

The Crisis and Regulation: Exchanges, Trust and Transaction Cost Economics

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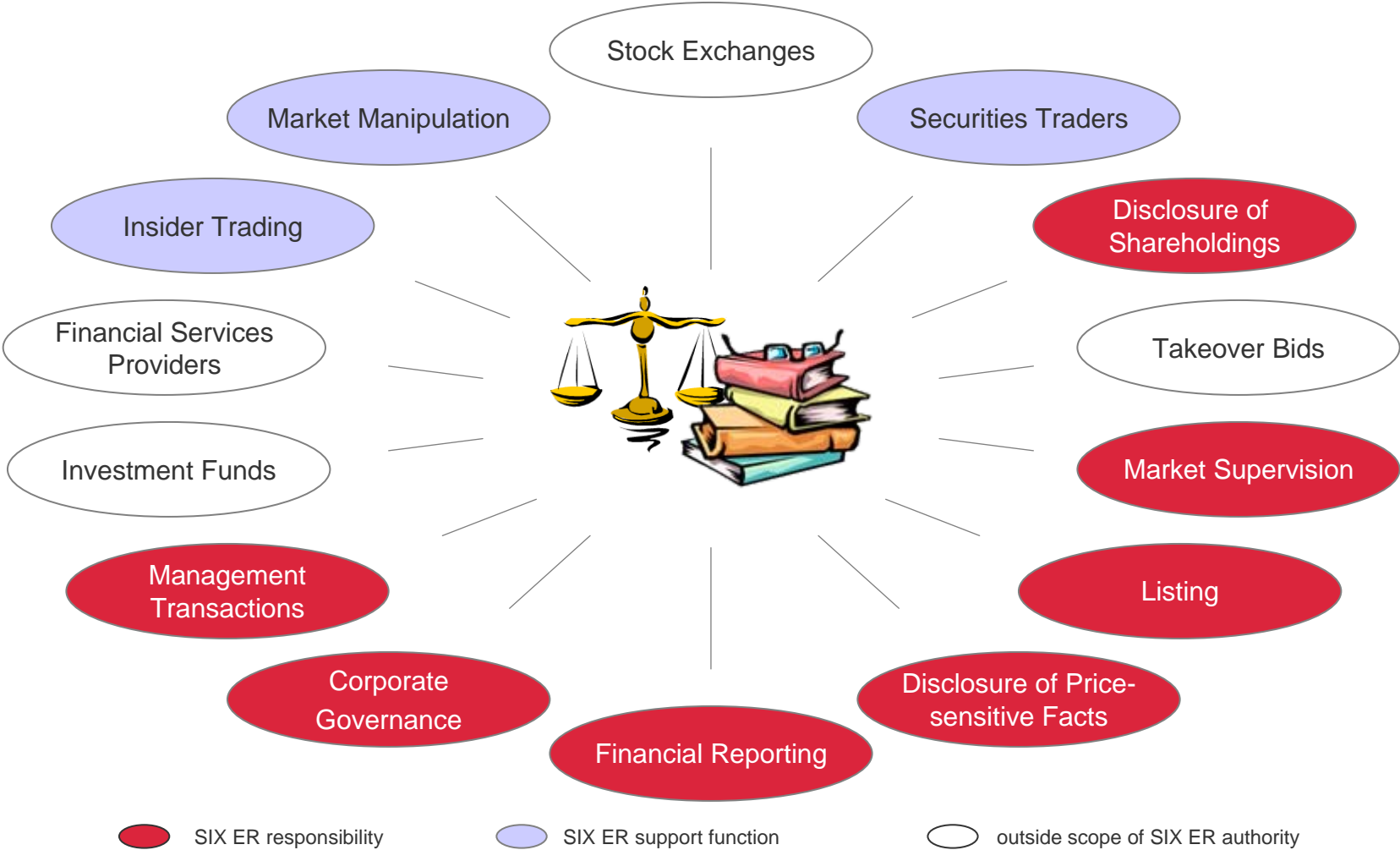
Introduction

- What's an Exchange?
- Regulatory Duties of the Swiss Exchange?
- What Drives Regulation?
- The Limits to Regulation?
- Things to Come...

What is an Exchange?

- First and foremost an exchange is a market.
- Exchanges operate markets and depending on their powers they organize markets
 - minimizing transaction costs
- What are transaction costs?
 - **All costs** of making an economic transaction/exchange (i.e. search and information costs, bargaining costs, policing and enforcement costs, transaction fees etc.)

Regulatory Duties of the Swiss Exchange



Exchange Regulation and Reputation of Exchanges

- Trust in the transaction cost minimizing setup
- Reputation
 - Customers don't have to check the transaction cost minimizing setup each time
 - Trust fosters reputation
 - Good reputation saves transaction costs – this increases attractiveness of an exchange
 - Loss of reputation is a major damage to an exchange
- Good regulation and enforcement, sound exchange governance and technology help building trust

What Drives Regulation?

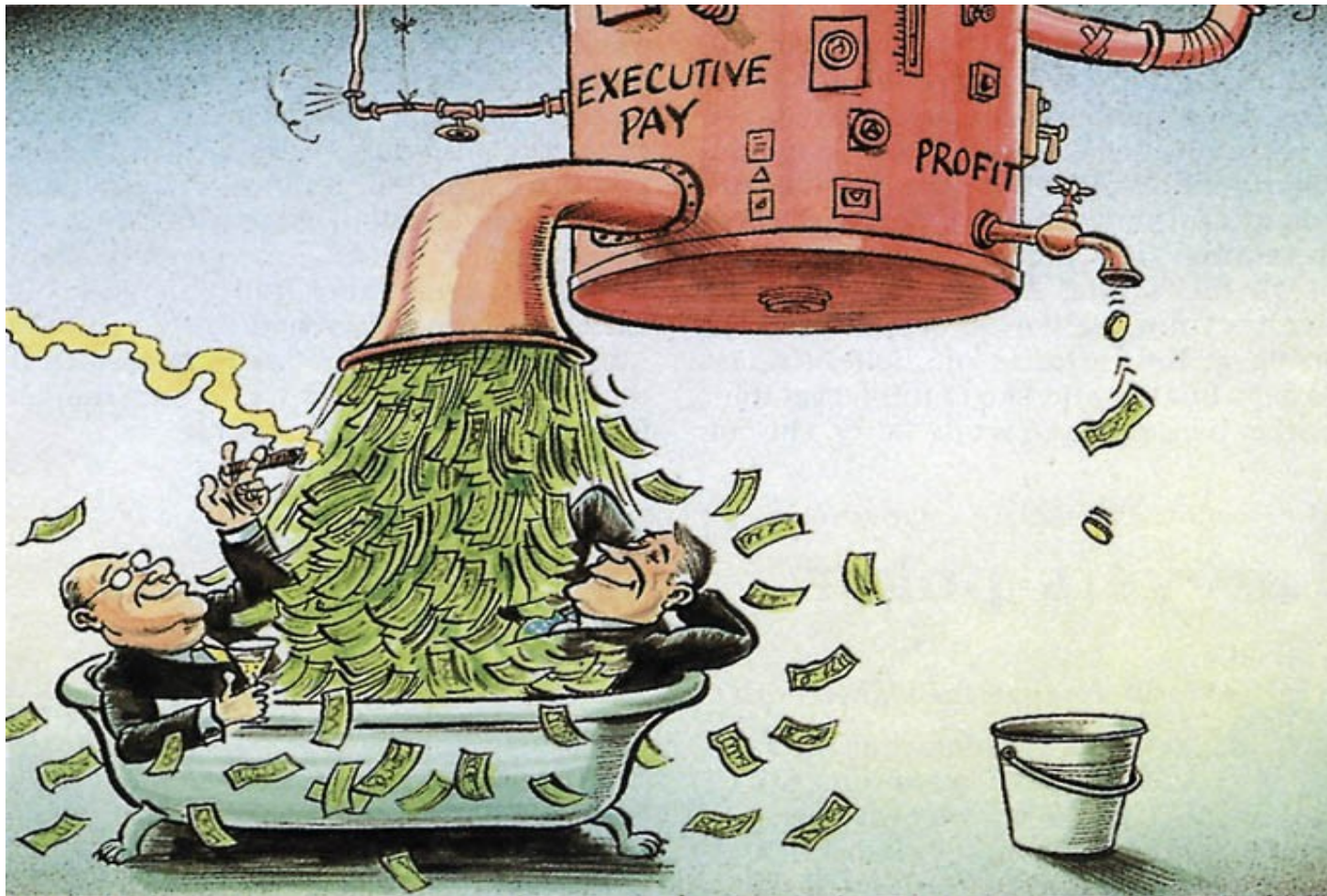


William Bramhall

- Demographics
- Pension Funds
- Public Outrage
- Media
- Politics



Scandals are the best source of regulation....



Economist,
April, 6th 2002
Page 57

Limits to Regulation?

■ Regulatory Competition

■ Practicability

- Enforcement
- Complexity

■ Systemic Limitations

- Transaction cost economics
- Economic role of the investor
 - Regulators have to respect „**sacred right to make a fool of oneself**“ (Louis Loss)
- Behavioural Finance?



Crisis

- Crisis in the automotive industry
- Financial industry
 - Subprime
 - Securitization
 - Basel II incentives
 - Rating agencies
 - Incentive schemes – executive pay
 - Strategic and operational mistakes in the financial industry
 - Regulators tampering with accounting rules (IFRS 39 and US equivalent)
 - Ban on naked short selling of financial industry securities
 - Temporary closing of exchanges
 - Conflict of interests between Regulators (Exchange Regulators – Treasuries/Central Banks)
- Rest of the economy (“real economy”)
 - Credit Crunch
 - Manufacturing industries risking default
 - Unemployment rates rising
 - Banks having risky credits on their books... (vicious circle)

The things to come – an outlook? (1)

■ Institutions

- Call for reorganizing regulators on a national and international level
- Call for more cooperation
- Risk of protectionism
- Basel II.2 or Basel III?

■ More regulation, more demand for transparency

- Securities lending and short selling
- Hedge Funds
- Complex financial instruments
- OTC-Transactions?
- Rating agencies
- Reliability of some indices?
- Disclosure of major shareholdings (empty voting, hidden [morphable] rights)
- Reducing information asymmetries
- Trust enhancing measures
- ...?

The things to come – an outlook? (2)

■ Corporate Governance

- Executive pay
- CG of financial institutions
- Role of regulators in CG of financial institutions?
- Compliance and management override?



The things to come – an outlook? (3)

■ Financial Reporting

- Convergence of IFRS and US-GAAP
- Increase of political influence (lobbying) in the making of accounting rules
- True and fair view and financial instruments
- Revenue recognition
- Increasing complexity of accounting rules
- Corporate Social Responsibility Reporting
- Carbon Dioxides Disclosure
- XBRL?

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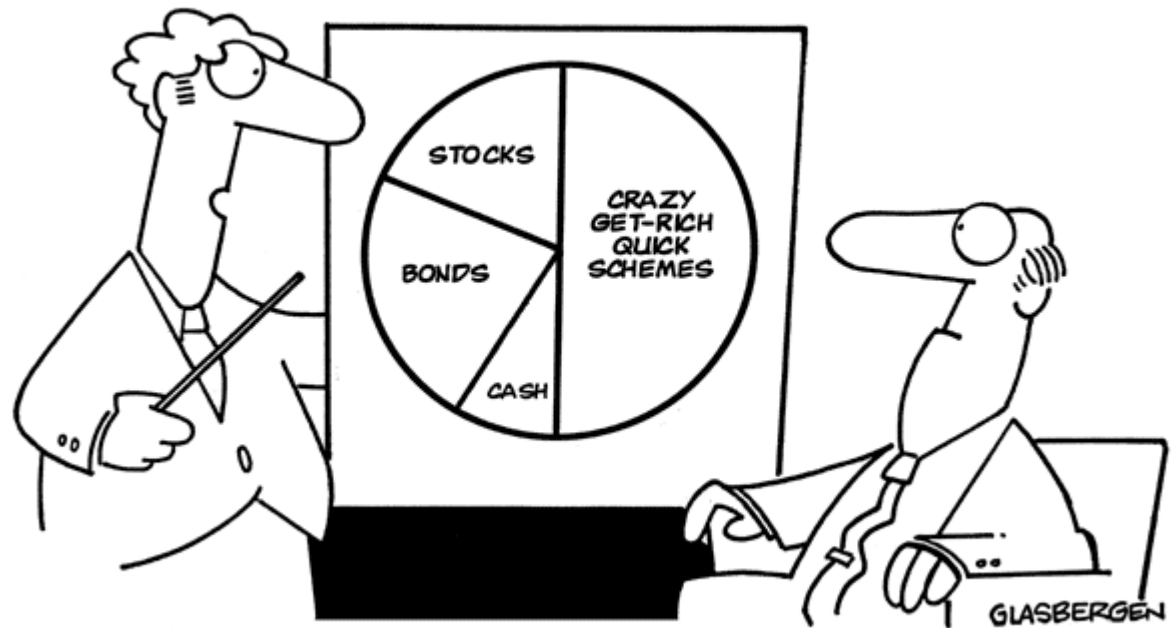


“Our books are balanced. 50% of our numbers are real and 50% are made up.”

The things to come – an outlook? (4)

- Investor Protection

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“I’d like you to consider a bold new strategy...”

What can Exchanges do?

- Keep in mind: Exchanges are not the disease, they are only the thermometer showing the fever of the patient
- Participate in the legislative process
 - Keeping an eye on transaction cost economics
 - Educate politicians, media, lobbyists and the public
- Minimize transaction cost, keep on building trust and continue to prove being trustworthy



Thank you very much!

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