

## Broker-Dealer SRO Can Make a Difference

**The "Capital Markets Development" training program** is aimed at improving the regulation of Ukraine's securities market and enhancing the relevant securities legislation according to international standards and best practices of operation. Launched earlier this year as a joint initiative by USAID/ Capital Markets Project and American and Ukrainian regulators US SEC and SSMSC, the program held its first training sessions in June offering regulators a complete overview of capital markets regulation, including case studies in supervision, enforcement, information disclosure and regulation. This time, SEC representatives focused on Ukrainian market professionals' interest in risk management as well as the SROs. It is built around twice-yearly sessions, focusing on various matters that are of interest to the Ukrainian regulator.

Representatives from the U.S. Securities and Exchange Commission, the American financial markets watchdog, conducted a four-day training program - as well as discussions - on risk management and Self-Regulatory Organizations (SROs) with Ukrainian regulators and top brokers, dealers, and exchanges. The event is **part of the "Capital Markets Development" program, a joint initiative by U.S. SEC, its Ukrainian counterpart the Securities and Stock Market State Commission (SSMSC) and USAID's Capital Markets Project.**

Jonathan Sokobin, Director of the US SEC's Office of Risk Assessment (ORA), together with his colleagues Katherine Martin (Counsel to the Director, ORA), Ester Saverson (Assistant Director, Office of International Affairs), and Jon Hertzke (Branch Chief, Office of Compliance Inspections and Examinations) shared their insight with "Ukraina-Business" :

### **Q – Could you please describe the purpose and scope of your mission here?**

[Jonathan Sokobin] It is based on the feedback that we receive from USAID/Capital Markets Project experts and from the Ukrainian Securities and Stock Market Commission. This time, it mainly concerned questions pertaining to building Self-Regulatory Organizations (SRO), broker-dealer supervision and risk management. The issue here is how a regulator thinks about risk, and about the management of these risks. We try to provide insight on how to take the highest level of risk management principles, and how to actually put them into practice. The benchmark should be to strive for a high quality regulator who can effectively fulfill the objectives of securities regulation – the protection of investors, ensuring that markets are fair, efficient, and transparent, thereby reducing certain risks for the customer. I'd stress the transparency requirements - transparency in the sense that the investor knows what he's investing in, he knows what the sources of income of issuers are, and risks linked to these securities. He should also know that not only can he enter a market paying a fair price (for the shares on offer), but also that he can exit at a fair price.

### **Q – When it comes to transparency, what is specific to the Ukrainian market?**

[Sokobin] Transparency of pricing is a big issue for markets where many of the trades happen over-the-counter. These types of markets can benefit from an efficient and reliable trade reporting system. This system should allow for immediate reporting and it should be public and accessible by all. And this is an issue where a

broker-dealer SRO can make a difference. The idea is that the people closest to the market are in the best position to regulate certain market activities such as trading, clearance and settlement, sales practice, licensing.

### **Q – According to Ukrainian law, a single broker-dealer SRO needs to be established by next Spring. How can such an institution then improve conditions of post-trade reporting?**

[Sokobin] It is the SRO that sets the high standards for reporting and is responsible for surveillance, because it is in the interest of the market professionals to make it work. Rather than such standards coming only from the top – the regulator – or from the bottom, those honest folks who want an honest market get together to work out rules, of course in a dialogue with the securities commission. The SRO is providing customers who feel that they have been treated unfairly a place to report. But in every instance, the SROs are subject to oversight of the regulator.

### **Q – The Commission as regulator plays a big part in setting these reporting and trade rules.... How do the two institutions – the SRO and the Commission - interact to work out these rules?**

[Sokobin] The way the SEC does it in our experience is that it sets the standards but lets the industry – through the SRO – come up with answers. Similarly, another regulator could, for instance, present the standards that they wish to see implemented to the SRO....it would look like a list of principles. Basically, in order for people to put their money in the market they need to feel sure that they are being treated fairly, and that there is enough liquidity, or in other

words a high level of trade activity. Then it could ask the SRO to work out a plan, a set of rules, that would match these objectives. I would expect that the message coming from a securities regulator to the SRO would be : ‘it’s up to you to live up to our expectations.’”

**Q – What about trade on the stock market...where do you see the priorities for the Ukrainian stock market in terms of regulation ?**

[Katherine Martin] Surveillance and enforcement by SROs and the securities regulator is a priority for most emerging markets. The SROs conduct surveillance and act as enforcer in the area that they are responsible for : in respect of trading rules for the exchange SRO, and brokers’ activities for the broker-dealer SRO. The securities regulator should have oversight over these SRO activities and the authority to conduct its own enforcement and surveillance. A strong enforcement program is vital for securities regulation in order to act as a deterrent – market participants need to be sure that they will be punished if they don’t play by the rules. An effective securities regulator should also have the authority to begin court proceedings directly instead of relying on other parts of the government.

**Q – How does enforcement work, how do the SRO and the Commission divide such responsibilities?**

[ Ester Saverson] The SRO is sort of the every day cop. In the U.S. it is the SRO for brokers and dealers – FINRA -

that handles most day-to-day violations, for instance like churning (when a broker manages a customer’s account in disregard of the customer’s interests). This allows the regulator to focus its resources on wider violations, like fraud.

**Q – What would the Commission’s first concerns regarding standards and violations be?**

[Jon Hertzke] It is important to make sure that at the SRO level the arbitration is fair and that the SROs decisions are enforced fairly.

**Q – How do you see your mission here in the future?**

[Sokobin] We are simply giving the fundamentals, and Ukrainian regulators then find their own way. We come from our own unique perspective, so we simply offer how to think about a problem, how to think through a problem – but we don’t give the answers. In this sphere of activity a lot of the rules that we make today depend on the rules that we made yesterday. And the terms that rule the U.S. market were, in part, worked out back in the 1930s ...Needless to say, things have changed since. So you can have new emerging markets today that skip some of the steps that the U.S. market had to go through at the time. You also have to keep in mind that it is a two-way experience. Local markets are in fact global. Things that happen globally affect Ukraine, but something that happens on the local Ukrainian market can affect the whole market, too. //