THE FUTURE OF SELF-REGULATION

CFA Institute Report Examines the Role of SROs in Regulatory Systems around the World

Many securities markets use self-regulatory organizations (SROs) to perform certain regulatory functions. A recent report from CFA Institute, *Self-Regulation in the Securities Markets: Transitions and New Possibilities*, draws on examples of SROs from various markets to examine the effectiveness of self-regulation in today's increasingly large and complex securities markets.

Report author Linda Rittenhouse, JD, director of capital markets policy at CFA Institute, discusses the challenges — and opportunities — facing SROs amid market developments, the advent of new technologies, and conflicts inherent in a system of self-regulation.

How has the SRO landscape changed since you released your previous report, *Self-Regulation in Today’s Securities Markets: Outdated System or Work in Progress?* in 2007?

**Rittenhouse:** In the United States, the role of the primary regulator has expanded to include responsibility for new market participants, areas, products, and technologies. But resources allocated to the US Securities and Exchange Commission have not grown commensurately. Consequently, the need for “front-line” regulators like SROs, which can aid the SEC by overseeing select areas of the financial marketplace, has increased.

However, the need for reform of the current self-regulatory system has also become more apparent. Recent governance failures by SROs — resulting in unprecedented sanctions against the New York Stock Exchange and the Chicago Board Options Exchange — have highlighted the inherent conflicts of interest in self-regulatory systems that must be effectively addressed for the system to retain its integrity.

Under what conditions are SROs potentially effective “front-line” regulators in the securities markets?

**Rittenhouse:** Given the specialized expertise most SROs offer, they are able to not only “stay ahead of the curve” in terms of implementing appropriate regulatory and surveillance systems but also free up primary regulators to focus resources on broad market integrity issues. To be effective in this role, SROs must have the authority to create and enforce rules, supervise members, and maintain strong surveillance mechanisms.

The use of self-regulation is often recommended in emerging markets as part of a broader strategy aimed at improving the effectiveness of securities regulation and market integrity. What are your report’s findings?

**Rittenhouse:** Emerging markets whose financial sectors are in the early stages of development often lack the resources to fund both a primary regulator and an SRO. Moreover, a particular market or country may lack the infrastructure to promote the innovation and growth needed for capital formation. A growing trend in these markets is for exchanges to harmonize their regulations across borders, allowing countries to “pool” their resources and raise the aggregate level of capital in the region. This “competing by cooperating” not only provides regional economic benefits but also encourages the development of a harmonized approach for addressing cross-border licensing, disciplinary, and surveillance issues.

*For more information, review* Self-Regulation in the Securities Markets: Transitions and New Possibilities.