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Plenary 2

Misconduct across Jurisdictions – The Enforcement Challenge

11. Practical Examples of the Value of Regulatory Cooperation,

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PRACTICAL EXAMPLES OF THE VALUE OF REGULATORY COOPERATION

Panel 2

Misconduct across Jurisdictions—the Enforcement Challenge
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It is a great pleasure to be here in Istanbul, a city beautifully situated on the ancient trade routes between East and West, a crossroads of cultures, religions and language and a historic center of civilization and learning. What better place to celebrate the opportunities and challenges of globalization as invited by the Capital Markets Board than in this uniquely global city.

Thank you also for this opportunity to present my views on regulatory cooperation. My perspective is that of Chairman of IOSCO's Implementation Committee [that was formed to determine how best to assess member regulators' adherence to IOSCO's Objectives and Principles of Securities Regulation], a market regulator with oversight responsibilities for the uniquely global futures markets in the US, and a long-time observer of financial markets developments.

As the Minister of State noted globalization is here to stay. And, globalization means that regulators have no choice but to cooperate to accomplish the responsibilities entrusted to them.

The benefits of capital formation markets as an alternative to bank financing and as a potential democratizer of wealth are well recognized. With the growth of capital and risk management markets, and the arrival of the information age, access of retail as well as professional customers to financial assets from around the globe is instantaneous and increasing. [In the Scandinavian countries for example as many as 70% of individuals hold equity investments. In Europe 30 years of movement toward an integrated market recently accelerated dramatically with the creation of the Committee of European Securities Regulators. In each of the other regions of IOSCO—Africa, the Asia Pacific, and the Americas--regulatory authorities are working to improve the regulatory infrastructure of

[1] Presented by Andrea M. Corcoran, Director, Office of International Affairs, US CFTC
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their local marketplaces and the marketplaces themselves are growing and becoming more open to outside investors. In the US more than 50% of trade volume reported to the Futures Industry Association originates on non-US markets.]

But while we value open, competitive and broadly accessible markets, we are also acutely aware of the risks as well as the benefits of global markets and of the responsibility for regulatory authorities to create conditions of doing business that keep them safe from abuse and from transmitting destabilizing risks. As the collapse of Barings illustrated, crises often are not confined to one jurisdiction and may cross domestic supervisory as well as geographic boundaries. Intermediaries rarely transact within a single jurisdiction and may carry exposures that can impact many markets and intermediaries in other locations in the event of difficulty. Market abusers, fraudsters and other financial violators can seek actively to hide behind multiple jurisdictions and transact in multiple markets specifically to make it more difficult for regulators and law enforcers to find the political will or the information essential to combat them.

Our failures to address market situations are always well-documented by a vigilant press. Making our successes more transparent may be prevented by confidentiality or other requirements that affect the sharing of information for regulatory surveillance and enforcement purposes. For that reason, I have chosen to focus on how national regulators have used cooperative arrangements to bridge their geographic boundaries to reach financial activity that spans markets and borders.

I therefore would like to describe six examples of how standard building and making a commitment to regulatory cooperation is good for markets and market participants and can reduce regulatory costs in the areas of licensing, prevention of fraud and theft, assurance of financial integrity and prevention of market disruption, and making enforcement efforts effective.

- ***Authorization or Licensing.*** *Preventing malfeasors from forum shopping or engaging in serial misconduct in a multitude of jurisdictions by permitting the authorization of financial firms to include confirmation of fitness and good standing information from other jurisdictions.*

Traders or firms that are barred from doing business or severely sanctioned in one jurisdiction often try to move shop to another jurisdiction and repeat their scam or misconduct. Increasingly regulators are making information readily accessible on the licensing status, and in some cases disciplinary history, of firms and where available principals and individuals. The recently published IOSCO Internet Task Force Report Appendix contains a link to public sites.

When a person has skipped town to escape the force of the law, the effect of sharing information can be dramatic. In some cases access to the new market can be denied outright, in others the fitness information can form the basis of a denial proceeding, thereby curtailing a cycle of crime and protecting unsuspecting investors. In one case a court in

Australia detained a person in transit through that jurisdiction to stand trial based on information of an administrative sanction of fraud or corrupt practice in another jurisdiction.

In the US the National Futures Association is automating its US licensing data base in such a way that it can push out public licensing status and material events information promptly after specified events to subscribing regulators. In many jurisdictions some of this information is non-public and therefore must be shared through routes that protect its use and confidentiality. Even in that case technology could be used to support making information exchange on fitness more efficient and timely. How often is fitness information exchanged? NFA reports that its BASICs site gets 38000 hits per month. In addition everyday regulators around the world handle information relating to fitness requests coming from other jurisdictions. In 2001 CFTC responded to 89 requests for assistance for documentary evidence and trading records, bank and brokerage records and testimony and daily exchanged information on registration and disciplinary history.

- ***Sham transactions.*** *Preventing theft or diversion of assets by confirming whether money is being transmitted properly and transactions are in fact being effected.*

Sometimes when money is solicited from or transmitted offshore, it does not reach its assigned destination as the funds are not routed, committed to trading or deposited in accordance with the expectations of the customer. Usually such solicitations, for example in the case of forex transactions, claim that the money will be used to trade on legitimate markets. Cross-border cooperation permits the tracing of funds and access to evidence needed to demonstrate that the transactions are not occurring and to sanction the unscrupulous. When funds and trades cross geographic borders and solicitors pocket the proceeds, regulators in one jurisdiction need help from another to trace funds to banks and brokerage accounts to confirm that they have been misappropriated.

The international community is quite aware that the best place to hide funds is in an uncooperative jurisdiction—this would not be the case if cooperation was not necessary to resolving these matters.

- ***Sizing credit risk.*** *Permitting surveillance of the financial integrity of persons doing business in multiple markets by confirming sizes of exposures and financial capacity in markets not directly subject to supervision.*

Because investors can now trade in multiple markets or trade cross-listed products it is possible to engage in abusive trading or to get into financial difficulty based on exposures in other markets outside the scrutiny of the primary regulator. Information sharing arrangements permit the confirmation of activity occurring in other jurisdictions, and where relevant to proving abuses assure the accessibility to such trading information.

In Barings, the risk of a position taken in Singapore that ultimately led to Barings collapse depended on the nature of transactions undertaken in Japan and England. The ability to

share that information in a timely fashion potentially would have given supervisors and market authorities in each jurisdiction a better ability to spot the rogue trader in the first instance and to manage the risks he incurred in the second. The public fact that the information can be made available through inter-regulatory exchange is also a deterrent to improper conduct.

Of course, information exchange is no substitute for proper internal controls that assure separation of functions. Those controls preserve the integrity of financial information and the lack of such controls may be exposed by what information is, and is not, available. More recently in the Enron case, the use of certain information exchanges between regulators of on-exchange markets in certain affected jurisdictions permitted each to better size counter-party credit exposures and market exposures and therefore to avoid inappropriate intervention as those positions were liquidated without default.

- ***Artificial prices and volumes.*** *Confirming whether trading is actually occurring or money is being passed through the market or volume is inflated.*

Recent events [and cases] have alerted the general public to the potential for markets to be used for wrongful as well as proper purposes. To the extent money is passed through so-called riskless trading, this can distort the market and give a false impression of trading activity. Information sharing arrangements and cooperative efforts can identify whether transactions are actually occurring in the markets and may be able to identify improper passing of monies between accounts. Regulators can share how such transactions can occur as well as compare information to attempt to identify instances of such activity.

- ***Substituted compliance.*** *Facilitating reliance on substituted compliance or on customer information being maintained subject to another regulatory regime based on the capacity to obtain that information as needed.*

The ability of a jurisdiction to demonstrate the capacity to identify the origin of funds when they enter the financial system and to share that information with another jurisdiction's law enforcement authorities can permit reliance on that jurisdiction for customer identification for law enforcement purposes. Sufficient powers to obtain information and to share it and proper standards of record-keeping can reduce the intrusions into how business is done (through omnibus accounts for example), allow firms to preserve the proprietary nature of customer lists, while still providing the necessary protections from suspicious activities.

Separately, appropriate information sharing arrangements and cooperation between jurisdictions also can facilitate arrangements between jurisdictions where reliance for oversight of some activities is undertaken by the jurisdiction in which a firm is established. The CFTC very early on joined in the development of these arrangements. This type of requirement for cooperation underpins the mutual recognition arrangements in the EU among other arrangements, for granting lighter oversight to entities regulated in another jurisdiction.

- ***Making law enforcement more efficient.*** *Providing expeditious means to retrieve very specific, pre-described information on matters such as warehouse stocks, handling of cash market products, or over-the-counter counterparties.*

As jurisdictions gain information with the benefits of sharing information, they may determine to develop special purposes arrangements that relate specifically to linked activity between them. For example, some jurisdictions have developed arrangements that permit the passing of surveillance information directly to market authorities, others permit obtaining specified information without making all the representations necessary for a more dispersed MOU request, or make clear that the regulatory authority will provide information obtainable only through a third authority. These practical arrangements are intended to speed up the process of information exchange to prevent fishing expeditions and to assure an up front meeting of the minds on the information that has regulatory uses.

- ***Leveraging enforcement powers.*** *Permitting use of the powers of other authorities to obtain statements, documents or other evidence that are located within their jurisdiction and powers but are necessary to your case.*

Obviously the assistance of on-the-ground help from regulators experienced with a particular jurisdiction and its forums for obtaining information can materially improve the accessibility and timeliness of retrieval of enforcement related information. Such assistance may also lead to other dialogue between the affected regulatory authorities about matters of common concern and can demonstrate a united front against abusive activities to firms doing business in multiple jurisdictions. Joint investigations (and parallel proceedings) do in fact occur when misconduct crosses borders and those conducting them tend to draw on the best features of each of the participating jurisdictions powers and authorities. At a minimum, because jurisdictions investigating matters often have different relief available to them through their court or administrative system, it is helpful to coordinate to obtain all the relief available in both jurisdictions. For example, some jurisdictions can withdraw licenses; others can obtain restitution for customers. The benefit of combining forces is reduced cost in bringing the case, better prospects of finality for the firm involved in the misconduct, and the optimal outcome for customers.

- ***IOSCO's role*** *as an international standard setting authority*

Because of these types of advantages of information sharing arrangements IOSCO has played an important leadership role in determining the types of powers and authorities regulators should have to maintain, obtain, and share information that they receive or have access to as a regulatory matter and to compel information for their own enforcement purposes and on behalf of other authorities.

IOSCO has not only defined the goal of cooperation as a standard of membership. See for Example the two 1997 resolutions of the Presidents' Committee, known as the "Resolution on Enforcement Powers," and the "Resolution on Principles for Recordkeeping, Collection of Information, Enforcement Powers and Mutual Cooperation." IOSCO also has set forth a

road map for accomplishing the objective and provided practical guidance on: designing information sharing mechanisms (1991 Principles for Memoranda of Understanding), a menu of what types of information are core information that should be accessible, retained and sought in specified market events and financial circumstances (Information Sharing Guidance, 1998), and what types of powers authorities must have in order for a jurisdiction to be considered capable of being "cooperative." Standing Committee 4 has also developed a manual on how to conduct Joint Cross-Border Investigations and Related Proceedings (2001).

IOSCO through its expert committee, headed by the French COB, also has worked to identify potential impediments to information sharing, and members have discussed practical issues such as differences in law and culture, regulatory protectionisms, and other matters including absent international bankruptcy law, a need *to sauve qui peut*.

Its role in this area has been important to other initiatives to endorse cooperative arrangements at the political level (the G7), across sectors (banking), and to various regional (CESRPOL) and special initiatives (the Boca Declaration) which have drawn on the IOSCO guidance.

The Special Project Team of IOSCO is taking these exercises further by setting up not only the terms of information exchange, assistance and cooperation that IOSCO members should aspire to, but by making clear the relevant authorities and legal permissions necessary to reach that goal. This will publicly demonstrate the commitment of the broad membership of IOSCO to having the regulatory powers and will to respond to the global marketplace.

This Project fits into the overall work of IOSCO to set and benchmark securities standards - to facilitate dialogues between countries about improving the regulatory infra structure and to achieve greater consensus on the components of a regulatory regime that meets its standards.

Securities regulators have taken aggressive steps to design effective means of cooperation to provide an effective enforcement framework for global markets. They also have provided leadership to other regulators who also must meet the