



Notes for  
an address by

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entitled:

***“Independence and External Supervision of Regulatory  
Authorities: Mandate, Management Contract and the Role of the  
Congress”***

presented as part of the international seminar organized by the  
Securities and Exchange Commission of Brazil under the theme:

**“CVM’s 30th Anniversary: Assessing the  
Present, Conceiving the Future”**

Rio de Janeiro, Brazil  
September 4, 2006

**Check against delivery**

**Good morning Ladies and Gentlemen,**

I am pleased to be with you here today.

At the outset, I wish to thank Marcelo Fernandez Trindade, Chairman of the Securities and Exchange Commission of Brazil, for this invitation to the international seminar organized in connection with the celebration of the 30<sup>th</sup> anniversary, not unfortunately of Marcelo's birthday, but of the agency that he heads.

I would like to take this opportunity to commend Marcelo and his agency for their great drive, as well as their contribution to promoting exchanges among members of the international financial community. The more we exchange information and reflect on the best regulatory practices, the better our financial markets will be able to operate. I tip my hat to the organizers of this international seminar!

We are meeting not only in a festive setting, but one that is also truly charming. This is a wonderful opportunity for me to see, for the first time, this fascinating and magnificent city of Rio de Janeiro.

It is therefore a privilege for me to be here with you this morning, in Rio de Janeiro, to share my views on financial market regulation.

## **Topic at Hand**

As you know, efficiency in the capital markets is based on the public's confidence in the integrity and fairness of those markets.

When considering the fundamental elements that are conducive to the establishment of a competitive economy, it is apparent that the level of confidence people can rely on in managing their businesses and carrying on their commercial activities is the cornerstone of prosperity and progress.

The success of entrepreneurs stimulates growth in our economy. The latter, in turn, requires new ideas and optimistic people who are ready to take risks. It also requires that the public have confidence in the capital markets.

It is the responsibility of market participants as well as regulators to implement and apply good governance practices in order to establish markets that function with integrity and fairness.

Accordingly, regulators must project an image of efficiency and credibility. To do so, a regulator must adopt best practices with respect to its independence, impartiality and governance, as well as its ability to carry out its responsibilities.

This is why, this morning, I will speak to you about the importance of the independence and external supervision of regulatory authorities.

This is a topic that is dear to me not only as the President and CEO of Québec's *Autorité des marchés financiers* (AMF), but also as a former Secretary General of the government of Québec. In my role as regulator, you will undoubtedly note a quest for independence, while, in my role as a former public servant, you will hear a plea for external supervision. I hope to be able to strike a proper balance between the two.

In fact, the general message I would like to convey today is the following:

First, regulatory agencies require all the independence necessary to conduct their operations; and

Second, they must report to elected representatives as part of a rigorous and transparent process.

## **Creation of the *Autorité des marchés financiers***

You are no doubt well aware that the profound changes that the capital markets have undergone over the past two decades have had a significant impact on regulatory organizations.

One need only think of the following:

- deregulation of the financial sector,
- cross-sector convergence,
- market globalization,
- as well as the launch of new financial products.

These changes to the financial landscape inevitably gave rise to a redefinition of regulatory structures.

As a result, a number of governments throughout the world have carefully re-examined their financial sector regulation. In the majority of cases, these examinations have led to the drafting of reforms that have either been announced or already initiated.

Québec's market regulation system was also part of this review process. In an effort to achieve more efficiency and thoroughness, Québec modernized its system. As Australia had done with its Wallis Commission, the government of

Québec established in 2001 a task force whose mandate was to review the structure of financial sector regulation in Québec.

In order to satisfy the need for streamlining and efficiency required in an ever changing financial sector, the task force recommended to the Québec Minister of Finance that regulation be entrusted to a single entity that would comprise the functions and staff of five organizations.

Thus, with the exception of federally chartered banks, the AMF's regulatory activities cover Québec's entire financial sector—be it securities, insurance, deposit institutions or the distribution of financial products and services.

The AMF launched its operations on February 1, 2004.

The launch has fostered synergy among all the key players involved in enforcing financial sector laws and regulations. In addition, through its one-stop service structure, the AMF has placed consumers front and centre.

Governments in numerous countries have or are in the process of assigning financial sector regulation to a single entity. These countries include the United Kingdom, Ireland, Denmark, Norway, Sweden, Japan and Singapore.

## **Principles of Independence and Impartiality**

As would be expected, faced with a major reform of Québec's financial sector regulation, industry participants and the general public expressed their concerns.

One of their principal concerns pertained to the provisions of the statute creating the AMF that were intended to establish a solid footing for the credibility of the new regulator in the eyes not only of Québec capital market participants but also of foreign capital market participants.

Many commentators believed, quite correctly, that this credibility would depend on the image that the AMF presented regarding its independence, impartiality and governance as well as its ability to carry out its responsibilities effectively and efficiently.

Accordingly, in order to avoid any political pressure, the AMF was not incorporated into the executive branch of government. It is therefore independent from political authorities.

Today, decision-makers and analysts are increasingly aware of the need to safeguard financial regulators from political pressure in order to improve the quality of regulation and monitoring.

The principle of independence is explicitly stated in the 30 regulatory principles, established by IOSCO, which set out minimum standards of quality that national regulators should seek to achieve.

I would like to cite just one of the paragraphs from section 6.1 of the IOSCO principles: *“The regulator should be operationally independent and accountable in the exercise of its functions and powers.”*

In fact, this principle is applied by the International Monetary Fund and the World Bank to assess the quality of capital markets and regulatory systems.

## ***External Supervision***

Independence, of course, does not entail the total absence of political control.

When regulators are safeguarded from political intrusion, one must also ensure that other groups, such as those representing the interests of industry, do not exert undue influence on the regulatory system.

A regulator that is subject to this type of pressure may confuse the interests of the industry with those of the public.

For example, regulators may seek to reduce the costs incurred by the entities they regulate, rather than attempt to strike a proper balance between those costs and the benefits to the public. As well, regulators might apply the rules in an inconsistent manner, such as allowing certain firms to sidestep regulatory requirements.

Some analysts have expressed concerns that such regulators might form a “fourth estate” within the government and defy all attempts at supervision.

Although such concerns may seem exaggerated, they nevertheless underscore the importance of an appropriate apparatus for accountability that strikes a balance between the advantages and disadvantages of the independence of regulators.

A useful study carried out in 2004 by the International Monetary Fund and entitled *“Should Financial Sector Regulators Be Independent?”* notes that: *“Financial sector regulators and supervisors might need a substantial degree of independence—not only from the government but also from the financial services industry—to fulfill their mandate to achieve and preserve financial sector stability.”*

## ***Accountability***

However, if a regulator is independent, how and to whom must it report? And if it forms part of the government's administrative machinery, can it be independent?

For many analysts, this question raises a dilemma.

Independence can never be absolute. Political legitimacy requires that every independent regulator be held accountable for the manner in which it asserts the prerogatives delegated to it by law.

The principle of independence, when properly applied, provides mechanisms for ensuring that the regulator concerned will be accountable for its actions, while being safeguarded from external interference.

A regulator's accountability is the key to its independence.

There is no need for compromise between independence and accountability, because the two notions are complementary. On the one hand, accountability gives full meaning to independence, and on the other hand, the more an agency assumes independence, the greater the importance of the rules defining its accountability.

In my opinion, in order to ensure the efficient operation of an independent regulator, careful attention must therefore be paid to four dimensions of this independence:

1. institutional independence;
2. budgetary independence;
3. regulatory independence;
4. and, finally, supervisory independence.

I will discuss the features of these various dimensions.

## **Institutional Independence**

Institutional independence is the first dimension that a financial regulator should possess.

Such independence is guaranteed by provisions that clearly define the following:

- the terms and conditions for appointing and dismissing senior executives;
- the governance structure;  
the roles and responsibilities of senior executives; and
- the transparency of the decision-making process.

As regards the AMF, these provisions have been clearly defined.

Senior executives should be appointed by the government, which in turn should determine their remuneration, employee benefits and other terms of employment.

The higher the body making the appointment, the easier it is to endorse the principle of independence.

Although a government appointment is more time-consuming and more complex than a ministerial appointment, it enables the appropriate minister to more easily avoid pressure from special interest groups or potential candidates. In addition, a government appointment extends greater credibility to the appointee. Ideally, a transparent process that emphasizes the skills of the candidates should be set up.

Senior executive should be bound by a code of ethics and professional conduct.

The integrity of staff is also essential. The task of achieving a regulator's objectives must not be compromised by inappropriate conduct or the desire to satisfy personal interests. Thus, a regulator's staff members should also be bound by a code of ethics and professional conduct.

It is also desirable to establish various internal policies, guidelines and procedures that foster good governance. Among other things, they should promote information security and the prevention of conflicts of interest.

### ***Advisory Board***

The top executive should be able to rely on the support of a board of directors or an administrative advisory board.

Unlike a board of directors, an administrative advisory board provides a regulator with numerous advantages, including:

- ability for management to act with full independence;
- timelier and more appropriate responses to market developments; and
- avoiding the possibility that a board of directors may be a channel for furthering the interests of an industry or company in particular.

The members of the advisory board should be able to participate directly in the regulator's governance and advise the top executive on his administrative duties.

They should be appointed by the government and chosen for their knowledge of the financial industry as well as for their expertise in the area of administrative management.

Such a board might be assigned several functions, including:

- advising the regulator on the compatibility of its actions with its mission;
- advising the regulator on its corporate governance, in particular as regards its budget estimates, staffing plan and activity plan;
- making recommendations to the top executive concerning the appointment of senior staff;
- making recommendations to the minister concerning the administration of the regulator and the efficient use of its resources; and
- reporting to the minister on any matter submitted to it by the minister.

Thus, the board could play an advisory role not only toward the regulator but also toward the appropriate minister. This would enable the government to exercise some degree of supervision over the regulator.

However, in order to maintain the independence of the regulator, the advisory board must not, under any circumstances, have any authority over the routine matters handled by the regulator, since this would severely impact the regulator's credibility and integrity. Its functions should be limited to the decision-making and governance processes.

## **Budgetary Independence**

The second dimension of independence that a financial regulator should assume relates to the budget.

Ideally, its financial autonomy should be ensured through the dues and fees paid by the individuals and firms governed by the laws enforced by the regulator.

This limits political interference.

However, as I mentioned earlier, accountability measures must also be implemented.

The regulator should therefore substantiate its budget management, in advance, as part of the budget appropriation process and, on a retrospective basis, when accounts are examined.

### ***Reporting***

Although a regulator's independence provides it with much leeway to take action, it creates the need for detailed accountability reporting.

In light of the significant responsibilities entrusted to a regulator, the public should be assured that it is using its powers in a proper and reasonable manner.



The government should therefore provide various monitoring and reporting mechanisms in legislation, such as:

- approval of the regulator's activity plan and budget estimates by the government;
- auditing of its books and records by a general auditor; and
- tabling of an annual activity report, including financial statements, before the elected representatives.

In addition to the reporting mechanisms provided for in legislation, the elected representatives should, at all times, be entitled to summon the regulator to discuss its orientations, its activities and its management.

## **Regulatory Independence**

The third dimension of a regulator's independence relates to regulation.

In some countries, the laws governing financial institutions and regulators are so detailed that they leave the supervisory agency with very little room to establish rules and regulations in an independent manner. In other countries, the laws simply define a general framework, giving the regulator a great deal of regulatory latitude.

However, regardless of a country's specific legal tradition, independent regulators should have all the necessary discretion to propose regulatory amendments.

In this manner, having actively participated in the drafting of regulations, regulators will be more inclined to enforce them. They will also be in a position to adapt the regulations quickly and with the flexibility required to respond to an ever evolving global marketplace.

The knowledge and expertise of a financial regulator makes it the entity that is best qualified and able to respond to changes in the various areas of the financial sector, through the development of regulations that are effective and useful throughout the entire industry.

Nonetheless, although regulations should be entrusted to the regulator, the government should maintain its regulatory power by approving the regulations drafted by the regulator, withholding its approval or imposing new regulations.

Moreover, it is essential that the process for adopting regulations be transparent and include a requirement for public notices and consultations.

## **Supervisory Independence**

The final dimension of independence that I would like to discuss is supervisory independence. As you know, this dimension is crucial in the financial sector.

Regulators carry out inspections and investigations, but they also often apply sanctions.

The principal problem faced by every regulator that exercises both supervisory and quasi-judicial functions is ensuring the independence and impartiality of entities entrusted with the quasi-judicial roles in relation to the other oversight functions.

The supervisory function of regulators is often excluded from direct public view such that interference from politicians or from the supervised entities themselves may be subtle and multifaceted.

Consequently, a regulator needs a clear legal foundation. Its powers and functions should be defined, preferably in a legislative text, in order to give it all the tools necessary for the fulfillment of its mission.

In addition, a regulator should be able to rely on a clear and public statement of its mission. Such a statement will allow the regulator to protect itself if politicians or supervised entities accuse it of failing to perform its mandate.

The legislator should also provide certain mechanisms to ensure the impartiality of decisions in respect of sanctions.

In many jurisdictions, the regulator is supported by other organizations to which it delegates certain powers of intervention. Clearly, this is what we refer to as self-regulation.

This delegation of functions or tasks must necessarily be set out in the legislation. Thus, before delegating tasks, a regulator must ensure that the principles for recognition as set out in the legislation are followed in support of the regulator's objectives.

The regulations and oversight approaches developed by self-regulatory organizations should remain under the control of the principal regulator.

## **Advantages of Regulator Independence**

This completes my overview of the four dimensions of independence that regulators should assume vis-à-vis not only the government but also the industry.

Experience has shown that several advantages are derived from the independence of regulators, provided it is tied to mechanisms for accountability:

- Firstly, it allows a regulator to make decisions and intervene without any interference whatsoever, political or otherwise;
- Secondly, it improves the effectiveness and efficiency of regulations and helps the markets to operate smoothly;
- And thirdly, it provides operational flexibility and the ability to adapt. Faced with changing circumstances, the regulator is able to quickly deliver operational responses to new issues.

Thus, independent regulators have a clear advantage over regulatory functions that are integrated in government departments.

This can only contribute to maintaining, and even strengthening, public confidence in the capital markets.

And as you know, this confidence is one of the pillars on which we must all build.

## **Increasingly Difficult Context**

This leads me to speak to you about another important topic: the increasingly difficult context resulting from the recent financial scandals.

It would not be an exaggeration to say that global capital markets, including those in Québec and in Canada, are currently facing a significant credibility crisis. The major scandals that have rocked the markets since 2000 in the industrialized countries, even though they were caused by only a minority of companies, have greatly undermined the credibility of the entire financial community.

This has led to a questioning of the models used for financial market regulation. Many critics have decried the powerlessness of regulators faced with frauds and other market abuses.

If this confidence were to be shaken irreparably, the proper operation of the markets would be affected, thereby also jeopardizing the economy. Restoring the relationship of confidence among all marketplace participants, including regulators and consumers, is an objective we must all strive for.

## **International Co-operation**

I am firmly convinced that co-operation and the exchange of information between market regulators is necessary in order to achieve this objective.

It is through enhanced co-operation and a better understanding of the issues at stake that we will be able to share our vision and aspirations for better financial market regulation and consumer protection.

This is why the AMF participates in numerous international initiatives and is a member of major international forums that bring together market regulators from around the world.

As regards its securities component, the AMF focuses its activities on the International Organization of Securities Commissions, the North American Securities Administrators Association, the Council of Securities Regulators of the Americas and the *Institut francophone de la régulation financière*.

In fact, the day after tomorrow, many of us will attend a meeting of the Council of Securities Regulators of the Americas (COSRA), and I would like to take this opportunity to express my appreciation for the work carried out by this important forum, whose members are striving to develop a regulatory structure based on market integrity and effectiveness as well as investor protection.

## **Conclusion**

To conclude, I would like to reiterate that it is our collective responsibility, through greater co-operation and a better understanding of our respective issues, to share our vision and aspirations for better financial market regulation and consumer protection.

Rest assured that, like legislative bodies and other regulators throughout the world, the AMF seeks to co-operate with its counterparts in other countries for the purpose of building an effective and credible international financial market.

This is why our participation in an event such as the one being held today is so essential.

Long live the Securities and Exchange Commission of Brazil!

And long live international organizations such as COSRA and IOSCO!

Thank you very much.