stack of individual decisions made by regulators with respect to that whole firm and by getting in and making that point over and over again at all levels of the firm.

MR. KNIGHT: Can I say, though, just fortunately, the regulators don't have to make all these detailed rules in order for them to be harmonized. The market will harmonize a lot of the rules itself if they're properly constructed.

If you look at Basel I, which brought in the eight percent risk-weighted capital adequacy ratio, it was only intended for the ten countries that -- the 11 countries, sorry, that at the time were members of the G-10 (there's always one more member than there is in the number of the group, at least). So the 11 countries of the G-10, that's all it was for and they had to have their own legislation in order to implement it. But within a few years, every country in the world said that it was also implementing Basel I. Why? Because if you say, well, my banks don't need to hold eight percent capital, they immediately pay an extra two or three hundred basis points on everything they borrow.

As regulators, it's totally appropriate to choose the areas where you want to do battle. The market will do a lot of the harmonization by itself.

MR. HANOMANSING: I'm going to ask one more question and then go to the floor for questions on this harmonization section before we move on. But briefly -- so you can get primed to grab a microphone - - can you talk about the Australia experience in 1991, Australia moving to a national regulator and as you have states and territories that had their

regulators before. Describe for us what the goals were of that and were those goals achieved?

MR. TANZER: Yeah. This is really coming to what sort of regulatory structure you should adopt, and it's a difficult question that's going to vary from jurisdiction to jurisdiction. I know that this is quite a charged issue in Canada a the moment.

But just to describe what happened in Australia, we had a state-based -- which is the equivalent of your provinces here -- a state-based regulatory regime for companies, public companies, and for securities takeovers regulation and everything else. We were moving towards a national coordination of all of that, and we'd set up a national or a federal body which was intended to coordinate that during the 1980s. We ran into some really quite severe corporate governance failures, which were exposed by the stock market crash of '87, but that they were really there, which kind of struck at the heart of business culture within Australia and was really quite severe in terms of the impact of that on foreign investors' perception of Australia as a place to invest. So it was really quite a serious political and business issue at the time.

So we moved to a structure of a national regulator for companies and for securities regulation as a whole. One of the aims of that was to make the regulation consistent across the whole of Australia at both the policy and a real operational implementation level.

One was to do some simple things like reduce costs. To avoid the problem of people having to register a company in eight different jurisdictions instead of one, just do it once. So there were some simple things around reducing cost.

One was overtly to deal with this enforcement problem that we had at the time, which was to bring much greater resources to the enforcement role of particularly securities regulation, focusing on these corporate governance problems. What was very important in

all of that was that there was a sort of confluence of political will at the national level, but also a very strong impetus from particularly business that this had to happen.

It also happened at the time that the stock exchanges itself -- we had a set of stock exchanges that were state-based. They had become a nationally linked organization. Over time, actually, they were also closing. It was combined with technological changes where trading floors were closing. It was becoming electronic trading, and this kind of nexus for a particular state exchange was becoming a little bit broken as well, that it was seen that the stock exchange had to operate on a more national level as well.

So those were some of the reasons and some of the thinking behind all of that. I think actually as it turned out -- it's all right for me to say that because I was there at the time -- but I think most of those objectives were actually achieved, and we've now moved to a position where that's a well-accepted position. As I say, whether it's right for Canada, I know that's a highly-charged political issue here, and that's one that you'll have to sort out -- or Doug will have to sort out, or lots of people of goodwill will have to sort out.

MR. HANOMANSING: All right. Thank you. Questions? Is there anybody who would like to jump in? Yeah, we have a question over here, so we'll get a microphone to you in the second row, just to my left.

MR. DOUG KNIGHT: Hello. My name is Doug Knight. I've been in the securities business for a long time as an investment manager. But it just struck me, as all of you were talking, that here we have Basel regulation which is eight percent capital which, I guess, if my math is right, is a 12 times leverage ratio.

And we all knew that the market regulated that, and that all banks followed that, and we were all told that that was true. Then, as we've heard from other questioners, UBS and all these other companies, Citibank, had leverage ratios all of a sudden of 50. Well, two

years ago, they had eight percent or ten percent capital. How is it that it was possible that they had a fifty times leverage?

It seems to me that when I entered the business 35 years ago, we had the three pillars: banking, insurance and securities. It would seem to be simpler then. But now, it's more complicated. CDS, is that a security or is it insurance? Is the money market mutual fund, is that a security or is it a bank?

So, again, as all of these things get grey, it turned out that the banks had offloaded things from banking regulation into securities, and as securities, they seemed to be fine, but at the end of the day, it turned out to be 40 or 50 times leverage. So we were duped, in a way, let's say, as investors. But where do the regulators come in? Is there a way to regulate that?

Because in the Canadian banking system, it was closer to 12 times leverage, not the 30 and 40 that it was in the United States and elsewhere.

MR. TANZER: Well, I'll start, but maybe others might like to add to that. I think that the fundamental problem was that, while there was a pretty clear rule on what level the capitalization should be, you make the accurate point that there were things happening outside the pure regulated sector which were affecting the actual leverage ratio once you brought all those risks back onto your balance sheet.

So I think that fundamentally there were some differences in approach at national level in how you actually implemented that standard, and I think that also there are a lot of risks that were outside even on the definition that was then applied. I think there were some risks that were outside that ended up getting taken back onto bank balance sheets, or maybe always should have been taken back into bank balance sheets.

We were talking this at breakfast about Vancouver real estate and the three golden rules of real estate being location, location, location. And the three golden rules of financial regulation, international financial regulation, if you read the G-20 stuff, is implementation, implementation, implementation. And there's a fourth one: it's implementation.

So, the emphasis here is very, very strongly on not just sort of raising the standard, but actually making sure that it's implemented and done in a consistent way. That's why there's a lot of attention currently given to -- the Financial Stability Board that Malcolm mentioned before has got an active project looking at -- peer reviews of countries' regulatory regimes, either in a whole or on particular themes. I think these things -- they're expensive, they're difficult to do, but I think they're essential and a very good way of testing real implementation when you have to explain to your peers from other jurisdictions how you do that and why that differs from what appears to be the global standard. I think that can be really salutary.

--- PROCEEDINGS ADJOURNED

--- PROCEEDINGS RECONVENED

MR. HANOMANSING: Thank you very much for being here now for the second session. We're going to try to compress some of the things we were going to cover in order to be out of here and get you out into lunch and the discussion on time. What I want to begin by doing is just dipping back to the last topic, because I had to race through that, harmonization. I know there's a lot of interest in that topic, and certainly a lot of expertise among our panel.

Malcolm, let me begin the second half of this morning's session with you. You're familiar obviously with coordination across the financial -- or among the financial regulators across Canada. How do you see a Canadian national securities regulator helping that national coordination?

MR. KNIGHT: Well, as Greg said, this is a topic with some political overtones in Canada, I guess, but the way I look at it is very pragmatic. Canada has always had a group which looks at financial stability from a number of perspectives, both the institutions and the broader system. That consists of the Department of Finance, which is responsible for the legal framework of the financial system; the Bank of Canada, which is responsible for overall issues of financial stability as a central bank that's not specifically responsible for supervision, but can only, under the Bank of Canada Act, lend to institutions that are solvent on the basis of collateral. Then you have the office of the Supervisor of Financial Institutions and the head of the Canadian Deposit Insurance Corporation. I think that's a good sort of college to look at financial stability from a number of perspectives. But there's always been a missing element, and that is a national securities regulator.

Again, as I mentioned in the first part of this, a lot of the contagion that has occurred in this financial crisis has come not so much from idiosyncratic risks within financial institutions themselves, but in the way frailties have been transmitted across institutions through markets.

I think that makes it particularly important that a national regulator -- when there is a national securities markets regulator -- has a seat at that table, and I think that college, it's actually named the SEC or the FISC, depending on which element of the mandate you're talking about, but the same group. That's a college that, as everybody acknowledges, has done rather well in terms of maintaining financial stability here through these difficult times.

MR. HANOMANSING: So the U.S. model is often held out in Canada, and probably other places, as the panacea for how to deal with things nationally. So there is the SEC, obviously, but there's a long list -- and I'll read it 'cause I certainly didn't know all the –

MS. WALTERS: You're probably going to miss some.

MR. HANOMANSING: I'm sure I will. I'm only as good as my notes here. Office of Thrift Supervision, the Office of the Comptroller of Currency, the Commodity Futures Trading Commission, Federal Deposit Insurance Commission, as well as state banking, insurance, securities regulators, attorneys general in the various states. I'm sure that's not an exhaustive list, but it gives us a sense of the patchwork of regulation and regulatory bodies.

Would having an SEC-like national regulator in Canada address the perceived problems here, or is there a different model that people should be looking at?

MS. WALTERS: Okay. So first, I love my country. But within that context then, I'm going to say where I think the problems are, right?

When I worked for the CFA Institute, one of the regular letters we would send to Canada would be, "It's time you got a national securities regulator." Anytime we had an opportunity to throw that in, we did.

So I think that Canada needs a national securities regulator. That said, I'm not sure it should look exactly like the SEC. The U.S. regulatory system has not been the poster child for great market transparency that it would like to pretend. I mean, if you think about all of the major scandals and bubbles, where did they all start?

Yes, we like to spread things around the world, maybe not the same way that, Queen Victoria did, but we still like our influence to be felt. So I think that there are good things about the SEC. In fact, part of the problem is I think most people see the SEC as the regulatory structure in the U.S. when in fact it's not. And often the SEC don't have the ability to act quite as quickly as some of the state regulators can.

So if you think of Eliot Spitzer in his brighter days, his ability to respond to problems with entities that were registered in his jurisdiction, he was able to do that more quickly than we might have been able to do it at a national level.

So in making recommendations to Doug and his commission about what the national securities regulator should look like, I think that he should look at the various structures that exist around the world, understanding the legal and tax structure and everything else that happens here in Canada, as well as the political issues to determine what's going to be the best structure here. I think that in the U.S. we need a different structure.

There's too many conflicting organizations that have jurisdiction over parts of the market in such a way that an entity can do what Malcolm said was regulatory arbitrage. Let's structure our company so it doesn't fall under anybody's jurisdiction, and I'll make sure I'm in the right state. Delaware is the most corporate-friendly state so you'll all want to be incorporated in the state of Delaware.

So that would be my recommendation. I think there are good things and bad things about the U.S. system. It hasn't shown itself to be the paragon of virtue that it would like to present to the world that it is, and that Canada should look to the good things about it and

look potentially to how things are working in Australia and other places for what works there, within the Canadian context.

MR. HANOMANSING: Doug, what do you see a national regulator doing to address international and cross-sectoral cooperation?

MR. HYNDMAN: One thing I should say is that when I was a provincial regulator, it used to annoy me when people would say that Canada needs to have a single national securities regulator just like the U.S. I'd say, well, actually, they don't.

We are, in my new job at the Transition Office, we're looking at regulatory structures around the world for ideas. We're certainly not proposing to replicate the U.S. structure with the kind of multiplicity of organizations. If we succeed in this, which we will, the Canadian securities regulator will essentially replicate the SEC plus all of the stage regulators plus the Commodity Future Trading Commission. It'll be a comprehensive regulator of the capital markets at all levels, local, national and participating in the international regulatory forums.

I think the big wins, frankly, in this exercise are the international involvement, giving Canada a greater presence and significant influence internationally, and I think we can do that.

Secondly, what Malcolm was talking about, having a national regulator in Canada that can participate with the other financial authorities nationally and collectively overseeing the markets, sharing information, trying to avoid the kinds of problems we've had over the last few years. Although Canada has done relatively well, we still did suffer some problems that might have been avoided.

There's some other things. We've talked about enforcement, making sure the standards are enforced, and I'm determined that in creating a national regulator, we will

make a difference not only in regulatory enforcement, but in criminal enforcement so that we have an active regulator that will be more efficient than we are now. But that's a more modest win than the big wins that I see in the international and inter-jurisdictional coordination. And we're aiming high. We want to have the best securities regulator in the world in Canada, and all of us in the Transition Office think that's achievable.

MR. HANOMANSING: Okay, thanks. Pat, we're going to talk a bit about International Financial Reporting Standards as an example of international harmonization, but as the ranking accountant in the room, especially for those of us who are not accountants at all, explain to us what that is, first of all.

MS. WALTERS: Okay. First of all, I have to say I've never been an accountant. I've always been an investor.

MR. HANOMANSING: Are you a professor of accounting?

MS. WALTERS: Yes, I am a professor of accounting, but I'm not an accountant. Nor have I ever practised as an accountant. You can take all of my remarks in that context.

All of my education has been in accounting and I have a lot of experience with the International Accounting Standards Board and its predecessor, the International Accounting Standards Committee, so I do know a lot about IFRS, which is how everybody refers to International Financial Reporting Standards.

So what is it? It's a set of high-quality financial reporting standards that is designed to be used by profit-making enterprises globally, and when the original organization, the IASC was created, the goal was to have one set of standards so that every investor in the world would understand the principles that went into the creation of corporate financial reports, corporate financial statements.

Currently, there is an organization based in London called the International Accounting Standards Board. It's a full-time organization independent from preparers, from auditing organizations, and it has 14 board members and they're appointed based on their technical expertise as well as their professional experience. And so they have a balance between preparers and auditors, regulators, and users of financial statements so that the standards that are created will attempt to meet the needs of all of those diverse groups with, fortunately, the pre-eminence of the investor/creditor community, because that's who financial statements are prepared for.

So interestingly enough, since 2000, which was the creation of the IASB, taking over from its predecessor, the acceptance of international financial reporting standards has essentially leapfrogged. So it went from a few countries - Switzerland probably being the most obvious - to all of the major countries in the world, major financial markets in the world except the United States, of course.

In some sense, the watershed was recognition of IFRS by Australia and by the European Union as sort of the major countries that went on board with these particular standards primarily for their listed companies, although each jurisdiction may tweak whatever that happens to be.

So here in Canada, all publicly accountable companies, which is a larger subset than listed companies, would be required to apply IFRS in their financial statements beginning December 31st, 2011 although since you have interim reporting here, the first IFRS statements we'll see from Canadian companies would be in March of 2011, unless a company chose to early adopt, or had been providing IFRS statements prior to that time.

The whole point of having one set of global financial reporting standards is so that investors only have to invest resources in understanding one set of principles. That doesn't mean that companies can only pick one particular type of option. For those of you who understand what depreciation is, you still get to pick between straight line and some other

method. But by and large, it's a contained body of knowledge that even a retail investor could get their hands around, as opposed to a whole bunch of different systems that may have nothing whatsoever to do with each other where, if you were going to invest in a particular country, you would need to understand what the standards were there before you could make a reasonable investment decision.

So that's basically what IFRS is.

MR. HANOMANSING: All right. So we'll use that as the jumping off point for discussing that a little bit more in terms of harmonization.

Malcolm, you are a former trustee of the International Accounting Standards Committee Foundation. How important do you consider harmonized accounting standards for the global financial system, and what hazards do you see in country-by-country implementation?

MR. KNIGHT: Well, actually, what Pat described, the International Accounting Standards Board, is the body that makes the standards. The trustee board that I was on actually oversees the International Accounting Standards Board from the point of view of its governance and membership, but not from the point of view of its actual technical work program. We could see it and comment on it, but that's a professional thing, as Pat said, where the exposure drafts are done by the IASB, and then they are commented on, and then the board meets again to decide on the final standard.

So I do have to declare an interest here. I have been -- I was a trustee of the International Accounting Standards Board - it's called a different name - from 2003 to 2007.

I basically agree with everything that Pat has said. In fact, a lot of the other elements of harmonization - for example, regulatory harmonization - I really don't see how we can

have harmonized standards for capital adequacy under Basel II if we don't have the same accounting standards in different countries.

IFRS, for example, gives hugely different numbers for a bank's leverage than U.S. GAAP because under IFRS, you're not allowed to net offsetting credit positions against the same counter-party to reduce the size of your balance sheet for leverage purposes, whereas under U.S. GAAP you can. It's just a technical point. It has no substantive relevance, really, but it creates very different-looking numbers. This is a bad thing for investors, for regulators, for other users of the account. So I think that harmonization is absolutely crucial.

Here I think there is a risk because, as Pat said -- in fact there are two risks, really, and they're very, very large ones. The European Union is probably the biggest jurisdiction that has adopted IFRS. It did so -- I think it was in 2005. It did so actually with a carve-out, which I think is a very bad thing. The carve-out's really never been used so it's kind of a moot point, but that put a little bit of a question mark under IFRS.

The other over 100 countries who have committed to implement IFRS have not really yet done so, and some of them I think would like to do it, maintaining a domestic accounting standards centre that will interpret IFRS for Upper Volta or some other jurisdiction. That's not a good thing. Both the standards and the guidance have to be harmonized.

The biggest risk, though, I think, is if there is not adoption of IFRS in the United States. The SEC has allowed firms that are quoted in the United States that report under IFRS to do so without reconciliation in the United States. That's a big step forward. But I think unless we get full harmonization fairly soon, there really are going to be problems because the U.S. is such a big jurisdiction.

So I think those are the risks. I hope that the convergence process, which both the Financial Accounting Standard Board in the United States and the ISB say that they are totally committed to, will go forward.

MR. HANOMANSING: Well, and Pat, let me ask you what's the assessment -- the likelihood of rapid implementation by the United States and the implications if they don't do it quickly or don't do it at all?

MS. WALTERS: Rapid? No way. One of the things that's happened within the past couple of months, actually, is the SEC, our new chair, Mary Shapiro, appointed a chief accountant. I happen to be in favour, okay, and I won't tell you that I'm in the majority in the U.S. I've been waiting with baited breath for our Chief Accountant to be appointed, because whoever they appointed was going to be a signal, based on that person's viewpoint of IFRS adoption, as to whether it was sort of back on track.

I used to use this analogy that a big avalanche had fallen in front of the IFRS bus and it was just waiting for somebody to come and dig it out to find out what the story was going to be.

Mary Shapiro spoke about two weeks ago -- maybe it's not even two weeks ago -- to the IOSCO Technical Committee, and informally people were telling me, oh, yes, she definitely said IFRS adoption was back on track, but I read her remarks. One of the things about the SEC is they post everybody's speeches regardless of where in the world they might have made them. So I looked at those within the past couple of days and that's not really what she said. She said that they were still committed to convergence and that they were re-opening the issues of the IFRS roadmap which happened to be our former chair, Christopher Cox's sort of brain child. So it comes with all the baggage of it being his brain child.

But there really wasn't anything in there in terms of let's get back on track for IFRS adoption. The SEC also just recently issued a draft five-year plan in which the accounting aspects of that plan was they were going to support all the convergence activities of the FASB and the IASB, but there was nothing in there that said IFRS adoption was on the radar screen.

There definitely is a significant, what I would call, the IFRS opposition in the U.S. and they just don't think if it was made anywhere else, it can't be any good and it certainly can't be any good for us. And then I'm going to go back the U.S. is not the poster child for great accounting. We're just not.

So as a proponent, I'm going to have to wait and see what they have to say. I know the convergence activities of the FASB and the IASB are going to be supported. There's lots of evidence to that. What that means in terms of the kind of harmonization I think Malcolm wants remains to be seen, because convergence doesn't mean that the standard is going to say the same thing when we're finished. Even converged standards, measurements are different, alternative types of recognition are different between the two sets of standards, and so I'm sort of suspicious about whether the convergence will get to the kind of harmonization you're looking for without full IFRS adoption.

Particularly given as a secondary item which sort of speaks to what Greg was saying, interpretation. IFRIC is the interpretive body of the International Accounting Standards Board, and they're goal really isn't to pump out interpretations. They're going to look at an interpretation and decide whether it's really necessary before they issue one. They can't issue one on their own account. They can do everything else up until the final analysis, but in the end, the IASB has to say, yes, we're willing to go with this interpretation.

In the U.S. you've got the EITF. Boy, they can't pump out interpretations fast enough. And they can do it on their own account. My big concern is even if you have "a truly

converged standard", how long is it going to stay converged when you have interpretation mechanisms that are so different?

So I'm back to what I said first. Rapid? No. Maybe you can tell that, one, I'm passionate about this, and two, I'm pretty depressed about it because I don't think we're going to get there very quickly, given some real institutional issues that have to do with the U.S. tax system as well as financial reporting.

MR. HANOMANSING: So, Doug, given this situation in the United States, what impact will that have on Canadian adoption?

MR. HYNDMAN: If you look at my bio, you'll see one of my jobs, unpaid at the moment, is the Chair of the Canadian Accounting Standards Oversight Council, of which Pat is also a member. So I'll answer this question with that hat on.

Canada made the decision to adopt IFRS before the U.S. roadmap came out, before there was any degree of commitment from the U.S. to actually adopt IFRS. There was the decision that the U.S. will accept financial statements from foreign companies in IFRS without reconciliation. I think that was a big factor in our deciding to go ahead, but since we hadn't anticipated whether or not the U.S. would go ahead when Canada picked a date and started the conversion process to IFRS, what happens to the U.S. schedule really doesn't matter and, in fact, the train has left the station in Canada.

Two-and-a-half months from now, companies are going to have to start collecting the data that's going to go into their comparative statements for 2011. The work is all being done. I think it's very important that we stick to the schedule because people are making investments in good faith in accounting systems to work with IFRS. Short of a nuclear bomb or some huge problem, I just can't see anything that would knock us off that track to be up and running January 1, 2011.

MR. TANZER: Ian, could I just ask one thing, perhaps for Pat or for Malcolm. Pat, you made a point there that you wouldn't say the U.S. is a poster child for good accounting, so is it really your sort of professional opinion, your doctor's opinion that you think the IFRS are a higher quality, that they actually produce a truer picture?

The second question was whether the political dimension here -- and you mentioned the suspicion about something that's invented from somewhere else, whether the political question is a lot simpler if you talk about convergence rather than talk about adoption of IFRS. Politically or for the opponents of IFRS, they would feel much more comfortable about the fact that you have a U.S. FASB, that is actually making the decisions, all while they are working under a mandate to try to converge.

MS. WALTERS: I don't think that you can, given the complexity of financial reporting, actually say one system is definitely better than another system. From an investor's standpoint, I have a view on every single issue, and there are some cases where I think the FASB got it right, and there are other cases where I think the IASB got it right, even on convergence.

So it's difficult for me to say that. One of the major differences between IFRS and U.S. GAAP is the extent of guidance. I think guidance is sort of a misnomer, because it basically says this is what you will do in this circumstance. There's no leeway there.

Where IFRS is definitely more of a principled-based system, there certainly are places where IFRS now says, no, you can't do what you want to do and this is the rule. So there are definitely rules in IFRS, but they're not quite the extent that there is in U.S. GAAP.

I spent the summer working on a project where I had to try to find out what the U.S. GAAP was in relation to an IFRS issue, and sometimes, I'm telling you, I could not figure out what it was. That's how extensive the tentacles are in terms of where one would go to

look for what U.S. GAAP is, because it's not just the standards of the FASB. It's also the requirements of the SEC for listed companies or SEC registrants, so it's not so easy.

But there's a significant amount of industry-specific guidance in the U.S. that does not exist in IFRS. Now, whether the convergence with the FASB is going to introduce more of that into IFRS, I don't know. But certainly one of the major areas in which people would say IFRS can't work in the U.S. is that we do tend to sue people at the drop of a hat, right? So companies would be concerned that if they couldn't point to the rule that told them what to do, that they would be more at risk for lawsuits. So there is that particular issue.

Then there's another issue that has to do with a choice for a measuring cost of goods sold, which is obviously a major expense on the financial statements that must also be selected for tax purposes that save companies billions of dollars since they first adopted this particular method. The current rule says if you switch back to another method, then you have to pay all the taxes that you had saved.

So if you figure from 1930 maybe, a major company has saved a few pennies in taxes, they'd have to pay that. So there's a whole group of people called LIFO Coalition because this is not a method that's permitted under IFRS.

So there's lots of sort of fundamental issues, not the least of which is how could we possibly let those people in London set regulations for the U.S.? How would that work?

MR. KNIGHT: Well, the starting point for IFRS, as Pat said, is to be a principle-based system, where the principle is clear.

The U.S. system is a rules-based system. It's got thousands and thousands of interpretations I understand. It's built into the regulatory system. It's built into the tax system. I think it's very hard to see the rest of the world adopting U.S. GAAP. So if we're going to adopt a single accounting standard, I think it is going to be IFRS.

But, that said, there are significant obstacles to that, not only in the United States but also elsewhere. In the European Union when the IASB put out its exposure draft on classification and measurement, which is a very, very crucial issue, on the 14th of July, there were dark rumblings in Europe, particularly in a country that speaks one of our official languages, that if this standard were adopted, then the EU should do a carve-out from the IASB standard.

Now, if the EU can do a carve-out, that might sound okay to some people, but what if Russia says they want to do a carve-out? Would we be as happy with that?

So I think there's a huge problem of international governance here, and I don't think that the G-20 has really addressed it. In the communications that they produce, they say the IASB and FASB should work to immediately adopt such-and-such an accounting standard. This is not consistent with the due process that's necessary to good accounting standards. So we have to be careful how we go forward here.

MR. HANOMANSING. Let's move on to the next topic, fair-value accounting, and I know a lot of people are here very much want to hear about this topic, and Pat -- not an accountant, but tremendous experience in accounting -- give us a brief overview of the debate over fair-value accounting.

MS. WALTERS: One of the reasons why I really can talk about fair-value accounting is that fair-value accounting is near and dear to the investor's heart. When you make an investment, any kind of investment decision, whether it's in a financial instrument or something else, you do it at fair value. You're not interested, for example, when you go to buy a house in what it cost the person who's selling it to you, what that price was. You just are interested in what the fair value is today, and you may have some negotiations about what that fair value might be, but eventually you settle on some sort of a fair value in order to do the transaction.

So information about the fair value of the assets and liabilities that a company has are important pieces of information to an investor, and if they look at a company as invested capital, then even changes in that fair value would be an important measure of a company's performance. I'd say the vast majority of investors would like to see information about changes in fair value of assets and liabilities appear in a performance statement, whether we call it the income statement or the statement of other comprehensive income. From my personal perspective, it doesn't matter because I'll move it wherever I think it belongs which may be different from where the company thinks it belongs.

But that's sort of the issue from the investor's perspective, and those are the people who tend to be the proponents of recognition of fair values on the balance sheet.

Now, what opponents would say, well, fair value information is less reliable than historical cost information. The analogy I usually like to use for that is that, well, if you break your watch - assuming you have an old-fashioned watch, it will be 100 percent reliable twice a day, right? But the rest of the time it's useless for getting around town and making sure you arrive on time. So, yes, it may be less reliable than historical cost information, but it's more relevant to the purposes for which financial statements have been prepared.

Now, the other -- one of the other issues is volatility. So a proponent would say, well, volatility is a normal experience of life. We have to learn how to deal with volatility. Pretending that it doesn't exist isn't helpful. Where preparers are concerned about volatility on their income statement, on their performance statement, because it looks like they may not know what they're doing depending on how volatile it is and, if we're honest, it may affect the bonuses that they get paid at the end of the year.

Now, one of the issues currently has to be with fair value of financial instruments. So in most cases, the standard-setters haven't gotten around to fair value of real estate yet

except in certain circumstances, so fair value of financial instruments, sometimes there is no market value so you can't point to an objective number for what fair value is. You have to use some sort of valuation model to come up with a fair value, and the valuation model is a function of the assumptions that you put into it.

So often preparers will say, well, the information really isn't even relevant because of the valuation models that we're using, and that there aren't good valuation models for certain types of instruments, and I would say, well, then, why are you investing in these instruments in the first place if you can't figure out what the fair values are?

It's like anything else. You don't improve mechanisms unless you have to use them. So valuation models will only improve if companies are required to use valuation models and provide this information.

So there are a few issues that I think need to be addressed. One is what happens when there is a complete market disruption that causes there to be what many might consider to be unrealistic values in the marketplace. For example, is an asset really worthless if no one will buy it from you as long as the counter-party is still making payments? I say the answer to that question is no, and perhaps the market prices aren't the place to look for fair values, but a fair value could still be determined.

So usually I end my description between why I think fair value should be both on the balance sheet and on the income statement, has to do with looking at the person who says, “No, I only want historical cost or amortized cost information to be on those statements” is "Are you going to be the first person in line to buy the security of a company who switches back from fair value to historical cost?" Because there's absolutely no way for you to understand the risk associated with that company unless you have that information.

My experience has been that providing that information in a footnote disclosure makes it less of a concern for reliability when it comes to the preparer. If it has to be on the

balance sheet and in the primary statements, they take it with greater seriousness than if it only needs to be in a footnote disclosure.

From a professional investor's standpoint, I don't really care where the geography is. I do care about how serious the preparer is in terms of what the measurement of those numbers might be and explaining to me what the assumptions are that went into those.

So from my perspective, fair value is the only measurement criteria that should be used for financial instruments.

MR. HANOMANSING: What does transparency look like if you move away from fair-value accounting?

MR. KNIGHT: Well, I'm very partial to fair-value accounting as well. Actually, for five-and-a-half years, I was the CEO of what is probably the world's largest bank that is entirely on fair-value accounting. The Bank of International Settlements has a balance sheet of about $550 billion, and I guess, as a former CEO, I would say that one of the wonderful things about fair value accounting, particularly since 2007, is that the volatility really catches your attention.

And it does make management much more alert. You're always asking why did that happen? I don't understand why that happened, and trying to figure it out. It often has very significant implications.

That said, I think that in the real world, and going beyond all of these complications, we probably are in a world of a mixed-accounting model in which some instruments will be recognized at fair value, and placed in a book like the trading book, and other instruments will be recognized on the balance sheet at historical cost with impairment.

These two valuation methods are very, very different at this point because fair value, when there actually are markets for things, in my opinion is fundamentally forward-looking. The price is always based on the expectation of what its return will be over a holding period. Whereas under current accounting and tax rules, impairment is based fundamentally on incurred loss and therefore is backward-looking. I believe that actually if the impairment rules and the provisioning rules could be made more forward-looking, the difference in the valuations between these two methods would be less. So I think we're going to have a mixed model with historical costs with impairment and fair value.

I just might add that the bank I ran was also probably the most liquid bank in the world, and I asked my chief accountant, when the crisis started, "what proportion of our assets were level 1", which means you really have a recognizable market price for that asset. The most liquid bank in the world, the answer was 22 percent of our assets. The other 78 percent were level 2 or level 3. So it's not so easy to get the fair values.

The final point I would make, which I think is important, is that sometimes the accounting can get in the way of behaviour that makes sense from an economic point of view. I think that in this crisis we saw too few shock absorbers in the system. Why did we see too few shock absorbers? We saw too few shock absorbers because there were no sectors that were willing to move in and pick up some types of assets that were obviously selling at low prices relative to what would be their -- their return in the longer term because they had a balance sheet which was fair-valued.

So I think there is a tendency for fair-value accounting, one, to give a false sense of the accuracy of the valuations which turned out to be very important in this crisis, and two, to make investors that should have a long term time horizon sometimes have a shorter one. These are risks. I think they can be corrected by a more forward-looking impairment and a mixed model.

MR. TANZER: Well, I was going to kind of add to and enforce Malcolm's point. As a non-accountant, I've always been struck by this issue about the difference between the historical cost with impairment rules and what you think of as a fair-value model which I do think -- and I agree with you, Malcolm -- tends to be more a forward-looking or a kind of predictive thing for what you think are the future cash flows.

I never quite understood the difficulty for fair value in thinking about impairment in a similar sort of way that if you have a loan book, that over twenty years will have these types of impacts. Why it actually isn't consistent with fair value to be able to take those future defaults into account I just don't understand that. Within the Financial Stability Board and all these discussions that are happening, a lot of the discussion has been about how provisioning and impairment rules can properly work with fair-value accounting in particular.

The other sort of key thing here, which has been very strongly debated, is the extent to which fair-value accounting drives pro-cyclical type behaviour, and seeing that as an undesirable feature, particularly from a banking or insurance -- or a general prudential regulation viewpoint. It tends to make people keep going to the punch bowl when things are going well and they're getting too drunk. And then at a time when, actually, they're pretty thirsty and they could do with some punch, they're not willing to go there for the reasons that you're suggesting.

I think there is a lot in recognizing accounting for what it is, which gives you an accurate picture or as accurate as you can get of the entity at the time, and the point that you made about what is it that we can [do to] get people to reflect on the slightly longer term. That's an easy thing for me to say as a regulator, and I can quite understand for people who are running businesses and they see their balance sheet just deteriorating and deteriorating.

But if you look now, and if you look at most of the crises that have happened at least throughout the last century, let's say the longest they last is a year or two. Now, I know

that's a long time, but it's actually not a long time in my lifetime. It might seem long at the time, but actually most of the money that I made and most of the financing leads that I have are extending over a much longer period than that.

And I'd like to think that my pension fund thinks the same and I'd just like to see some more longer-term thinking in that. As I say, maybe that's pie in the sky.

MR. HANOMANSING: So, Doug, whether it's fair value or emissions trading schemes, obviously there continue to be proposals about changing accounting standards. Should regulators use standards of accounting to achieve economic or policy outcomes?

MR. HYNDMAN: I'll go back to what Pat said at the outset. I mean, I think the purpose of financial statements is to provide useful information for the users of the statements, and when we're talking about publicly-traded companies or publicly-accountable enterprises, that means investors and creditors. I think you need to be very cautious about getting in and mucking around with accounting standards to achieve other objectives, like financial stability or whatever, by distorting useful information for investors.

I think Greg was touching on this as well, that we really need different ways to focus on how to get people to think long-term, how not to have fluctuations in asset values as a result of market fluctuations drive counter-productive regulatory reactions because of their impact on regulatory capital, for example.

So if fair-value accounting is causing a problem for the way the capital rules work, I say change the capital rules don't change the accounting.

Having said that, there's lots of room for improvement in accounting, and I think you touched on one of them is that we know at the top of a cycle when banks are out making loans, that's when they're making their bad loans. They're not going to know they're bad for a while, but they should be making provisions for them then. The problem is from an

accounting and from an auditing point of view, auditors -- they can't [say] “where's your evidence? How can you take that impairment charge? You don't know what loans are going to go bad yet.” I think we have to find a way around that so that we get more realistic values from that perspective.

But that, to me, is improving fair-value accounting, not throwing it out and not changing the purpose of financial statements.

MS. WALTERS: There were two words that I don't use for financial reporting. One is truth and accurate -- and the other is accuracy. The reason I don't use those is because every single balance sheet line item is an estimate of one kind or another, even cash and cash equivalents. Because, if you're looking at a multi-national, there's foreign currency translation involved and what the rules are for how to do that.

I think one of the big issues between fair-value and amortized historical cost with impairment testing and uncollectibles estimates is how one does the estimation. So if you're looking at receivables and held at amortized costs, some sort of asset, and your job is to do an estimate of uncollectibles, well, you're going to look at past history and how that went along, so there is more historical information built into the estimate.

But the estimate still has to be forward-looking in some fashion, because you want to know what you're not going to collect in the future.

Fair value looks at that in a different way. It does the estimate in a different way, and one of the arguments is which of those estimates is closer to what reality is going to be, and certainly people that are involved in the markets and think that the markets are mostly efficient, if not 100 percent efficient, would say that the fair-value information has a better estimate in it of future uncollectibles than the company's estimate of its own historical uncollectible rate, so to speak.

So I do think that even amortized cost has a forward-looking component to it, it's just different.

One of the things on my list that I definitely wanted to get across, Doug did for me, which is that one of the issues with fair value is that it really causes problems for banks with their prudential regulator.

But I'm totally in agreement with Doug on this, is that the purpose of the financial statements are for external investors and creditors. If that doesn't meet the needs of the prudential regulator, then the prudential regulator should develop standards by which it measures capital that makes sense for it, as opposed to trying to change what the financial reporting rules are going to be so that they disadvantage investors in the capital markets. They probably don't want to hear that, but that's what I think should happen here.

MR. HANOMANSING: Okay. So questions from the floor over here.

MR. SORBO: Lehman Brothers you mentioned earlier, and I think they had a lot of leverage. I looked at their 2007 financial statements, and you could not tell from those statements the leverage or the off-book transactions they had. Enron, I think, was a big problem with off-book transactions and that you couldn't tell their products that blew them out of the water, and I think certainly Arthur Anderson audited those statements.

So with Lehman Brothers, a lot of their securitized vehicles were set up and put in the Cayman Islands. And certainly their financial statements went to the SEC, and the RAC was not clearly showing the problems that may come out of Lehman Brothers.

So is IFRS going to change that, and if U.S. GAAP doesn't change to IFRS, is this problem going to repeat itself?

MR. KNIGHT: I actually don't like the concept of leverage as a way of looking at the risks in an individual institution. I think that the Basel type risk adjusted capital asset ratio is much superior.

To my mind, the issue of financial stability has been that, in the period from 2001 to 2007, excessive leverage built up in the financial system, and a lot of that leverage is embedded leverage. You can buy an instrument with cash, but if it has a very non-linear payoff, that creates embedded leverage in your balance sheet.

So I think that one of the things that we need to do in looking at systemic risk is to get much better measures of systemic leverage. That said, I don't think that whether we look at leverage using IFRS measures or U.S. GAAP measures, I don't think that's really the answer. They will give very different numbers for different institutions, that's for sure. But I think we should look at risk-weighted ratios rather than crude non-risk-weighted ratios.

MR. HANOMANSING: Pat?

MS. WALTERS: Well, first of all, I think the issue that you're bringing up about Lehman Brothers is a different issue from Enron, so let's just talk about off balance sheet vehicles for one minute. It's my personal belief - and I have written about it - that I think that it would have been more difficult under IFRS to move some of these vehicles off balance sheet. So that doesn't mean that companies didn't move them anyway, but I think that if the standards were applied correctly, then more things would have been on companies' balance sheets than would have been on a U.S. GAAP balance sheet because IFRS didn't have this separate legal qualifying entity where, as long as you had somebody come along and make a legal statement that you were separate from this entity, you were able to move it off balance sheet. You had to look to the substance of the transaction to do that.

So assuming that holds going forward, the answer to your question would be yes. In this particular instance, I think IFRS would be of a higher quality than U.S. GAAP in that

respect, but I think that U.S. GAAP has learned from that mistake. So it's going to move closer to what IFRS would have required in the first place.

Enron, on the other hand, was fraud. There may have been applications of U.S. GAAP that would have contributed to off balance sheet entities, but there's no question that there was fraud in Enron.

There you have an issue -- whether or not Arthur Anderson participated in the fraud is a separate question -- I'm usually not an apologist for auditors, as anyone who knows me would know. But most audits are not what we call a forensic audit, so they're not out there looking to see if anyone has done fraud. If it happens to leap up and bite them, then they'll do something about it.

But I don't care what GAAP you're under. If there's an entity that's attempting to defraud not only its investors but the auditors, there will be some who will be successful at that because the system just isn't set up to catch it in every case.

MR. HANOMANSING: One of the hallmarks of the financial crisis has been the many complex products that were involved in the lead-up to the crisis, securitization, collateralized debt obligations, the list goes on. Should regulators have done more to control these?

MS. WALTERS: Well, my short answer to that is, yes, they should have, I think there were several problems for regulators. One, they probably weren't part of their mandate and they would have had to get additional regulations to do that, and certainly with the hedge fund industry, in the U.S., we've seen very successful political actions to prevent the SEC from having control over them. I don't think that's going to hold going forward because of the crisis.

But the overall mandate of the regulator matters in terms of what instruments they can control and what instruments they shouldn't control. If any of these are sold to anybody, even what we might consider to be a sophisticated investor, then I think the regulator should have the ability to control them at their leisure.

Now, one of the problems that the regulator often has is these kinds of instruments are not simple to understand. They're not simple to understand for people in the industry. And so the regulator has to have people on staff that can do that.

In some sense, the issue that came up earlier about Bernie Madoff was that there was somebody out there who was asked by their employer to reproduce Bernie Madoff's returns. He set about trying to do that, and he basically said this can't be done. Something is wrong here. So you have somebody whose whole life is determining complex transactions who basically wrote to the SEC saying, "This is not doable. Whatever this guy is claiming he's getting is not possible in the current marketplace." But how many people in the world would have been in a position to do that?

Certainly very few people, I would venture to say, who are employed by securities commissions unfortunately because they're making more money out there determining what these instruments are.

So I really think that a major problem for securities regulators is that the people that are actually coming up with the instruments are getting paid a way more money than the people who are trying to figure out what they're doing and what those things are going to do to the financial system.

It's sort of like a tax accountant. A friend of mine is a tax accountant. He said he has far more incentive to understand what the tax regulation is than the person who works for the IRS who's going to call him in on the carpet because he's getting paid to do that.

So, yes, I think they should control these, but they need to have the resources in order to do it.

MR. HANOMANSING: And, Greg, should we allow these complex products out into the retail space?

MR. TANZER: Yeah, it gets to this key question about whether the role of the regulator is to be like a gatekeeper or somebody who kind of approves products that are suitable for retail distribution. We all do that. We all approve or register or do something with a prospectus or a disclosure statement. But what we don't do is give any sort of warranty about whether this is a good product or a bad product.

The normal approach is that provided all of the risks of the particular product are appropriately disclosed, and leave it to the good sense of investors to make their own decisions.

And I've got to say that as a regulator of some years, I certainly question that assumption myself for two reasons, really. One was that in this case, and in the case of the recent crisis, I mean we actually weren't dealing with retail investors buying most of this who had all of these risks fairly disclosed to them and just made a dumb decision. We were dealing with so-called sophisticated or professional investors.

But, when we talk about professional investors, I normally think about somebody that's pretty wealthy, sits, looks at the screen and largely they're playing with their own money, and that's what I think of as a professional investor. These were actually the guys who were employed by somebody else to play with somebody else's money to manage. These were highly professional people who were paid to do this job, and made some really dumb decisions about some of this.

When even the most professional people were making really a dumb decision, you've got to question the sort of underlying assumption that you've got that people can make a good decision provided they've got adequate disclosure.

That said, having put up five arguments why we should change this, I'll tell you one really good argument why we shouldn't, which gets back to the point that Pat made. I don't think regulators are actually in a very good position to make those sorts of judgments. They're never going to be ahead of the market. That would stifle financial innovation entirely. I can tell you, if you want me to make all of your investment advice decisions, you're going to end up with a pretty boring portfolio. I've worked in regulation for a long time; I'm kind of risk averse, so sorry about that.

I do say, though, that I think there is room for regulators to think about something that's a step back from making a value judgment about the product, and that's in the area of suitability of products. We have all of this product safety regulation to make sure that children's toys can't choke them -- as if they're going to jump up and choke the child, but we've got product safety-type regulation for a whole range of things, and I think that this suitability notion could be applied a bit more, just to kind of put a bit of a break and a bit more sort of ethical and sensible behaviour into the design and structure of products.

Because, at least if I was talking about Australia, you could produce a product whose primary purpose is just to generate fees through the sale of it and be able to sell that provided you just disclose that the whole purpose of the product was to take five percent off the top. We're not going to do anything else with your money, we're just going to give you back the rest at the end. That's a really poor product, or to have something that is really an entirely unsafe business proposition where the chance of it actually turning a profit is so small.

I'd kind of like something built into the system that says, well, actually, what you're doing here is producing something that really is unsuitable for its purpose. You're

marketing this as something that is viable for someone to invest in, and only a complete idiot could possibly buy this, or this thing is simply not suited for its purpose.

I think that might put a little bit more emphasis back on people in the selling and distribution part of it, to take a little bit more responsibility for the products at least being reasonably calculated to achieve their purpose.

But this is a very touchy part of the debate. I just think some of that incentive could be realigned by looking a bit harder at suitability.

MR. HANOMANSING: Well, thank you very much. It's been very interesting listening to the four of you, and I want to finish with the same question for all four.

What advice do each of you give the conservative risk-averse investor looking for a long-term strategy.

MR. HYNDMAN: Well, you could hire Greg to manage your money for you. It might be a start.

But seriously, I think the first thing an investor should do is develop an appreciation for what the market is all about, that it's about a balance between risk and return. When people come to you and promise high return, no risk, that there's something wrong there. Investors just have to be able to understand that there is a trade-off here and there's no free lunch. They've got to be realistic about what's achievable.

They need to respect the market. Don't fear it, but recognize that markets go up and down. If you're going to put a good chunk of your money into the equity markets, you have to be prepared to ride the ups and downs and take a kind of long-term view that Greg was talking about earlier.

Thirdly, I think it's really important to find yourself an advisor of some kind with whom, as an investor, you could work closely who you can develop a level of trust with, but to follow the supposed old Russian proverb: trust but verify. Ask lots of questions, make sure you understand everything before you buy it. It's your advisor's obligation to make sure that you only take risks that you understand. If the advisor can't explain it to you, you should either not buy the product or find yourself a new advisor.

MR. TANZER: I'll pick up Doug's last point and make it as my first one and say that I thought of it first. Actually, to adapt it a little bit, I think it's very important for people to read the disclosure that's given to them and to ask themselves a simple question: whether they think that what's being promoted can actually produce the return or the money that the promoter is saying. And if it looks too complicated and you feel like you don't understand it, that's their fault, not your fault. You shouldn't buy it.

I link that to the point that in my ASIC experience, we have a lot of scams in Australia. We came from a convict culture, I guess. But you would be surprised by the number of scams where there is disclosure, and if you read the disclosure, it looks vague and stupid that you just think I just don't understand this, but people still invest because they think they're too silly or they're not sophisticated enough or whatever.

So the first point of advice is read it and just ask yourself the question whether you can understand how this is going to make you money. If you do that, you'll probably end up avoiding a lot of dead weight losses in your life. A scam, you just lose all your money. If you make a bad investment, sometimes, you might get some of your money back at least.

I think the other point is really just be prepared to invest for the long term.

MS. WALTERS: Well, certainly I think that the average person should educate themselves at least to some level that they know what questions to ask. I also think that the average

retail investor does need an advisor. But I think the process of how to select an advisor isn't communicated to them well enough.

One, you should know what kind of education and credentials your investment advisor has. That shouldn't be, "I'm good at marketing."

The second is you should know how the investment advisor is paid. Is he paid by selling you something, or is he or she at risk as you are at risk in investing in a particular vehicle?

I also think that the investment advisor -- you should be expecting the investment advisor to understand and question you about your risk and return profile so that he or she does not recommend anything to you that is unsuitable for that profile. It shouldn't be his or her profile, it should be your profile, and everything should be in writing in terms of the understanding of what your risk and return profile is and how the vehicles that they're going to recommend to you are going to support that profile.

Personally, I think that anyone who sits across a table from someone else and either recommends an investment or a borrowing of some kind should be required by law to worry about suitability, so suitability to that particular client.

Last, but not least, I would say the following: If it looks to good to be true, it is too good to be true, and don't put your money into it because you're just increasing the wealth of the person who's sitting across the table from you and not yours.

MR. KNIGHT: While all this is sage advice, even if you've probably all heard it before, know what your risk return preferences and tolerances are. Hold a diversified portfolio and never invest in any asset that you really don't understand. Get a good investment advisor, diversity, et cetera. Look to the longer term. These are all good suggestions.

The problem last year, though, was that -- and maybe it wasn't true here in Canada -- if you were in the United States, it was very frightening. The period from the failure of Lehman Brothers until all the banks were brought into the net of a global guarantees and capital injections, which is about the middle of October, was a terrifying period for two reasons.

One is that after the stock market started to drop, all asset returns appeared to be positively correlated and going down. Secondly, there were no assets other than Treasury bills that you could buy that were risk-free, and you couldn't buy Treasury bills because the banks were grabbing them up. So that was a frightening time, and it was a time of fundamental failure of the financial system.

I think the issues that we were talking about before the break are absolutely crucial to this. I do believe that anybody who advises, is dealing with a retail client, either selling them a product, or getting a fee from and advising to buy a retail product, has a fiduciary responsibility because there's information asymmetry there. You only buy a house a couple of times in your life, at least in Canada, but the mortgage broker is selling this package of mortgage debt all the time. That person should make judgments about whether you're really going to be able to stay in that house and service the mortgage.

But beyond that, in that period September 15th to October 15th, the whole financial system failed the retail investor. The regulators, the big banks, all of the large financial institutions, we have to create a system that doesn't do that again.

MR. HANOMANSING: So what's the good news?

MR. KNIGHT: The good news is that we can

MR. HANOMANSING: Well, thank you very much, and I hand it back over to Brenda.

MS.LEONG: Well, thank you, Ian, and I want to thank our panellists - Patricia Walters, Doug Hyndman, Malcolm Knight and Greg Tanzer - for their very clear and thought-provoking comments and observations today.

Ian Hanomansing, you were terrific in guiding the discussion and we invite you back again next year.

It's obvious that there were many, many issues that were covered today and I wouldn't even begin to try and summarize where we ended up or to capture what was said today.

But just a couple of observations. We started out by talking about systemic risk and the need for a systemic-risk regulator, whether that be in a single entity who's independent and accountable for that function, or whether or not it lies with the regulators who come together in a forum by which they can gather data, debate and discuss whether or not there are emerging risks to our capital markets.

I'm not sure that we ended up agreeing on where we should end up on that, but I think what came out for me was that there is risk inherent in our financial markets. That's not a bad thing. So what we need to do, I think, as regulators, is to not get rid of it, but to do a better job of identifying it and managing it so that we're able to withstand unforeseen circumstances.

We also talked about the need and importance of international cooperation and harmonization, and that can't be any more true than it is today, given what we've learned over the last two years. With the inter-connectedness of our global markets, this becomes increasingly important. For Canada and securities regulators, of course, the challenge is going to be how much harmonization do we need?

I was encouraged to hear the panellists, and I think there was some agreement here that while international standards are important, that it was also equally important to ensure

that we implement those standards in a way that's practical and that makes sense for our individual capital markets. Certainly that's the take-away that I'll be bringing to many of the discussions and debates we'll be having as we talk about the G-20 commitments that are being made.

We touched a lot on international financial reporting standards and I have to thank Patricia particularly for making a very difficult subject very interesting and very understandable, and I'm sure all of you would agree with that and particularly those in the audience who are non-accountants.

We closed by having some very thoughtful comments from each of our panellists about some advice and tips about how to invest for the long term and to protect ourselves in a very complex and very fast-paced market. So, with that, I just want to thank our panellists again and please join me in showing our appreciation.