Importance of Financial Regulation in the Securities Industry

An English poet, John Donne famously wrote that "no man is an island." An old adage which can also speak to the interconnectedness of financial markets and how their actions impact the global economy. The global financial crisis of 2007 – 2008 ("the financial crisis") serves as a stark reminder of the domino effect of the downturn in major financial markets on other economies. Inadequate regulation and supervision in global financial markets and banking systems are one of the main causes of the financial downfall. More than ten (10) years later, regulators worldwide continue to explore the lessons learnt from the financial crisis and have since implemented financial regulatory reforms to lessen the likelihood of the recurrence of such a colossal economic downturn. Adequate and appropriate regulation is critical to mitigate market failures. Through financial regulation, the Trinidad and Tobago Securities and Exchange Commission ("TTSEC"), with the cooperation of other local regulators, aim to mitigate systemic risk. This week's article explores the meaning of financial sector regulation and its importance to the proper functioning of the securities market.

Definition of financial regulation

Financial regulations are laws or rules that govern financial institutions. As it relates to the local securities industry, entities registered with the TTSEC are required to abide by these laws or rules. Unregistered entities are not excluded from the TTSEC's supervision, in that, where an unregistered entity engages in the prescribed business activities outlined under the securities regulations, the TTSEC issues a cease and desist order to stop engaging in such activities. Financial regulation in the securities industry includes disclosure and reporting requirements, restrictions and guidelines that aim to protect investors from fraudulent and improper practices; build market confidence and mitigate systemic risk.

The types of securities regulation

A 2020 Congressional Research Service Report[1] categorises regulations applied to participants within the financial markets. In relation to the securities industry, some types of regulations utilised by the TTSEC are as follows:

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[1] Congressional Research Service. (2020). *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework.* Retrieved January 17, 2022 from https://crsreports.congress.gov/product/pdf/R/R44918.

- **Prudential** – This regulation ensures the institution's financial safety and soundness. Regulators analyse the risks of the institution on both micro and macro levels. The TTSEC utilises its Micro and Macro-Prudential Reporting Framework to obtain and analyse the financial data of registrants, self-regulatory organisations and collective investment schemes. This data allows the TTSEC to evaluate the financial health, soundness and potential vulnerabilities of the reporting entity and the securities market.
- **Disclosure and Reporting** – This regulation requires market participants to abide by certain disclosure and reporting obligations. For example, the timely disclosure of financial statements or information allows investors to make more informed investment decisions.
- **Standard Setting** – This regulation involves the establishment of standards by the regulator for financial products, markets and conduct.

The objectives of securities regulation

The International Organization of Securities Commissions ("IOSCO") outlines three (3) objectives of securities regulation:

- **The Protection of Investors –** Regulators' main focus is to protect investors from misleading and fraudulent practices such as insider trading.
- **Ensuring that markets are fair, efficient and transparent –** Regulation should aim to provide fair access of market facilities and market or pricing information. In addition, it allows the dissemination of relevant and timely information to allow the investor to make informed decisions on whether to buy, sell or hold securities.
- **The reduction of systemic risk -** Regulators should establish regulation to allow the active monitoring and assessment of risks taken by market intermediaries. This prudential oversight reduces the possibility of market failure.

The role and powers of the securities regulators

Regulators are charged with the responsibility of supervising the market in which they operate. Each regulator should have adequate powers, resources and capacity to allow the proper discharge of their functions. Specifically, Section 7 of the Securities Act, Chapter 83:02 of the Laws of the Republic of Trinidad and Tobago ("SA 2012") empowers the TTSEC to:

1. formulate principles for the guidance of the securities industry;
2. treat with such matters as may be referred to it by any person from time to time;
3. register and regulate market actors in accordance with this SA 2012;
4. monitor the solvency of registrants, securities markets and self-regulatory organisations and take measures to protect the interest of investors where the solvency of any such person is in doubt;
5. adopt measures to supervise and minimise any conflict of interest that may arise in the case of registrants or self-regulatory organisations and where appropriate, other market actors;

6. review, approve and regulate takeovers, amalgamations and all forms of business combinations in accordance with the SA 2012 or any other written law in all cases in which it considers it expedient or appropriate to do so;
7. review the contents of prospectuses and issue receipts therefor, and review any form of solicitation, advertisement or announcement by which securities are proposed to be distributed;
8. take enforcement action against any person for failing to comply with the SA 2012;
9. recommend By-Laws to the Minister of Finance;
10. formulate, prepare and publish notices, guidelines, bulletins and policies describing the views of the TTSEC regarding the interpretation, application or enforcement of the SA 2012;
11. make orders;
12. undertake such other activities as are necessary or expedient for giving full effect to the SA 2012; and
13. do all things, and take all actions, which may be necessary, expedient, incidental or conducive to the discharge of any of its functions and the exercise of its powers under the SA 2012.

Regulation is one of the main tools utilised by the TTSEC to regulate the securities industry. It bestows powers and authorises the TTSEC to perform its functions to ensure the protection of investors; the development of the local securities market; and the mitigation of systemic risk. In next week's article, we will take a closer look at the specific securities regulations of Trinidad and Tobago.

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