Methodology

For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation

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TABLE OF CONTENTS – BOOK I[1]

[1] Book II is a compilation of Annexes relating to the conduct of assessments prepared for IOSCO members. Book II is not publicly available on the IOSCO website.

LIST OF PRINCIPLES

A. PRINCIPLES RELATING TO THE REGULATOR

1. The responsibilities of the Regulator should be clear and objectively stated.

2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.

3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

4. The Regulator should adopt clear and consistent regulatory processes.

5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.

6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.

7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.

8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

B. PRINCIPLES FOR SELF-REGULATION

9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

C. PRINCIPLES FOR THE ENFORCEMENT OF SECURITIES REGULATION

10. The Regulator should have comprehensive inspection, investigation and surveillance powers.

11. The Regulator should have comprehensive enforcement powers.

12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

D. PRINCIPLES FOR COOPERATION IN REGULATION

13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

E. PRINCIPLES FOR ISSUERS

16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.

17. Holders of securities in a company should be treated in a fair and equitable manner.

18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.

F. PRINCIPLES FOR AUDITORS, CREDIT RATINGS AGENCIES, AND OTHER INFORMATION SERVICE PROVIDERS

19. Auditors should be subject to adequate levels of oversight.

20. Auditors should be independent of the issuing entity that they audit.

21. Audit standards should be of a high and internationally acceptable quality.

22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.

23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.

G. PRINCIPLES FOR COLLECTIVE INVESTMENT SCHEMES

24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.

25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.

26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.

27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.

H. PRINCIPLES FOR MARKET INTERMEDIARIES

29. Regulation should provide for minimum entry standards for market intermediaries.

30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.

32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.

I. PRINCIPLES FOR SECONDARY MARKETS

33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

35. Regulation should promote transparency of trading.

36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.

37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

J. PRINCIPLES RELATING TO CLEARING AND SETTLEMENT

38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

INTERPRETATIVE TEXTS AND METHODOLOGY FOR ASSESSING IMPLEMENTATION OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

I INTRODUCTION

IOSCO is the leading international grouping of securities[2] market regulators. Its current membership comprises regulatory bodies from over 100 jurisdictions that have day-to-day responsibility for securities regulation and the administration of securities laws. The IOSCO membership represents a broad spectrum of markets of various levels of complexity and development, of different sizes, operating in different cultural and legal environments.

This Methodology is designed to provide IOSCO's interpretation of the International Organization of Securities Commission's *Objectives and Principles of Securities Regulation* ("Principles")[3] and to give guidance on the conduct of a self-assessment or third-party assessment of the level of Principles implementation.

Securities and derivatives markets are vital to the growth, development and strength of market economies. They support corporate initiatives, finance the exploitation of new ideas and facilitate the management of financial risk. Further, since retail investors are placing an increasing proportion of their money in mutual funds and other collective investments, securities markets have become central to individual wealth and retirement planning.

Sound and effective regulation and, in turn, the confidence it brings is important for the integrity, growth and development of securities markets.[4]

The Preamble to IOSCO's By-Laws states that securities authorities resolve:

- to cooperate in developing, implementing and promoting adherence to internationally recognised and consistent standards of regulation, oversight and enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
- to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
- to exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.

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2 For convenience, in this Methodology, the words "securities markets" are used, where the context permits, to refer compendiously to the various market sectors. In particular, where the context permits they should be understood to include reference to the derivatives markets. The same applies to the use of the words "securities regulation." (See IOSCO By-Laws, Explanatory Memorandum.)

3 *Objectives and Principles of Securities Regulation*, Presidents' Committee of IOSCO, June 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf.

4 *Measures to Disseminate Stock Property*, Report of the Emerging Markets Committee of IOSCO, May 1999, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD95.pdf.

The IOSCO By-Laws also express the intent that securities regulators, at both the domestic and international levels, should be guided by a constant concern for investor protection.

IOSCO recognizes that sound domestic markets are necessary to the strength of a developed domestic economy and that domestic securities trading are increasingly being integrated into a global market.

Increasingly globalized and integrated financial markets pose significant challenges to the regulation of securities markets. At the same time, markets, particularly some emerging markets which have seen much growth in recent years, have been prone to effects of cross-border and cross-asset interactions, and some are also susceptible to higher short- term volatilities after economic shocks or during periods of great uncertainty. Therefore, in a global and integrated environment regulators must be in a position to assess the nature of cross-border conduct if they are to ensure the existence of fair, efficient, and transparent markets.

An increasingly global market place also brings with it the increasing interdependence of regulators. There must be strong links between regulators and a capacity to give effect to those links. Regulators must also have confidence in one another. Development of these linkages and this confidence will be assisted by the development of a common set of guiding principles and shared regulatory objectives. Consistently high regulatory standards and effective international cooperation will not only protect investors but also reduce systemic risk.

Regulators should be prepared to address the significant challenges posed by the increasing importance of technology and particularly developments in the area of electronic commerce.

The international regulatory community should provide advice, and a yardstick against which progress towards effective regulation can be measured. As the leading international grouping of securities regulators, IOSCO accepts responsibility for helping to establish the high standards for regulation. This revised Methodology evidences IOSCO's continued commitment to the establishment and maintenance of consistently high regulatory standards for the securities industry.

All of the topics addressed in this Methodology are already the subject of IOSCO reports or Resolutions.[5] The reports published by IOSCO and the Resolutions adopted by its membership are also a valuable source of information on the Principles that underlie effective securities regulation and the tools and techniques necessary to give effect to those Principles. This Methodology draws upon those reports as a primary source as IOSCO's reports generally provide a more detailed treatment of the particular topic. Reference is made to IOSCO reports and Resolutions in this Methodology and these should be consulted when considering particular topics.

[5] A full list of IOSCO Public Documents and Resolutions is published on IOSCO´s Web Site: www.iosco.org.

A. OBJECTIVES OF SECURITIES REGULATION

1. The Objectives

The three IOSCO core objectives of securities regulation are:

- **The protection of investors**[6]**;**
- **Ensuring that markets are fair, efficient and transparent; and**
- **The reduction of systemic risk.**

2. Discussion of the Objectives

The three objectives are closely related and, in some respects, overlap. Many of the requirements that help to ensure fair, efficient, and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many of the measures that reduce systemic risk provide protection for investors.

Further, matters such as thorough surveillance and compliance programs, effective enforcement, and close cooperation with other regulators are necessary to give effect to all three objectives.

The objectives of securities regulation are further described below. This Methodology explores in greater detail, in the context of actual market structures and arrangements, the means to satisfy the objectives articulated in the 38 Principles.

The Protection of Investors

Investors should be protected from misleading, manipulative or fraudulent practices, including insider trading, front running or trading ahead of customers and the misuse of client assets. Investors in the securities markets are particularly vulnerable to misconduct by intermediaries and others, but the capacity of individual investors to take action may be limited. Investors should have access to a neutral mechanism (such as courts or other mechanisms of dispute resolution) or means of redress and compensation for improper behaviour.

Further, the complex character of securities transactions and of fraudulent schemes requires strong enforcement of securities laws. Where a breach of law does occur, investors should be protected through the strong enforcement of the law.

Full disclosure of information material to investors' decisions is the most important means for ensuring investor protection. Investors are, thereby, better able to assess the potential risks and rewards of their investments and, thus, to protect their own interests. As key components of disclosure requirements, accounting and auditing standards should be in place and they should be of a high and internationally acceptable quality.

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6 For purposes of this Methodology, in the case of derivatives markets, the term "investor" includes the term "customer."

Only duly licensed or authorized persons should be permitted to hold themselves out to the public as providing investment services, for example, as market intermediaries or the operators of exchanges. Initial and ongoing capital requirements imposed upon those license holders and authorized persons should be designed to achieve an environment in which a securities firm can meet the current demands of its counterparties and, if necessary, wind down its business without loss to its customers.

Regulation of market intermediaries should assist investor protection by setting minimum standards for market participants. Investors should be treated in a just and equitable manner by market intermediaries according to standards which should be set out in rules of business conduct. Supervision by regulators should include a comprehensive system of inspection, surveillance, and compliance programs.

Effective supervision and enforcement depend upon close cooperation between regulators at the domestic and international levels.

Ensuring that Markets are Fair, Efficient, and Transparent

The fairness of the markets is closely linked to investor protection and, in particular, to the prevention of improper trading practices. Market structures should not unduly favour some market users over others. The regulator's approval of exchange and trading system operators and of trading rules helps to ensure fair markets.

Regulation should detect, deter, and penalize market manipulation and other unfair trading practices. Regulation should aim to ensure that investors are given fair access to market facilities and market or price information. Regulation should also promote market practices that ensure fair treatment of orders and a price formation process that is reliable.

In an efficient market, the dissemination of relevant information is timely and widespread and is reflected in the price formation process. Regulation should promote market efficiency.

Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available on a real-time basis. Pre-trade information concerns the posting of firm bids and offers as a means to enable investors to know, with some degree of certainty, whether and at what prices they can deal. Post-trade information is related to the prices and the volume of all individual transactions actually concluded. Regulation should ensure the highest levels of transparency.

The Reduction of Systemic Risk

The reduction of systemic risk is closely linked to investor protection however, risk taking is essential to an active market and regulation should not unnecessarily stifle legitimate risk taking. Rather, regulators should promote and allow for the effective management of risk and ensure that capital and other prudential requirements are sufficient to address appropriate risk taking, allow the absorption of some losses, and check excessive risk taking. An efficient and accurate clearing and settlement process that is properly supervised and utilizes effective risk management tools is essential.

There must be effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction.

Instability may result from events in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

Although regulators cannot be expected to prevent the financial failure of market intermediaries, regulation should aim to reduce the risk of failure (including through capital and internal control requirements).[7] Where financial failure nonetheless does occur, regulation should seek to reduce the impact of that failure, and, in particular, attempt to isolate the risk to the failing institution.[8] Market intermediaries should therefore, be subject to adequate and ongoing capital and other prudential requirements. If necessary, an intermediary should be able to wind down its business without loss to its customers and counterparties or systemic damage.

B. THE REGULATORY ENVIRONMENT

Regulation of securities and derivatives markets is necessary for the achievement of the three IOSCO core objectives. Nevertheless, inappropriate regulation can impose an unjustified burden on markets and inhibit market growth and development.

Implicit throughout this Methodology is the belief that regulation should facilitate capital formation and economic growth. In the context of regulation, there should also be recognition of the benefits of competition in the market place.

It is possible to identify general attributes of effective regulation that are consistent with sound economic growth:

- there should be no unnecessary barriers to entry and exit from markets and products;
- markets should be open to the widest range of participants who meet the specified entry criteria;
- in the development of policy, regulatory bodies should consider the impact of the requirements imposed;
- there should be an equal regulatory burden on all who make a particular financial commitment or promise.

More generally, there must be an appropriate and effective legal and accounting framework within which the securities and derivatives markets can operate. Securities laws and regulation cannot exist in isolation from other laws; there must be an appropriate and effective legal, accounting, and auditing requirements in a jurisdiction. This may include framework documents, such as a constitution or charter as appropriate.

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7 See *Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets - Interim Report*, Report of the Emerging Markets Committee of IOSCO, September 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD80.pdf; and *Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets*, Report of the Emerging Markets Committee of IOSCO, November 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD99.pdf.

8 See *Hedge Funds and Other Highly Leveraged Institutions*, Report of the Technical Committee of IOSCO, November 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD98.pdf.

Matters that IOSCO considers are of particular importance in the legal framework of a jurisdiction are set out in Appendix 1. This Appendix is not intended to be an exhaustive list of matters to be addressed in domestic legislation but rather to identify some matters that particularly impact upon the securities markets.[9]

The accounting and auditing framework may also be considered an aspect of the legal framework however they (particularly the preparation of financial statements and auditor independence) are the subject of specific Principles and are discussed in Part II, Principles 18 and 21 respectively of this Methodology.

C. BACKGROUND OF THE PRINCIPLES

The Principles set out a broad general framework for the regulation of securities including the regulation of: (i) securities markets; (ii) the intermediaries that operate in those markets; (iii) the issuers of securities; (iv) the entities offering investors analytical or evaluative services such as credit rating agencies; and (v) the sale of interests in, and the management and operation of, collective investment schemes.

The Principles were first adopted by the IOSCO Presidents' Committee at the IOSCO Annual Conference of September, 1998.[10] The Principles were adopted as "a valuable source of information on principles that underlie effective securities regulation and on the tools and techniques necessary to give effect to those principles…" The Presidents' Committee further found that: "just, efficient and sound domestic markets are critical components of many national economies and that domestic securities markets are increasingly being integrated into a global market, the Objectives and Principles encourage countries to improve the quality of their securities regulatory systems; and the Objectives and Principles represent international consensus on sound prudential principles and practices for the regulation of securities markets." These statements remain true of today's markets.

In 2003, the Principles were revised and a detailed Methodology for assessing implementation of the Principles was adopted. In 2010, the IOSCO Presidents' Committee adopted a revised set of 38 Principles, drawing on developments in securities regulation and the lessons from the global financial crisis which emerged in 2007.

IOSCO Resolutions, which provide content to the more broadly-stated IOSCO Principles, and cited IOSCO reports, are a valuable source of information that should be consulted on the Principles and the tools and techniques to achieve their implementation.[11]

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9 In addition, sound corporate governance practices are an important additional protection of the interests of shareholders. Corporate governance may be addressed through statute or exchange listing rules or code of practice, the details of which are outside the scope of this Methodology (see also Annexure I). See also the Organization for Economic Cooperation and Development's *OECD Principles of Corporate Governance* at http://www.oecd.org/pdf/M00008000/M00008299.pdf.

10 At the same meeting, IOSCO indicated that it welcomed the efforts of other groups to strengthen financial markets and to improve the level of investor protection, in particular, work of the G-22 economies related to enhancing transparency and disclosure of information, strengthening financial systems in national economies and globally. See also the *Resolution of the Presidents' Committee on IOSCO Adoption of the Objectives and Principles of Securities Regulation*, September 1998, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES16.pdf.

11 A full numerical list of IOSCO Resolutions and Public Documents is set out on the IOSCO internet website at http://www.iosco.org/library/, catalogued by reference to the month and year of their issuance.

The IOSCO Principles are one of the key standards and codes (including those on clearing and settlement) highlighted by the Financial Stability Board as key to sound financial systems and deserving priority implementation.[12] Further articulation of how to apply the Principles pursuant to this Methodology helps to effectuate the general objectives of IOSCO as expressed in its By-Laws, in particular that securities authorities should cooperate to ensure better regulation of the markets on the domestic and international level by establishing standards, among other things.

Shortly after initial publication, the Principles formed the basis of an IOSCO-directed, comprehensive self-assessment exercise[13] and continue to be used by the World Bank and the International Monetary Fund (hereinafter referred to together as IFIs, or International Financial Institutions) in the Financial Sector Assessment Program.[14] Further information on the assessment process is provided in section F.

D. PURPOSE OF DEVELOPING AN ASSESSMENT METHODOLOGY

The IOSCO Principles were drafted at a broad conceptual level to accommodate the differences in the laws, regulatory framework, and market structures among its Member jurisdictions. In drafting the Principles, IOSCO concluded that it should avoid being overly prescriptive in its requirements while, at the same time, providing sufficient guidance as to the core elements of an essential regulatory framework for securities activities.

The IOSCO Executive, Technical and Emerging Markets Committees, endorsed the development of benchmarks for assessing the Principles at the IOSCO Annual Conference in Istanbul in May, 2002. Those Committees agreed that the criteria establishing the benchmarks should be as objective as reasonably possible and should permit the assessor to assign a jurisdiction to an assessment rating. This approach has been maintained and has been applied to the new Principles. Additionally, the detail of the existing Principles was considered and updated as necessary as part of the 2010 revision.

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12 http://www.financialstabilityboard.org/cos/index.htm. The Financial Stability Board (FSB) has been established as a successor to the Financial Stability Forum (FSF) to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. IOSCO has contributed actively to the work of the FSB, previously to the FSF, which has urged commitment by national authorities to the implementation of the 12 key standards and codes.

13 This exercise involved the development and completion by IOSCO Members of six surveys, as follows: a high level survey as to the regulator's opinion of the level of implementation of each Principle in its jurisdiction and five more detailed surveys intended to draw information that would facilitate documentation that the Principles in fact have been implemented, these related to the regulator (including enforcement and cooperation), issuers, collective investment schemes, market intermediaries and secondary markets. A checking exercise also was conducted through IOSCO's regional committees led by regional coordinators. This exercise provided feedback on the extent to which the responses of individual jurisdictions to these surveys were clear, complete, and consistent. This process led to the publication of the initial Methodology in October 2003.

14 The joint World Bank/IMF Financial Sector Assessment Program (FSAP), initiated in April 1999, seeks to diagnose potential vulnerabilities and analyze development priorities in the financial sectors of member countries of the IFIs and other jurisdictions.

This Methodology draws together the key aspects relevant to the implementation of the Principles. It explains how the Principles can be implemented in practice and provides benchmarks by which the level of implementation can be assessed. It draws from, but does not expand on, relevant IOSCO Resolutions and Reports, which are the core documents that IOSCO members seeking more information should use.

E. SCOPE OF THIS METHODOLOGY AND INTENDED SCOPE OF ASSESSMENTS

This Methodology is intended to apply to the securities markets, intermediaries, information service providers (such as CRAs) and products addressed by the Principles and to take account of the actual configuration of the markets, the stage of their development, and participation therein.

The words "securities markets" are used, as the context permits, to refer compendiously to the various market sectors, including markets for derivatives that are securities. The same interpretative convention applies to the use of the words "securities regulation."[15] The Principles are not, however, specifically tailored to address all issues that are particular to derivatives markets. Accordingly, in determining whether the context permits the application of a Principle to derivatives, assessors should take into account the functional differences between, and the relevant jurisdiction's statutory treatment of, securities and derivatives.

The Methodology does not apply to other markets such as the currency, bullion, or physical commodity markets, for example, except to the extent that securities intermediaries deal for customers in such markets. The Methodology also contains information on the legal framework relevant to meeting the objectives addressed by the Principles[16].

F. THE ASSESSMENT PROCESS AND ASSESSMENT MEASURES

Implementation Intended to Be a Dynamic and Constructive Process for Regulatory Improvement

The assessment is not an end in itself. Rather, assessment should be viewed primarily as a tool for identifying potential gaps, inconsistencies, weaknesses, and areas where further powers or authorities may be necessary, and as a basis for framing priorities for enhancements or reforms to existing laws, rules and procedures. This Methodology specifically contemplates that the assessment process will involve a dialogue in which the regulator will explain the details of its market structure, laws, and regulatory program and how, in view thereof, the regulator believes its regulatory program addresses the Key Questions and Key Issues so as to meet the objectives of the Principles.

In this regard, IOSCO has made clear that the Principles are not intended to be a pure checklist and that the regulator and the assessors will need to exercise judgment when using the Methodology as a tool, in particular when Questions relating to the sufficiency of a program, of resources, or to the degree of achievement of a certain principle are being assessed.

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15 See footnote 2 above.

16 See Appendix 1 of this Methodology.

Adequacy of Implementation Depends on the Level of Development and Complexity of the Market

There is often no single correct approach to a regulatory issue. Legislation and regulatory structures vary between jurisdictions and reflect local market conditions and historical development. The particular manner in which a jurisdiction implements the objectives and principles described in this Methodology must have regard to the entire domestic context, including the relevant legal and commercial framework. The assessor needs to be aware of the basic legal structure of a jurisdiction, including its civil, commercial and criminal law.

Consistently, this Methodology should not be interpreted as limiting the specific techniques or actions that may be taken to achieve sound securities regulation, provided that the objectives of the Principles are met. Accordingly, in order to apply this Methodology in a manner that appropriately reflects the nature of the market situation in the jurisdiction being assessed, it will be necessary to provide, or to obtain, a complete and clear description of a jurisdiction's capital markets as part of any assessment. Markets with a single or a few issuers, that are totally domestic in nature, or that are predominantly institutional, will pose different questions and issues as to the sufficiency of application of the Principles, and as to the potential vulnerabilities likely to arise from their non-application, than jurisdictions where there are substantial numbers of retail participants, intermediaries frequently are part of complex groups, issuers are established in other jurisdictions, or the markets have other international or cross-border components.

Thus a jurisdiction could satisfy an assessor that its approach, while not explicitly described in the Methodology, nonetheless met the objectives of a particular Principle. Similarly, a jurisdiction could document that the application of a particular approach was not applicable to the particular trading system but that the objectives of market integrity for example were achieved through other means. In general this type of room to explain is often contained in the Key Questions themselves or in the Explanatory Notes or Scope. Accordingly, in all circumstances assessors must explain the reasons for reaching their conclusions as to whether a Key Question is satisfied, why they reach a "Yes" despite the presence of some deficiencies, why they reach a "Yes" answer based on an alternative means of achieving the objectives set out in the Key Issues and related Key Questions, or why they believe a particular Key Question is not applicable or material in a particular jurisdiction's circumstances.

The regulator should frequently review the particular way in which securities regulation is carried out as markets themselves are in a constant state of development, therefore the content of a jurisdiction's regulation must also change if it is to continue to facilitate and properly regulate evolving markets.

How to Use the Methodology

This Methodology addresses each Principle in detail. It provides interpretative text to the Principles; sets out the Key Issues addressed by each Principle; establishes the Key Questions relevant to the assessment of how the jurisdiction is addressing the Key Issues; where necessary it provides explanatory notes; and also Benchmarks for evaluating the level of implementation.

This Methodology envisions that the assessor will establish bases for testing whether the objective of the Principle is sufficiently met from two perspectives:

(i) *From a legal (or design) perspective*, by identifying the powers and authorities conferred on the regulator, the relevant provisions of applicable laws, rules and regulations, and the programs or procedures intended to implement these that form the framework of securities regulation in the jurisdiction.

(ii) *From the perspective of the exercise of those powers and authorities in practice*, by documenting or otherwise measuring, through statistics, interviews with regulators, regulated firms, and market participants, and other methods, how the powers and responsibilities contained in the laws, rules and regulations are being exercised and whether enforcement of the relevant framework is effective. It is understood that, with respect to judging the effectiveness of the framework from a legal perspective, understanding of the basic legal structure of the jurisdiction is important, and from an empirical perspective, the fact-finding processes need to be carefully designed.

Where firms, products, or transactions are exempted from regulatory requirements or where the regulator has discretion to grant such exemptions, the reason the exemption is conferred and the process by which it is conferred should be transparent, give similar results for similarly situated persons or sets of circumstances, and be explainable in the context of the Principles.

The ability to test implementation will understandably be limited by the scope of the inquiry, the assessor's need to rely in certain respects on statistical and anecdotal information, and the fact that implementation will be as of a point in time and not continuing or periodic. Generally, an assessment of the level of implementation of the Principles assesses only the quality of securities regulation in a jurisdiction. There may be other factors (such as the economic and political climate) that affect consistent delivery of a fair and equitable regulatory system. Any assessment of implementation cannot be expected to provide assurance against a political or economic failure or the possibility that a sound regulatory framework can be circumvented.

Certain Principles should be assessed in conjunction with one another. The Methodology provides more details in this regard.

Assessors using this Methodology should refer to the assessed jurisdiction's responses to the Key Questions as a first step in the conduct of an assessment.[17]

In assigning an assessment rating, the assessor should be aware that the Principles with respect to the regulator and to Enforcement and Cooperation[18] should be considered to be applicable to all jurisdictions, whether or not they have a market. In contrast, the other Principles that relate to regulatory functions may not apply to some jurisdictions.

For example, if a jurisdiction does not operate or permit direct access to a secondary market, the provisions relating to secondary markets may not apply. However, even in a jurisdiction without its own secondary market, there should be laws that permit the jurisdiction to combat insider trading or other market misconduct originating from its jurisdiction into other jurisdictions.

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17 See footnote 9, supra.

18 The Enforcement and Cooperation Principles reflect the provisions of the IOSCO Multilateral Memorandum of Understanding which has become a benchmark among securities regulators at the international level.

Assessment Measures

The Methodology sets out clear guidance on the Key Questions that must be answered in the affirmative for a jurisdiction to score a *Fully, Broadly* or *Partly Implemented* rating (see below for an explanation on these assessment measures). It is understood that, where a Key Question is applicable, either "yes" or "no" answers to Key Questions used for testing implementation should be augmented by explanations that refine and explain the status of implementation in the context of a particular jurisdiction and that answers might be qualified to explain any departure from a full "yes" or full "no" response.

Nonetheless, assessors should consider the materiality of any weaknesses and the applicability, to the jurisdiction, of the Key Questions when making an assessment of compliance with individual Key Questions. Where a Key Question refers to the existence of specific powers or authorities, the judgment as to implementation will generally be precisely specified, limited only by applicability. However, where a Key Question addresses the sufficiency of resources, or the sufficiency of application of a system of enforcement, or effective achievement of specific regulatory functions, the jurisdiction and the assessor may need to make a judgment as to the sufficiency of the program or related resources or degree of achievement.

Although the Methodology contemplates that judgment must be applied in assigning assessment categories in these circumstances along the spectrum between *Partly* and *Fully Implemented*, the reasons for such judgments should be expressed by reference to the Key Questions, the assessment criteria in the benchmarks, and the related objectives of regulation expressed in the Key Issues and should be documented.

It is also expected that the status of implementation will be tested as at a specific point in time, that is, the time of the assessment. Where changes are planned, the manner in which those changes further implement the Principles, the timetable for their implementation and the reasonableness of the timetable should be reflected in the comments, but should not alter the assignment of an assessment rating.

Where new legislation, programs or procedures have been adopted recently and are untested in their application, the jurisdiction may receive a *Fully Implemented* status only as to having in place the necessary powers, and/or the design of necessary programs, to effectuate the affected principle and not as to full implementation of the powers or the program designed to use those powers.[19] Additionally, failure actually to use the powers, or to apply the program, however well designed, may also implicate an assessment of the existence of the powers.

After having replied to all the Key Questions of a Principle, the assessors determine the assessment rating according to the Principles benchmarking. Once this has been established, assessors should see whether this rating is in line with their general appreciation of the regulatory system in relation to the given Principle. If this is not the case, based on clear explanation, the assessors may decide to decrease or increase the assessment rating by one category.

[19] If, however, the regulator's prior program would have been *Fully Implemented* and the new program would be an enhancement, the jurisdiction should have an opportunity to demonstrate this and should not be penalized for improving its program.

Wherever a regulatory framework is assessed to be *Broadly*, *Partly*, or *Not Implemented* with respect to a particular Principle, recommendations should be proposed for achieving full implementation. Where a jurisdiction has adopted, but not yet implemented new legislation or procedures, the assessor may refer to these in its recommendations.

Assessment categories

Fully Implemented: A Principle will be considered to be Fully Implemented whenever all assessment criteria (as specified in the benchmarks) are generally met without any significant deficiencies.

Broadly Implemented: A Principle will be considered to be Broadly Implemented whenever a jurisdiction's inability to provide affirmative responses to applicable Key Questions for a particular Principle is limited to the Questions excepted under the Principle's Broadly Implemented benchmark and, in the judgment of the assessor, such exceptions do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.

Partly Implemented: A Principle will be considered to be Partly Implemented whenever the assessment criteria specified under the Partly Implemented benchmark for that Principle are generally met without any significant deficiencies.

Not Implemented: A Principle will be considered to be Not Implemented whenever major shortcomings are found in adhering to the assessment criteria as specified in the Not Implemented benchmark.

Not Applicable: A Principle will be considered to be Not Applicable whenever it does not apply given the nature of the securities market in the jurisdiction and relevant structural, legal and institutional considerations. Criteria defining this assessment rating are not indicated for every Principle.

II PRINCIPLE-BY-PRINCIPLE ANALYSIS

A. PRINCIPLES RELATING TO THE REGULATOR

1. Preamble

In this Methodology, the regulator refers to the authority or authorities responsible for regulating, overseeing, and supervising securities and/or derivatives markets ("regulator"). Responsible, or competent, authority(ies) are those with jurisdiction over each of the issues addressed in the Principles and this Methodology under the headings: Issuers, Auditors; Credit Rating Agencies and Other Information Service Providers; Collective Investment Schemes, Market Intermediaries; and Secondary Markets (including clearing and settlement), and may include other law enforcement, governmental and regulatory bodies.

The Principles do not prescribe a specific structure for the regulator.

In this Methodology, the term "regulator" is used compendiously.

There need not be a single regulator. In many jurisdictions, the desirable attributes of the regulator set out in the Principles are in fact the shared responsibility of two or more government or quasi-government agencies with governmental powers.

The Principles establish the desirable attributes of a regulator. An independent and accountable regulator with appropriate powers and resources is essential to ensure the achievement of the three core objectives of securities regulation. The Principles consider the enforcement and market oversight work of the regulator and the need for close cooperation between regulators essential to achievement of the regulatory function. The potential role of self regulatory organizations and the desirable attributes of such organizations are separately addressed under Principle 9.

Regulators also have an important role to play in monitoring, mitigating and managing systemic risk, in regularly reviewing the perimeter of regulation and in addressing conflicts of interest and misalignment of incentives.

The regulator and the effectiveness of its actions should be assessed in the context of the regulatory framework and the legal system of the jurisdiction being assessed. The regulator should also be assessed taking into account the situation, and stage of development, of the market of the assessed country (see the Introduction to this Methodology).

To the extent objectives or tasks are to be achieved or powers exercised by the "regulator," a jurisdiction should be deemed to have implemented the Principles as long as one of the competent authorities can achieve each individual objective or task or exercise a specific power even if the various objectives or tasks are achieved, or the various powers are exercised, by several different law enforcement, governmental and regulatory authorities.

Principles 1 to 5 closely interrelate with Principles 10 to 15. Therefore, evaluations of these Principles should be consistent. For example, it should be impossible to conclude that Principle 3 is fully implemented if the regulator is not endowed with comprehensive surveillance powers as required under Principle 10.

In every case, regulators should be held accountable for issuing and implementing rules and regulations necessary to achieve the key core objectives of securities regulation, monitoring whether the objectives are achieved, and taking enforcement or other appropriate action when there is a violation or lack of compliance with regulatory requirements within the context of their own legal and regulatory framework. Regulators also should be required to implement the regulatory framework responsibly, fairly and effectively.

2. Scope

The assessor should obtain a comprehensive overview of a given jurisdiction's regulatory system. As the responsibility for securities regulation can be shared by more than one competent authority, the assessor should obtain information that reflects each authority's structure, powers, scope of responsibility and operations. For example, in some jurisdictions, market intermediaries, other than securities firms, e.g., banking or credit institutions; insurance providers; and retirement, pension, and superannuation funds, may engage in the securities activities listed above, but may be subject to a different regulatory authority, for all or certain of their activities.

Where more than one authority is responsible, the assessor should obtain a description of the division of responsibility with respect to each of the functional areas of regulation identified above and the details of cooperative arrangements among the authorities.

The sharing of tasks in the regulatory system should be also considered when assessing Principles 6 - 7. With regards to Principle 8, the assessor should see whether the regulator has identified and assessed the degree to which the conflict exists and determine the degree to which regulation may be necessary to ensure the conflict is avoided, eliminated, disclosed, or otherwise managed.

3. Principles 1 through 8

Principle 1	**The responsibilities of the Regulator should be clear and objectively stated**

Unless the regulator's responsibilities are clearly and objectively stated, investors and market participants may be uncertain about the degree to which the regulator is able to protect the market's integrity through fair and effective oversight. Where this uncertainty exists, concerns about the market's integrity may become a self-fulfilling prophecy, to the detriment of all market participants. The capacity of the regulator to act responsibly, fairly and effectively, therefore is assisted by a clear definition of responsibilities, preferably set out in law; and strong cooperation among responsible regulators, through appropriate channels.

The desirable attributes of a regulator include an organizational structure and powers that permit it to achieve the basic objectives of securities regulation. In assessing this Principle, the assessor should consider whether, and how, the legal provisions that authorize and provide for the operation of the regulator demonstrate that the regulator can perform its duties, according to procedures and objectives predefined by the relevant regulatory framework. The assessor also should assess whether the arrangements in place demonstrate the ability of the regulatory framework to create and implement a system intended to protect investors, provide fair, efficient, and transparent markets, and reduce systemic risk.

The packaging of products and services may be such that a single product or service exhibits characteristics traditionally associated with at least two of the following: securities; banking; and insurance. Legislation should be designed to ensure that any division of responsibility among financial sector regulators avoids gaps or inequities. Where there is a division of regulatory responsibilities, similar types of conduct or products should be subject to similar regulatory requirements regardless of how responsibility is divided among regulators.

Key Issues

1. Responsibilities of the regulator should be clear and objectively set out, preferably in law.

2. Legislation should be designed to ensure that any division of responsibility among regulators avoids gaps or inequities. Where there is a division of regulatory responsibilities, substantially the same type of conduct and product generally should be subject to consistent regulatory requirements.

3. There should be effective cooperation among responsible regulators, through appropriate channels.[20]

[20] Supra, footnote 13. See also Principles 13 and 14.

Key Questions

1. Are the regulator's responsibilities, powers and authority:[21]

   (a) Clearly defined and objectively set out, preferably in law, and in the case of powers and authority, enforceable?

   (b) If the regulator can interpret its authority, are the criteria for interpretation clear and transparent?

   (c) Is the interpretative process transparent enough to preclude situations in which an abuse of discretion can occur?

2. When more than one regulator is responsible for securities regulation:

   (a) Where responsibility is divided among regulators, is legislation designed to avoid regulatory differences or gaps?

   (b) Is substantially the same type of conduct and product generally subject to consistent regulatory requirements?

   (c) Are responsible regulators required to cooperate and communicate in areas of shared responsibility?

   (d) Are there arrangements for cooperation and communication between responsible regulators through appropriate channels and are cooperation and communication occurring between responsible regulators without significant limitations[22]?

Explanatory Notes

Where the responsibilities for securities regulation are shared by more than one regulator and there are differences in the responsibilities and powers of those regulators, the assessment should identify each of the relevant responsible regulators and take into consideration whether the responsibilities and powers of the regulators taken in combination are sufficient to address each component of the Principles and the Key Questions and Key Issues thereunder. This will require an explanation of how powers and responsibilities considered relevant in the Methodology are distributed and executed in a jurisdiction or where and how regulatory powers are distributed e.g., by function, security, service or entity.

In this respect, the Principles are neutral as to whether securities regulation can be distinguished by security, function, service, entity, and/or type of transaction. What is important is to determine, and to consider, how regulation applies to the financial markets, participants, intermediaries, securities and services that characterize the jurisdiction being assessed.

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[21] Regulatory discretion may be necessary to meet regulatory objectives in a rapidly evolving market, but how the scope of such discretion is determined and how the manner of its exercise is subject to review is relevant to the regulator's ability to act responsibly, fairly and consistently.

[22] Measures to protect the confidentiality of non-public information consistent with permitted uses should not be considered significant limitations. See also Principle 14.

Gaps should be construed to mean gaps in coverage (not in performance) of areas of the basic elements (functions and objectives) of securities regulation (e.g., collective investment schemes, issuers, auditors, credit rating agencies, and other information service providers, market intermediaries, secondary markets, enforcement) which are applicable to, and are not covered by, the system being assessed. The assessor should draw the views of the jurisdiction being assessed regarding gaps and inequities. More specific functional gaps or deficiencies should be treated under the specific Principles related to each element of securities regulation. Evidence should be provided as to how all areas addressed by the Principles are covered and, where there are divisions of authority that effective arrangements exist for cooperation.

Where legislation does not satisfactorily address gaps or inequities and amendment is not possible in the short-term, potential gaps or inequities may be addressed by procedures intended to ensure their avoidance as a result of any division of responsibilities, such as protocols or arrangements with other responsible authorities to assure appropriate and equitable coverage of the functions and objectives of securities regulation.

Benchmarks

Fully Implemented

> Requires affirmative responses to all applicable Questions except to Question 2, where it is not applicable as there is a single regulator responsible for securities regulation in the jurisdiction.

Broadly Implemented

> Requires affirmative responses to all applicable Questions except to Questions 2(b) and 2(d) provided that different responsible regulators do not supervise the same entity, e.g., where prudential and conduct of business supervision of the same entity is performed by different responsible regulators.

Partly Implemented

> Requires affirmative responses to all applicable Questions except to Questions 1(c) and 2(b) and 2(d), if more than one responsible regulator supervises the same entity.

Not Implemented

> Inability to respond affirmatively to one or both of Questions 1(a) and 1(b) and, if applicable, one or more of Questions 2(a) or 2(c).

Principle 2 The Regulator should be operationally independent and accountable in the exercise of its functions and powers

While the regulator should be accountable under a jurisdiction's legal and governing structure, the regulator should also be operationally independent from external political or commercial interference. Without such independence investors and other market participants may come to doubt the regulator's objectivity and fairness, with deleterious effects on the market's integrity. Generally, the regulator's independence will be enhanced by a stable source of funding. It also means that the regulator should remain independent from the market participants that it supervises.

In some jurisdictions, particular matters of regulatory policy require consultation with or even approval by, a government, minister, or other legislative authority. The circumstances in which such consultation or approval is required or permitted should be clear and the process sufficiently transparent or subject to review to safeguard its integrity. Generally, it is not appropriate for these circumstances to include decision making on day-to-day technical matters.

Independence implies:

- a regulator that operates independently of sectoral interest; and
- the ability to undertake regulatory measures and enforcement actions without external (political or commercial) interference.

Accountability implies that the regulator is subject to appropriate scrutiny and review, including:

- periodic public reporting by the regulator on its performance;
- transparency in the regulator's process and conduct; and
- a system permitting judicial review of licensing, authorizing or enforcement related final decisions of the regulator.

The confidential and commercially sensitive nature of much of the information in the possession of the regulator must be respected. Safeguards must be in place to protect such information from inappropriate use or disclosure.

The capacity of the regulator to act independently will be enhanced by adequate legal protection for the regulator and its staff when acting in the bona fide discharge of their functions and powers.

Key Issues

Independence

1. The regulator should be operationally independent from external political interference[23] and from commercial, or other sectoral interests, in the exercise of its functions and powers.

2. Consultation with or approval by a government minister or other authority should not include operational decisions.

3. In jurisdictions where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority, the circumstances in which such consultation or approval is required or permitted should be clear and the process of consultation and criteria for action sufficiently transparent or subject to review to safeguard its integrity.

4. The regulator should have a stable source of funding sufficient to exercise its powers and responsibilities.

5. There should be adequate legal protection for the regulator and its staff acting in the *bona fide* discharge of their functions and powers.

Accountability

6. The regulator should be publicly accountable in the use of its powers and resources to ensure that the regulator maintains its integrity and credibility.

7. There should be a system permitting judicial review of final decisions of the regulator.

8. Where accountability is through the government or some other external agency, the confidential and commercially sensitive nature of information in the possession of the regulator must be respected. Safeguards should be in place to protect such information from inappropriate use or disclosure.

Key Questions

Independence

1. Does the regulator have the ability to operate on a day-to-day basis without:

   (a) External political interference?

   (b) Interference from commercial or other sectoral interests?[24]

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[23] The term "interference" means a formal or informal level and method of contact that affects day-to-day decision making and is unsusceptible to review or scrutiny.

[24] Principle 3. Administrative actions, such as licensing or commencement of inspections or investigations ordinarily should be particularly scrutinized for freedom from inappropriate influence.

2. Where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority:

   (a) Is the consultation process established by law?

   (b) Do the circumstances, in which consultation is required, exclude decision making on day-to-day technical matters?

   (c) Are the circumstances in which such consultation or approval is required or permitted clear and the process sufficiently transparent, or the failure to observe procedures and the regulatory decision or outcome subject to sufficient review, to safeguard its integrity?

3. Does the regulator have a stable and continuous source of funding sufficient to meet its regulatory and operational needs?

4. Are the regulator, the head and members of the governing body of the regulator, as well as its staff, accorded adequate legal protection for the *bona fide* discharge of their governmental, regulatory and administrative functions and powers?[25]

5. Are the head and governing board of the regulator subject to mechanisms intended to protect independence, such as: procedures for appointment; terms of office; and criteria for removal?

Accountability

6. With reference to the system of accountability for the regulator's use of its powers and resources:

   (a) Is the regulator accountable to the legislature or another government body on an ongoing basis?

   (b) Is the regulator required to be transparent[26] in its way of operating and use of resources and to make public its actions that affect users of the market and regulated entities, excluding confidential or commercially sensitive information?

   (c) Is the regulator's receipt and use of funds subject to review or audit?

7. Are there means for natural or legal persons adversely affected by a regulator's decisions or exercise of administrative authority ultimately to seek review in a court, specifically:

   (a) Does the regulator have to provide written reasons for its material decisions?[27]

   (b) Does the decision-making process for such decisions include sufficient procedural protections to be meaningful?

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[25] Principle 5.

[26] The regulator must be accountable as a matter of law. The regulator may be considered to be *required* to be transparent, if, as a general principle of administrative law, procedure or practice, its use of its powers and resources generally is transparent.

[27] The regulator need not be required by legislation to give written reasons provided that it has formal written procedures as to when it will do so.

(c) Are affected persons permitted to make representations prior to such a decision being taken by a regulator in appropriate cases?[28]

(d) Are all such decisions taken by the regulator subject to a sufficient, independent review process, ultimately including judicial review?

8. Where accountability is through the government or some other external agency is confidential and commercially sensitive information subject to appropriate safeguards to prevent inappropriate use or disclosure?

Explanatory Notes

The balance between independence and accountability is delicate. The Principles take no position on location of the regulator within the governmental structure. Nevertheless, in different circumstances the safeguarding of independence must be particularly scrutinized. Not only should the allocation of regulatory responsibilities, the framework for accountability and procedures, or other mechanisms in place to achieve independence be considered, but also the actual operation of the relationship between the regulator and any governmental overseer should be considered. If possible, the effect of such inter-relationship should be reviewed in specific cases. For example, in some jurisdictions, rules or policies may require approval by a government minister or other authority or other important regulatory matters may require consultation with or approval by a government minister or other authority. Also, sometimes matters are reviewed within the government for compliance with applicable law. The circumstances in which such consultation or approval is required or permitted should be clear and the process sufficiently transparent or subject to review as to safeguard its integrity.

Independence or accountability is not necessarily compromised just because the regulator is part of the government and/or the top officials of the regulator are political appointments, including appointees that previously served in the government

Criteria for decision-making also can insulate the process from inappropriate political interference. For example, the ability to reverse licensing decisions at the ministerial level without clear criteria both for the refusal to licence and related decision-making process would inappropriately infringe independence. A stable source of funding is critical because operational independence can be compromised if funding can be curtailed by external action. The assessor may inquire of the assessed jurisdiction as to whether the source of funds can adversely affect its accessibility.

Forms of funding may vary for each regulator and it includes cases where the regulator is funded by the government's budget.

As this Principle tests independence, the ability to protect sensitive information passed to other decision-making authorities should be part of the regulatory framework to prevent undue interference with the regulatory authorities' operations. The safeguards in place must be part of the system.

[28] For example, a warning letter may not be subject to additional process.

One example of adequate legal protection for regulators acting in *bona fide* performance of regulatory functions would be qualified immunity from personal liability for actions taken in good faith within the scope of the regulator's authority. Other arrangements may also be possible. The adequacy and type of legal protection for regulators acting in *bona fide* performance of their regulatory functions must be evaluated according to the legal system applicable in the assessed jurisdiction.

Formal consultation with commercial interests, including those subject to regulation, as contemplated under Principle 4, does not impair independence.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 6(b).

Partly Implemented

Requires affirmative responses to all applicable Questions except to either Question 2(b) or 2(c), and to Questions 4, 5, 6(b) and 7(c).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), both 2(b) and 2(c), 3, 6(a), 6(c), 7(a), 7(b), 7(d) or 8.

Principle 3 **The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.**

The regulator should have adequate powers, proper resources (including adequate funding), and the capacity to perform its functions and exercise its powers, both in regular and in emergency situations. What this means in practical terms is the subject of elaboration in this section. It includes powers of licensing, supervision, inspection, investigation, and enforcement. It also includes the capacity and resources to attract and retain appropriately trained, qualified, and skilled staff to perform its functions and exercise its powers, while being able to provide ongoing training to this staff.

The regulator must ensure that its staff receives ongoing training as required.

The powers and resources of the regulator should be consistent with the size, complexity, and types of the markets that it oversees and its need to meet the functions contained in these Principles. The assessor should determine after assessing all the Principles and the effectiveness of the jurisdiction's regulatory program if there is a substantial basis for concluding that the powers, resources, and capacity of the regulator are sufficient.

This Principle is relevant for the work of the regulator taking into account that the Principle makes sure the appropriate performing of the regulator's functions and the effective exercise of its powers, which is fundamental in terms of achieving both 1) successful preventative measures (surveillance, inspection, investigation), and 2) credible and effective corrective measures (detect, deter, enforce, sanction, redress and correct violations of securities laws). Any circumstance that impedes or challenges the appropriate and effective exercise of the functions and powers of the regulator is detrimental to the Objectives behind these Principles. In this way, this would be consistent and in compliance with Principles for the Enforcement of Securities Regulation (10 - 12) and Principles for Cooperation in Regulation (13 - 15), and the other way around, taking into account that they are inter-related.

The regulator should play an active role in the education of investors. Investor education may enhance investors' understanding of the role of the regulator and provide investors with the tools to assess the risks associated with particular investments and to protect themselves against fraud (and other abuses).

Key Issues[29]

1. The regulator should have powers of licensing, supervision, inspection, investigation and enforcement.

2. The regulator should have adequate funding to exercise its powers and responsibilities.

[29] See also Key Questions on enforcement and cooperation under Principles 10, 11, 13 and 15 and Key Questions relating to regulatory powers related to Issuers, Market Intermediaries, Collective Investment Schemes and Secondary Markets.

3. The level of resources should recognize the difficulty of attracting and retaining experienced staff.

4. The regulator should ensure that its staff receives adequate, ongoing training.

5. The regulator should have policies and governance practices in place to perform its mandate adequately.

6. Regulators should play an active role in promoting the education of investors and other market participants.

Key Questions[30]

1. Are the powers and authorities of the regulator sufficient, taking into account the nature of a jurisdiction's markets and a full assessment of these Principles to meet the responsibilities of the regulator(s) to which they are assigned?

2. With regards to funding:

   (a) Is the regulator's funding adequate to permit it to fulfil its responsibilities, taking into account the size, complexity and types of functions subject to its regulation, supervision or oversight?

   (b) Can the regulator affect the operational allocation of resources once funded?

3. Does the level of resources recognize the difficulty of attracting and retaining experienced and skilled staff?

4. Does the regulator ensure that its staff receives adequate ongoing training?

5. Does the regulator have policies and governance practices to perform its functions and exercise its powers effectively?

6. Does the regulator play an active role in promoting education in the interest of protecting investors?

Explanatory Notes

The powers granted to the regulator should be commensurate to the functions committed to the regulator. Where there is more than one responsible authority, the powers required for implementation may be distributed among them. The powers granted, taken together, should be sufficient to provide the ability to achieve implementation of the other Principles set forth in this Methodology. The assessor may wish to review this Principle after the full assessment is complete.

In complex markets, technology may be necessary to assure efficient discharge of regulatory functions. An appropriate program of investor education in a jurisdiction may also assist the regulator in carrying out its responsibilities.

[30] The answers to these questions should be consistent with powers and authorities discussed in other sections.

The regulator should be given an opportunity to demonstrate to the assessor that its powers and funding are adequate and, in particular, how they are deployed to achieve its objectives and legal and regulatory responsibilities; for example, how the regulator measures effectiveness, promptness of action, level of coverage and ability to meet its priorities.

Turnover of staff may be an indication of inability to attract and retain qualified staff. The assessor should inquire further about the reasons.

The regulator should also be invited to explain what sorts of investor education activities or programs are promoted by the regulator within the assessed jurisdiction.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented[31]

Requires affirmative responses to all applicable Questions except to Question 3.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 2(b), 3, 4, 5, and 6.

Not Implemented

Inability to respond affirmatively to one or both of Questions 1 and 2(a).

[31] For *Broadly* and *Partly*, the availability and sufficiency of resources in fact may need to be evaluated along the spectrum of *Fully* to *Partly* with guidance from the assessed jurisdiction.

Principle 4 The Regulator should adopt clear and consistent regulatory processes

Clear, consistent, transparent procedures and processes are part of fundamental fairness and of a framework for developing regulatory decisions and for undertaking regulatory actions that assure accountability. Transparency policies must however, balance the rights of individuals to confidentiality, and regulators' enforcement and surveillance needs, with the objective of fair, equitable and open regulatory processes.

In exercising its powers and discharging its functions, the regulator should adopt processes, which are:

- consistently applied;
- comprehensible;
- transparent to the public;
- fair and equitable.

In the formulation of policy, the regulator should:

- have a process for consulting with the public including those who may be affected by the policy;
- publicly disclose its policies in important operational areas;[32]
- observe standards of procedural fairness;
- have regard to the cost of compliance with the regulation.

Many regulators have authority to publish reports on the outcome of investigations or inquiries, particularly where publication would provide useful guidance to market participants and their advisers. Any publication of a report must be consistent with the rights of an individual to a fair hearing and the protection of personal data, factors that will often preclude publicity when a matter is still the subject of investigation.

Key Issues

Clear and Equitable Procedures with Consistent Application

1. In exercising its powers and discharging its functions, the regulator should adopt processes which are:

   (a) Consistently applied.

   (b) Comprehensible.

[32] In some operational areas, and in some cases, particularly in the areas of surveillance and enforcement, consultation and disclosure may be unnecessary or inappropriate as it may compromise the effective implementation of the policy.

(c) Transparent to the public.

(d) Fair and equitable.

2. In the formulation of policy, subject to enforcement and surveillance concerns,[33] the regulator should:

(a) Have a process for consulting with the public, including those who may be affected by the policy.

(b) Publicly disclose its policies in important operational areas.[34]

(c) Have regard to the cost of compliance with regulation.

3. The regulator should observe standards of procedural fairness.

Transparency and Confidentiality

4. Transparency practices, such as publication of reports on the outcome of investigations or inquiries, where permitted, should be consistent with the rights of an individual to a fair hearing and the protection of personal data, factors that will often preclude publicity when a matter is still the subject of investigation.

Key Questions

Clear and Equitable Procedures

1. Is the regulator subject to reasonable procedural rules and regulations?

2. Does the regulator:

(a) Have a process for consulting with the public, or a section of the public, including those who may be affected by a rule or policy, for example, by publishing proposed rules for public comment, circulating exposure drafts or using advisory committees or informal contacts?

(b) Publicly disclose and explain its rules and regulatory policies, not including enforcement and surveillance policies, in important operational areas, such as through interpretations of regulatory actions, setting of standards, or issuance of decisions stating the reasons for regulatory actions?

(c) Publicly disclose changes and reasons for changes in rules or policies?

(d) Have regard to the costs of compliance with regulation?

(e) Make all rules and regulations available to the public?[35]

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[33] In some operational areas and in some cases, particularly in the areas of surveillance and enforcement, consultation and disclosure may be unnecessary or inappropriate as it may compromise the effective implementation of policy.

[34] That is policies with respect to Issuers, Collective Investment Schemes, Market Intermediaries and Secondary Markets.

[35] For example, on its website or through readily accessible reports. See also Principle 1.

(f) Make its rulemaking procedures readily available to the public?[36]

3. In assessing procedural fairness:

(a) Are there rules in place for dealing with the regulator that are intended to ensure procedural fairness?

(b) Is the regulator required[37] to give reasons in writing for its decisions that affect the rights or interests of others?

(c) Are all material decisions of the regulator in applying its rules subject to review?

(d) Are such decisions subject to judicial review where they adversely affect legal or natural persons?

(e) Are the general criteria for granting, denying, or revoking a licence made public, and are those affected by the licensing process entitled to a hearing with respect to the regulator's decision to grant, deny, or revoke a licence?

Transparency and Confidentiality

4. If applicable, are procedures for making reports on investigations public consistent with the rights of individuals, including confidentiality and data protection?

Consistent Application

5. Are the regulator's exercise of its powers and discharge of its functions consistently applied?

Explanatory Notes

The assessor should establish whether there are specific laws, rules or procedures that govern the administrative structure and whether these rules are clear, accessible and transparent. Such rules would assist in assuring that procedures are: consistently applied; comprehensible; transparent to the public; and fair and equitable.

In some operational areas, and in some cases, particularly in areas of surveillance and enforcement, consultation and disclosure may be unnecessary or inappropriate as they may compromise the effective implementation of regulatory policy.

There may be different levels of, or procedures for, review for different types of regulatory actions. For example, rulemaking may be subject to different review procedures than actions with respect to granting licences or taking enforcement action. This is not inconsistent with the Principles if the review procedures are transparent and equitably applied.[38]

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[36] Principle 2.

[37] The regulator need not be required by legislation to provide reasons, provided that it has written procedures as to when it will do so.

[38] Principle 2, Key Question 7, supra.

An effective consultation process may be responsive to the need to take into account the impact of regulation and to have regard to the costs of compliance with regulation. The regulator should be able generally to assess the use of its resources. A regulator is not required to conduct a specific cost/benefit analysis in order to be found to have regard for the cost of compliance when framing regulatory policy.

Interviews with affected parties and other documentation may be necessary to confirm whether procedures are, in fact, consistently applied, fair and equitable and the market is open to fair competition practices.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.[39]

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 2(d).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 2(b), 2(d), 2(f) and 5.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(c), 2(e), 3(a), 3(b), 3(c), 3(d), 3(e), or 4.

[39] Principle 2. If there is no power to make reports public, then there would be no need to protect confidentiality.

Principle 5 **The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality**

This Principle refers to the integrity and the means for achieving and demonstrating the integrity of the regulator and its staff. In the context of this Principle, the term "staff" is intended to include the head of the regulator, as well as its members. Only the highest professional standards of conduct are appropriate to achieving the objectives of regulation.

Key Issues

1. The staff of the regulator should observe the highest professional standards and be required to follow clear guidance on matters of conduct including:

   (a) The avoidance of conflicts of interest (including the conditions under which staff may trade in securities).

   (b) The appropriate use of information obtained in the course of the exercise of powers and the discharge of duties.

   (c) The proper observance of confidentiality and privacy provisions and the protection of personal data.

   (d) The observance of procedural fairness standards.

2. Failure to meet standards of professional integrity should be subject to sanctions.

Key Questions

1. Are the staff of the regulator required to observe requirements or a "Code of Conduct" or other written guidance, pertaining to:

   (a) The avoidance of conflicts of interest?

   (b) Restrictions on the holding or trading in securities subject to the jurisdiction of the regulator and/or requirements to disclose financial affairs or interests?

   (c) Appropriate use of information obtained in the course of the exercise of powers and the discharge of duties?

   (d) Observance of confidentiality and privacy provisions and the protection of personal data?

   (e) Observance by staff of procedural fairness standards in performance of their functions?

2. Are there:

   (a) Processes to investigate and resolve allegations of violations of the above standards?

   (b) Legal or administrative sanctions for failing to adhere to these standards?

Explanatory Notes

The Key Questions are intended to address requirements relating to maintenance of high professional standards. The assessor should obtain documentation of specific procedures and how they have been used in specific cases. The assessor should also look at documentation of confidentiality measures and arrangements to avoid conflicts of interest.[40] For example, guidance on conflicts of interest should address outside employment and holding of other positions, among other things.

Restrictions on trading could include, for example, pre-clearance of transactions or restrictions on transactions above a specified threshold.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except that there may not be active monitoring of matters under Questions 1(a) and 1(b).

Partly Implemented

Requires affirmative responses to all applicable Questions except that with respect to Questions 1(a) through (e), there may be minor shortcomings in observance of procedures, including no active monitoring under Questions 1(a) and 1(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d) or 1(e), subject to the departures from full compliance permitted under *Partly Implemented*, or failure to respond affirmatively to either of Questions 2(a) or 2(b).

[40] Principle 4.

Principle 6 **The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate**

Objective

Systemic risk refers to the potential that an event, action, or series of events or actions will have a widespread adverse effect on the financial system and, in consequence, on the economy. Securities regulators are concerned about systemic risk because it not only has the potential to harm a large number of investors and market participants, but because it also can have a widespread negative effect on financial markets and the economy.

Reducing systemic risk is one of the Core Objectives of Securities Regulation. Principle 6 recognizes that securities regulators have an important and unique role to play in monitoring, mitigating, and managing systemic risk. Systemic risk is not limited to sudden catastrophic events; it may also take the form of a more gradual erosion of market trust. Implementing many of the other principles of securities regulation will be important in mitigating risks to market trust. In particular, strong investor protection standards, vigorous enforcement, the transparency offered by extensive disclosure requirements, robust resolution regimes, or other factors are all important elements of how the regulator can mitigate and manage risks against a gradual erosion of market trust.

Promoting financial stability is a shared responsibility amongst the financial sector regulatory community. Securities regulators, prudential regulators and central banks all have important roles to play and come equipped with different tools at their disposal. The nature of the risk identified will, to a large extent, dictate which set of tools may be most effective in addressing the risk. The tools available to securities regulators to reduce systemic risk generally consist of strong investor protection standards and enforcement, disclosure and transparency requirements, business conduct regulation and resolution regimes for market intermediaries. This Principle explicitly recognizes that securities regulators may not have the appropriate tools to address certain forms of systemic risk and, therefore, it is important that they cooperate with other regulators.

Effective securities regulation is predicated on preserving market integrity, financial stability, and investor protection. This approach recognizes that the market is composed of an interconnected network where the activities of one or more participants can have spill-over effects on all. Systemic risk arising in one part of the financial system may also be spread to other parts of the financial system through the markets and the economy. Consequently, securities regulators need to work with other regulators to understand the interconnections between market participants, markets, and market infrastructures.

Securities markets are characterized by rapid changes and financial innovation. Innovation should be encouraged and facilitated where it has the potential to improve the functioning of the markets and to provide investors with greater choice. However, innovation may not always be beneficial, particularly when it leads to opacity or is associated with poor risk management. Regulators should be aware of new and evolving products, business models and participants, and the potential risks they pose to the financial system as a whole. Regulators need to strive to understand the potential risks associated with financial innovation and develop approaches that permit beneficial innovation while preserving investor protection.

Securities regulators should look to develop key risk measurements relevant to systemic risks arising within securities markets, and improve their understanding and application of tangible steps to mitigate such risks. Securities regulators may be able to leverage work done by other supervisors but it will be important to develop their own risk indicators through the use of qualitative and quantitative data. Such indicators are being developed and will evolve over time.

Key Issues

1. The regulator should have or contribute to regulatory processes, which may be cross-sectoral, to monitor, mitigate, and appropriately manage systemic risk. The process can vary with the complexity of the market.

2. Given the central role of markets in the overall financial system and their capability to generate and/or transmit risks, securities regulators should work with other supervisors to improve the overall understanding of the economics of the securities markets, their vulnerabilities and the interconnections with the broader financial sector and the real economy.

3. The Regulator should have or develop systems and processes to permit the sharing of information and knowledge as an essential component for the delivery of an effective regulatory response to systemic risk.

Key Questions

1. Does the regulator have or contribute to a regulatory process (which may be focused on the securities market or be cross-sectoral) to monitor, mitigate, and appropriately manage systemic risk, according to the complexity of the regulator's market consistent with its mandate and authority?

2. Is the regulator developing expertise regarding risk measurements and analysis relevant to systemic risk, or if not, is the regulator able to take into consideration and apply risk measurements and analysis developed by other regulators?

3. Is there communication and information sharing between the regulator and other financial sector regulators who have responsibility for systemic stability with respect to efforts to reduce systemic risks?

Explanatory notes

Disclosure and transparency are critical to identifying and understanding the development of systemic risk and arming regulators with the information needed to take the appropriate action. Transparency in markets and products is also crucial to allow market participants to better price risk. Regulators have a particular responsibility and interest in promoting transparency at the market level as well as adequate disclosure at the product and market participant level.

Regulators also have a particular responsibility for establishing organizational requirements, business conduct regulation, and resolution regimes for market intermediaries, which are important elements in mitigating and managing systemic risk. Robust oversight of organizational requirements and business conduct is essential to managing the build-up of undesirable incentive structures which can be an important source of risk in the financial system.

Reducing systemic risk also needs to be considered within the context of the regulator's broader mandate. A number of other principles also contribute to the regulator's efforts to identify, mitigate, and manage systemic risk. These include, in particular, principles relating to the perimeter of regulation (Principle 7), conflicts of interest (Principle 8), cooperation and information-sharing with other regulators (Principle 13-15), oversight of Credit Rating Agencies (Principle 22), oversight of hedge funds and/or hedge funds managers and advisors (Principle 28), procedures for dealing with the failure of a market intermediary (Principle 32) and supervisory requirements of clearing and settlement (Principle 38).

When assessing Key Question 1, the assessor should consider whether the regulator has or contributes to a regulatory process (which may be focused on the securities market or be cross-sectoral) with respect to systemic risk posed by entities within the scope of its regulation, e.g., with respect to market intermediaries, hedge funds or central counterparties which are themselves systemically important in the relevant securities market.

Benchmarks

Fully implemented

Requires affirmative responses to all applicable Questions.

Broadly implemented

Inability to respond affirmatively to either Question 2 or Question 3.

Partly Implemented

Inability to respond affirmatively to both Questions 2 and 3.

Not Implemented

Inability to respond affirmatively to Question 1.

Principle 7 **The Regulator should have or contribute to a process to review the perimeter of regulation regularly.**

Objective

Regular review of the perimeter of regulation promotes a regulatory framework that supports investor protection, fair, efficient, and transparent markets and the reduction of systemic risk.

Depending on the structure of the market and the legal system that underpins it, not all market activities or market participants may be subject to direct regulation or oversight. The decision whether to regulate a specific product, market, market participant or activity is ultimately a policy judgment made by the relevant authorities in each jurisdiction based on an assessment (to which regulators should contribute) of the jurisdiction's particular circumstances. Therefore, the regulator should have or contribute to a process to regularly review whether its current regulatory requirements and framework adequately addresses risks posed to investor protection, and to fair, efficient and transparent markets, as well as to the reduction of systemic risks.

A regular review of the perimeter of regulation will also consider the effectiveness of existing regulations and the need to modify them or adopt new regulations in light of new market developments. In particular, that review will need to address the risk of regulatory arbitrage arising from changes to the intensity of regulation across the financial sector.

Key Issues

1. The regulator should:

   (a) adopt or adapt its own process, or participate in a process with other regulators and/or government policy-makers, for conducting a regular review of products, markets, market participants and activities so as to identify and assess possible risks to investor protection and market fairness, efficiency and transparency or other risks to the financial system; and

   (b) regularly review the perimeter of regulation in order to promote the identification and assessment of these risks.

2. Such review should include consideration of:

   (a) whether developments in products, markets, market participants and activities have an effect on the scope of securities regulation; and

   (b) whether the policy approach underlying the existing statutory or discretionary exemptions, continues to be valid.

3. The process should focus on determining whether the regulator's existing powers, operational structure, and regulations are sufficient to meet emerging risks.

4. The process should also allow for any changes to the existing perimeter of regulation to be made in a timely manner in response to an identified emerging risk. Such a necessary change may include the regulator seeking changes to legislation.

Key Questions

1. Does the regulator have or participate in a process, to identify and assess whether its regulatory requirements and framework adequately addresses risks posed by products, markets, market participants and activities to investor protection, fair, efficient and transparent markets and the reduction of systemic risk?

2. Does the regulator have a process to review, where it is presented with evidence of changing circumstances, its past regulatory policy decisions on products, markets, entities, market participants or activities, especially decisions to exempt, and take measures as appropriate?

3. Does the regulator participate in a process (with other financial system supervisors and regulators if appropriate) which reviews unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage, in order to promote investor protection and fair, efficient and transparent markets and reduce systemic risks?

4. Does the regulator seek legislative or other changes when it identifies a regulatory weakness or risk to investor protection, market fairness, efficiency, and transparency that requires legislative or other changes?

Explanatory Notes

Assessors should recognize that each regulator may have its own unique process in reviewing the perimeter of regulation and deference should be given to regulatory prerogative.

Examples of such processes could include:

- a team, group or division within the organization to identify risks, regulatory gaps or conflicts;
- the regulator could be party to a formal or informal group of financial regulators that share information and discuss regulatory perimeter;
- ad hoc groups to identify and assess risks in response to a crisis or on a periodic basis; or
- other formal or informal means of surveying or assessing the perimeter of regulation.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all Questions except Question 4.

Partly Implemented

Requires affirmative responses to all Questions except Question 2 and 4.

Not Implemented

Inability to respond affirmatively to Question 1 or 3.

Principle 8	**The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.**

Objective

A recurring concern of securities regulators has to do with what economists call "agency problems," where market participants entrusted to act in the interests of others use their position, power, or information to advance their own interests instead.

Such conflicts of interest or misalignment of incentives are common problems in many financial markets and are often the focus of securities regulation. They arise for a range of reasons including compensation programs in firms. Conflicts and misalignments should be and are the focus of securities regulation because they can undermine investor protection and the fair, efficient, and transparent operation of markets or present systemic risk. This focus on conflicts of interest is reflected in references to conflicts of interest in a number of Principles (5, 9, 22, 23, 24, 28, 29, and 31).

This Principle is an overarching Principle which sets out the role securities regulators should have in addressing conflicts of interest and the misalignment of incentives. Where conflicts of interest may exist that pit the interests of a market participant against those it has been entrusted to advance, the regulator should identify and assess the degree to which the conflict exists and determine the degree to which regulation may be necessary to ensure the conflict is avoided, eliminated, disclosed or otherwise managed.

This Principle also sets out the role securities regulators should have where the incentives and interests of those engaged in bringing financial products to market are not aligned with the interests of investors.

This is a particular issue where different firms are responsible for the design, manufacture, and distribution of a financial product (as is the case with asset-backed securities and other complex financial products). Even where each firm engaged in bringing a product to market avoids, eliminates, discloses or otherwise manages conflicts of interest with, and meets its obligations to, direct counterparties and clients incentives may exist for it to act in a way which is not in the best interests of the end consumer or investor. Firms in these circumstances may owe no duty to the end consumer or investor but their actions may not always be in the interests of the end consumer or investor.

The design, manufacture, and distribution of asset-backed securities in the years preceding the 2008 global financial crisis provide an example of what is called a "lack of alignment of incentives" or "misalignment of incentives".[41] Originators, sponsors, issuers and underwriters during this period, while meeting contractual obligations and managing direct conflicts of interest to their immediate client or counterparty, had no additional incentive to perform appropriate levels of due diligence on the asset pools backing the security or to employ robust underwriting standards. Originators and brokers may have focused on the origination of securitized products without due regard to longer term performance of the

[41] *Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, pp 15-21, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf.

products encouraged by short term incentive remuneration structures.[42] Asset quality suffered, resulting in diminished returns (and losses) to end investors.

Key Issues

1. The regulator should identify and evaluate potential and actual conflicts of interests regarding regulated entities and misalignment of incentives for issuers and regulated entities providing analytical or evaluative services to investors and other users of those services within the securities market.

2. The regulator should take steps so that conflicts of interest or misalignment of incentives among regulated entities are avoided, eliminated, disclosed, or otherwise managed. Disclosure of potential or actual conflicts of interests and misalignment of incentives should be made to or accessible by investors and/or other users of the services or products.

Key Questions

1. Does the regulator have in place a process designed to identify and evaluate potential and actual conflicts of interest regarding regulated entities and misalignment of incentives regarding issuers and regulated entities?

2. Where the regulator identifies significant conflicts of interest among regulated entities or misaligned incentives, does it take steps so that these conflicts of interest or misalignments are avoided, eliminated, disclosed or otherwise managed?

3. Where the regulator requires conflicts of interest or misaligned incentives to be disclosed, are the disclosures mandated in such a way that they are accessible by investors and/or the users of the services or products?

Explanatory Note

Decisions on which regulatory tools to use to address particular conflicts of interest among regulated entities (e.g., prohibitions, disclosures, use of information barriers, etc.) will necessarily entail policy decisions reflecting legal and market structures and regulatory philosophies. The critical issue from an assessment perspective is the process by which the regulator monitors conflicts of interest in the market that may have an effect on investor protection, market fairness, efficiency, and transparency, or pose a systemic risk.

Examples of conflicts of interest and misaligned incentives commonly highlighted in past financial crises involve:

- mortgage brokers hired by financial institutions to assess the quality of loan applications but who were compensated based on the volume and size of applications processed (giving rise to an incentive to exaggerate the quality of the loan applications);

[42] Ibid. p. 16, paragraphs 52 and 53.

- credit rating agencies hired by issuers, arrangers and/or investors to publicly or widely opine on the credit-worthiness of a security in which the issuer, arranger or investor has an interest (and, therefore, a willingness to compensate the CRA according to whether the rating aligns with the issuer's, arranger's or investor's interest); and
- the judgement of audit firms being affected by the provision of non-audit services to audit clients.

Not all of the entities are always regulated by securities regulators, and these above examples should not be read as conflicts of interest or misaligned incentives that all regulators should seek to address, unless noted in other Principles. For example, mortgage brokers often fall under banking regulation.

Examples of approaches where the regulator has identified, evaluated and taken steps to avoid conflicts of interests in areas highlighted in the 2008 financial crisis might include:

- imposing risk retention requirements for originators, sponsors, original lenders and/or issuers of securitized products; or
- requiring the independence of service providers engaged by, or on behalf of, an issuer, where an opinion or service provided by those service providers may influence an investor's decision to acquire a securitized product.

An example of how misalignments could be addressed is in relation to the issue of asset-backed securities. Jurisdictions may require regulated entities engaged in the issue of such securities to meet requirements intended to align incentives including by requiring disclosure of information about asset pool performance or requiring retention of risk by originators, sponsors, original lenders, and/or issuers. In these circumstances the assessor could consider whether the regulator monitors compliance with these requirements.

These examples are for illustrative purposes only, and are not intended to imply that these approaches are required or, indeed, preferred, when addressing particular conflicts of interest or misaligned incentives.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all Questions, except Question 3.

Partly Implemented

There is no 'Partly Implemented' rating for this Principle.

Not Implemented

Inability to respond affirmatively to Questions 1 or 2.

B. PRINCIPLE RELATING TO SELF-REGULATION

1. Preamble

Self Regulatory Organisations (SROs) can be a valuable complement to the regulator in achieving the Objectives of securities regulation.[43]

Various models of self-regulation exist and the extent to which self-regulation is used varies. The common characteristics of SROs in most jurisdictions are a separation from the regulator (although government oversight and authorization generally exists), and the participation of business, industry and, if appropriate, investors in the operations of the SRO.

There can be substantial benefits from self-regulation:

- SROs may require the observance of ethical and business conduct standards which go beyond government regulations.
- SROs may have broader ability to compel the production of information than government regulators.
- SROs may offer considerable depth and expertise regarding market operations and practices, and may be able to respond more quickly and flexibly than the government authority to changing market conditions.
- SROs often build and maintain technology infrastructure to undertake their own, and the regulator's regulatory functions, with this infrastructure being funded entirely by regulated persons, not taxpayers.

SROs should undertake those regulatory responsibilities which they have expertise to perform most efficiently. The actions of SROs will often be limited by applicable contracts and rules.

2. Scope

Self-regulation may encompass the authority to create, amend, implement and enforce rules of trading, business conduct and/or qualification regimes with respect to the persons (i.e. legal and natural persons) subject to the SRO's jurisdiction and to resolve disputes through arbitration or other appropriate dispute resolution mechanisms. This authority may be derived from a statutory delegation of power to a non-governmental entity or through a contract between an SRO and its members as is authorized or recognized by the regulator. In some jurisdictions, SROs may not cover all the functions mentioned above.

An organization should be classified as an SRO (and subject to assessment under Principle 9) if it has been given the power or responsibility to regulate and its rules are subject to meaningful sanctions regarding any part of the securities market or industry.

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[43] See generally, *Model for Effective Self-Regulation*, Report of the SRO Consultative Committee of IOSCO, May 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD110.pdf.

3. Principle 9

Principle 9	**Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.**

The Principles recognize the value that a properly regulated SRO can play and set out general recommendations for the proper authorization and oversight of SROs. However, the use of SROs is a discretionary policy option, and therefore, the absence of SROs in a jurisdiction should have no assessment implication.

The "appropriate use" of an SRO is related to:

1. The SRO's capacity to carry out the purposes of relevant governing laws, regulations, including the development and implementation of SRO rules as well as the monitoring and enforcement of compliance by its members and associated persons with those laws, regulations and rules as reflected in the SRO's regulatory authorization requirements and oversight program.

2. The adequacy of the regulator's oversight.

3. The augmentation of regulatory resources by utilizing the SRO's expertise, its proximity to the market and its flexibility in addressing issues that arise in the changing market environment.

4. Adequate standard of corporate governance, to effectively manage the conflicts of interest inherent to the activity of self regulation.

"Inappropriate use" of an SRO by extension might include the exercise of SRO functions by an unauthorized entity or without regulatory oversight, designation of private sector institutions that demonstrate an insufficient capability to meet standards of authorization, delegation or enforcement to perform SRO functions, evidence of misuse of quasi-governmental powers, or insufficient performance of the functions of self-regulation.

The regulator should require an SRO to meet appropriate standards before allowing the organization to exercise its authority. These standards must include, inter alia, the ability to:

- Enact rules that prohibit fraudulent and manipulative practices.

- Maintain the organization and capacity to monitor compliance and have a disciplinary mechanism to enforce rules, inter alia, expulsion; suspension; limitation of activities, functions, and operations; fine; censure and suspend or bar.

Oversight of the SRO should be on-going.

Moreover, once the SRO is operating, the regulator should assure itself that the exercise of this power is in the public interest and protects investors, and results in fair, effective, and consistent enforcement of applicable securities laws, regulations and appropriate SRO rules.

The effectiveness of an SRO may be compromised by conflicts of interest. The regulator should monitor and address the potential that may arise for conflict of interest. The regulator must ensure that no conflict of interest arises because of the SRO's access to valuable information about market participants (whether or not they are members of the SRO itself). The risk of conflict arising may be acute when the SRO (e.g., an exchange) is responsible both for the supervision of its members and the regulation of a market sector.[44]

Regardless of the extent to which self-regulation is used the regulator should retain the authority to inquire into matters affecting investors or the market. Where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct or where a conflict of interest necessitates it, the regulator should take over the responsibility for an inquiry from an SRO. It is important, therefore, to ensure that the information provided by the SRO to the regulator allows these matters to be identified at an early stage.

SROs should follow similar professional standards of behaviour on matters such as confidentiality and procedural fairness as would be expected of the regulator.[45]

In assessing this Principle the assessor should consider whether an SRO's powers and levels of oversight are consistent with its functions and responsibilities. Like a regulatory authority, an SRO's processes should be fair and consistent; its decisions should be subject to regulatory review; it should protect the confidentiality of its data; and it is the professional responsibility of its staff that their conduct should be similar to that expected of regulator staff. The regulator should have full authority to oversee effectively any SRO.

Key Issues

1. If self-regulation is used, the SRO should be subject to appropriate oversight by the regulator.

Authorization

2. As a condition of authorization, the legislation or the regulator should require an SRO to demonstrate that it:

   (a) Has the capacity to carry out the purposes of relevant governing laws, regulations and SRO rules, and to enforce compliance by its members and associated persons subject to those laws, regulations, and rules.

   (b) Treats all members of the SRO and applicants for membership in a fair and consistent manner.

   (c) Develops rules that are designed to set standards of behaviour for its members and to promote investor protection and market integrity.

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44 *Principles of Effective Market Oversight*, Council of Securities Regulators of the Americas, May 1995 at http://www.cvm.gov.br/ingl/inter/cosra/inter.asp; *Issues Paper on Exchange Demutualization*, Report of the Technical Committee of IOSCO, June 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD119.pdf.

45 SROs are generally non-governmental agencies and so will not always be subject to the same standards as apply to a government agency.

(d) Submits to the regulator its rules for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy directives established by the regulator.

(e) Cooperates with the regulator and other SROs to investigate and enforce applicable laws and regulations.

3. The SRO should have:

(a) statutory delegation or other formal recognition from the regulator; and

(b) MoUs or other arrangements in place to secure cooperation between it and the regulator.

4. Its own rules which are enforced and whose non compliance is appropriately sanctioned

5. It should also :

(a) Assure a fair representation of members in selection of its directors and administration of its affairs.

(b) Avoid rules that may create anti-competitive situations.

(c) Avoid using the oversight role to allow any market participant unfairly to gain advantage in the market.

Oversight

6. Oversight should be on-going to ensure that:

(a) An SRO meets the conditions of its authorization on an ongoing basis.

(b) The government regulator retains the authority to inquire into matters affecting investors or the market.

(c) Where the powers of an SRO are inadequate to investigate, or otherwise to address, alleged misconduct or where the SRO has a conflict of interest that cannot be appropriately managed, the regulator conducts any necessary investigation rather than the SRO.

(d) An SRO provides information to the regulator that allows matters requiring regulatory intervention to be identified at an early stage.

Professional Standards

7. The SRO should adopt standards of confidentiality for its staff and standards of procedural fairness applicable to its members comparable to those for the regulator.

Conflicts of Interest

8. The SRO should have procedures in place to address potential conflicts of interest.

Key Questions

Performance of Functions of an SRO

1. Are there organizations that:

   (a) Establish rules of eligibility that must be satisfied in order for individuals or firms to participate in any significant securities activity?

   (b) Establish and enforce binding rules of trading, business conduct and qualification for individuals and/or firms engaging in securities activities?

   (c) Establish disciplinary rules and/or conduct disciplinary proceedings, which would enable the SRO to impose appropriate sanctions for non compliance of its rules?

Authorization or Delegation Subject to Oversight

2. As a condition to authorization, does the legislation or the regulator require the SRO to demonstrate that it:[46]

   (a) Has the capacity to carry out the purposes of its governing laws, regulations and SRO rules consistent with the responsibility of the SRO, and to enforce compliance by its members and associated persons subject to its laws, regulations, and rules?

   (b) Treats all members of the SRO, applicants for membership and similarly situated market participants subject to its rules in a fair and consistent manner?

   (c) Develops rules that are designed to set standards for its members and to promote investor protection?

   (d) Submits to the regulator its rules and any amendments thereto, for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy directives established by the regulator?

   (e) Cooperates with the regulator and other domestic SROs to investigate and enforce applicable laws, regulations, and rules?

3. Does the SRO:

   (a) Have statutory delegation or other formal recognition from the regulator?

   (b) Have MoUs or other arrangements in place in secure cooperation between it and the regulator?

   (c) Have its own rules which are enforced and whose non-compliance is appropriately sanctioned?

[46] In the case of a newly operational SRO, the applicant should demonstrate that it has programs and procedures in place to meet the conditions of authorization, and ongoing and effective execution of such programs or procedures should be considered a condition of authorization.

(d) Where applicable, e.g., a mutualized organization, assures a fair representation of members in selection of its board of directors and administration of its affairs?

(e) Avoid rules that may create anti-competitive situations as defined in the Explanatory Note?

(f) Avoid using the oversight role to allow any market participant unfairly to gain an advantage in the market?

Oversight

4. Does the regulator:

(a) Have in place an effective on-going oversight program of the SRO, which may include:

(i) inspection of the SRO;

(ii) periodic reviews;

(iii) reporting requirements;

(iv) review and revocation of SRO governing law, regulations, and rules; and

(v) the monitoring of continuing compliance with the conditions of authorization or delegation.

(b) Retain full authority to inquire into matters affecting the investors or the market?

(c) Take over or support an SRO's responsibilities where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct or allegations of misconduct or where a conflict of interest necessitates it?

Professional Standards Similar to those Expected of a Regulator

5. Does the regulator, the law or other applicable regulation require the SRO to follow similar professional standards of behaviour as would be expected of a regulator:

(a) On matters relating to confidentiality and procedural fairness?

(b) On the appropriate use of information obtained in the course of the SRO's exercise of its powers and discharge of its responsibilities?

Conflicts of Interest

6. Does the regulator, the law or other applicable regulation assure that potential conflicts of interest at the SRO are avoided or appropriately managed?

Explanatory Notes

Use of properly overseen SROs can expand regulatory resources in financial markets.[47]

The level and extent of regulatory oversight and the types of necessary powers and protections may be affected by the structure of the SRO. For example, there may be more concern for conflicts of interest, or appropriate use of self-regulatory resources, in the case of for-profit, demutualized markets. Furthermore, in some markets, certain very specific functions are delegated to the SRO and others are not. Assessors must sensibly apply the benchmarks in this case, only requiring oversight of the functions performed and not testing powers or attributes not performed by the SRO. In addition, if an entity is not an SRO, but may perform certain SRO functions, for example an exchange, those SRO functions should be tested against Principle 9 as applicable even though the exchange is authorized under Principle 33. The assessments for Principle 33 and Principle 9 in this case should be consistent. Reference also may be made to other relevant Principles for testing the adequacy of performance of regulatory functions by SROs where such functions are delegated to the SRO.

Anti-competitive situations may include situations where the SRO acts in an exclusionary, unfair, or inequitable manner when governing access to the SRO, or when taking action with respect to enforcement, or promulgating or interpreting SRO rules and procedures in a way that is not fair and equitable to similarly situated market participants. Among other things, regulatory oversight should be directed to the SRO undertaking its responsibilities in a way that unreasonably prevents access to the market or that unreasonably creates barriers to entry in the business of providing investment services that are unrelated to oversight of the market or prudential concerns.

SROs that are public companies also should be subject to the governance provisions applicable to other issuers. See Principles 16 through 18.

Benchmarks

An affirmative response to Questions 1(a), 1(b) or 1(c) requires assessment of Principle 9.

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except that, in the case of Questions 3(d) and 3(e), the regulator does not have the power to require that the SRO:

(a) assures a fair representation of members in the selection of its board of directors and the administration of its affairs; or

(b) avoids rules that may create anti-competitive situations;

[47] See also, Principle 3.

(c) provided that, the SRO has relevant rules and procedures and/or there is general law that addresses these issues and there is not a *record* of substantial complaint.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3(d), 3(e) and 6, provided that in the case of Question 6, the regulator can take over actions undertaken by the SRO where these matters are at risk and there is no evidence of obvious abuses.

Additionally, although the SRO may not have the power to assist in investigation of compliance with applicable laws and regulations, the regulator *requires the SRO*, as a condition of authorization and on an ongoing basis, to make all relevant information available to the regulator in regards to Question 2(e).

Not Implemented

Inability to demonstrate that the regulator can require an SRO to meet standards or failure to respond affirmatively to one or more of Questions 2(a), 2(b), 2(c), 2(d), 3(c), 3(f), 4(a), 4(b), 4(c), 5(a) or 5(b) or to Questions 2(e) or 6, absent the qualifications under *Partly Implemented*, and/or a finding that the exercise of SRO functions in practice occurs without oversight or there is demonstrable evidence of abuse or insufficient performance of SRO functions.

C. PRINCIPLES RELATING TO ENFORCEMENT

1. Preamble

The complex character of securities transactions and the sophistication of fraudulent schemes require strong and rigorous enforcement of securities laws to help foster investor confidence and maintain fair and efficient markets. The Principles do not consider that what is encompassed by the term "enforcement" should be interpreted narrowly. Instead, that term should be interpreted broadly enough to encompass powers of surveillance and inspection, as well as investigation, such that the regulator should be expected to have the ability, the means, and a variety of measures to detect, deter, enforce, sanction, redress, and correct violations of securities laws.

While Principles 10 and 11 are intended to establish the nature and extent of the regulator's powers, Principle 12 is designed to measure the ability of the regulator to use and how effectively and credibly it exercises these powers. Together they seek to determine a regulator's ability to monitor the entities subject to its supervision, to collect information on a routine and *ad hoc* basis, and to take enforcement action to ensure that persons and entities comply with relevant securities laws.

The assessment under these Principles requires a careful consideration of the legal system in which the regulator operates. The Principles do not prescribe any specific model to be followed and contemplate both civil law and common law systems. There are several models that have been shown to be effective. These include models in which responsibilities are shared between several government or quasi-government agencies or in which responsibilities are shared with SROs.

It is important that not only are the legal mechanisms in place for ensuring inspection, investigation, surveillance and enforcement powers, but that the authority has the ability to carry out effective inspection and enforcement programs. This includes ensuring that adequate resources are devoted to enforcement because only through effective enforcement will regulators most effectively deter future misconduct.

Enforcement of securities regulation towards all entities and products is of key importance. Principles 10, 11 and 12 are therefore highly interrelated with the specific regulatory functions and responsibilities described under the Principles sections on Issuers, Collective Investment Schemes, Market Intermediaries and Secondary Markets. Assessors should ensure that the evaluation of Principles 10, 11 and 12 is consistent with the assessments of the other Principles from an enforcement perspective in the assessed jurisdiction.

Under this framework, these Principles are relevant to the work of the regulator on the basis that they ensure the appropriate performance of the regulator's functions and the effective exercise of its enforcement and supervisory powers.

2. Scope

Mechanisms for ensuring enforcement of securities laws should be in force in all jurisdictions. It is not necessary, however, that the responsibility for all aspects of enforcement of securities laws be given to a single body.

Where enforcement is undertaken by an authority other than the regulator or where enforcement is shared between the regulator and another authority, cooperation among such bodies is critical and the ability to do so in a timely and effective manner should be particularly scrutinized.

3. Principles 10 through 12

Principle 10	**The Regulator should have comprehensive inspection, investigation and surveillance powers.**

Principle 10 is designed to address whether a regulator has the powers to conduct surveillance, undertake inspections, undertake investigations, and take corresponding enforcement action in relation to *regulated entities* to ensure that they comply with relevant securities laws. It covers the circumstances where, and methods by which, the regulator may obtain information from those entities in the course of its inquiries. Principle 10 also addresses the regulator's authority to conduct ongoing oversight and supervision of regulated entities as preventative measures

Key Issues

1. The regulator should have the power to require the provision of information in the ordinary course of business, in response to an inquiry or as part of a reporting cycle, or to carry out inspections of regulated entities' business operations[48] whenever it believes it is appropriate to verify compliance with relevant standards.

   (a) The suspicion of a breach of law should not be necessary to enable the regulator to conduct inspections or require information of regulated entities.

   (b) The regulator should be able to conduct on-site inspections of regulated entities.

2. The regulator should be able to require the provision of all information reasonably needed to examine compliance with relevant standards, including books, records, documents, communications, and statements.[49]

3. The regulator should have the power to conduct or supervise surveillance of trading activity on its authorized exchanges and regulated trading platforms.

4. Where regulatory enforcement responsibilities are delegated to a third party, including an SRO, the third party should be subject to disclosure and confidentiality requirements that are as stringent as those applicable to the regulator.

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[48] *Outsourcing in Financial Services*, Report of the Joint Forum, February 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf.

[49] *Resolution on Principles for Recordkeeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws*, Resolution of the Presidents' Committee of IOSCO, November 1997, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES15.pdf ("Resolution on Recordkeeping").

Key Questions[50]

1. Does the regulator have the power to inspect a regulated entity's business operations,[51] including its books and records:

   (a) Without giving prior notice?

   (b) On-site?

2. Does the regulator have the power to obtain books and records and request data or information from regulated entities without judicial action, even in the absence of suspected misconduct:

   (a) In response to a particular inquiry?

   (b) On a routine basis?

3. Does the regulator have the power to conduct or supervise surveillance of trading activity on its authorized exchanges and regulated trading platforms?

4. Does the regulatory system have record-keeping and record retention requirements for regulated entities?[52]

5. Are regulated entities required:[53]

   (a) To maintain records concerning client identity?[54]

   (b) To maintain records that permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions?

6. Does the regulator have the authority to determine or have access to the identity of all clients of regulated entities?[55]

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50 Questions for Principle 10 are generally taken from the Resolution on Recordkeeping, *supra*, and confirmed by the *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information*, IOSCO, May 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf (the "IOSCO MMoU").

51 "Regulated entity" includes authorized or licensed entities or persons. These regulated entities remain accountable to the regulator for any delegated activity.

52 The FAQs to the *IOSCO MMoU* consider five years as the norm for maintenance of records. See also, Principles, 29 – 32 on relating to market intermediaries.

53 Key Question 4 is testing if a jurisdiction does have record keeping requirements and if there are retention requirements for those records for regulated entities. Key Question 5 is testing if a jurisdiction has specific categories of documents that should be maintained by regulated entities. These requirements can be found in securities, banking, anti-money laundering or other laws of the jurisdiction and assessors should review all relevant laws of the jurisdiction for these requirements.

54 See *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf. See also *Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism*, Report of the Joint Forum, June 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD146.pdf.

55 See *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf.

7. Where a regulator[56] out-sources or otherwise grants inspection or other regulatory enforcement authority to a third party, including a SRO:

   (a) Does the regulator supervise the outsourced functions of the third party?

   (b) Does the regulator have full access to information maintained or obtained by the third party?

   (c) Can the regulator cause changes/improvements to be made in the third parties´ processes?

   (d) Is the third party subject to disclosure and confidentiality requirements that are no less stringent than those applicable to the regulator?[57]

Explanatory Notes

Full access to information maintained or obtained by the third party includes access to information being outsourced by the third party, taking into account that the SRO might use some outsourced services for its surveillance and inspection activities.[58]

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions, except to Question 7(c).

Partly Implemented

Requires affirmative responses to all applicable Questions, except to Questions 7(c) and 7(d).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b) 2(a), 2(b), 3, 4, 5(a), 5(b), 6, 7(a) or 7(b).

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56 In the case of an SRO, the regulator should have these powers as a condition of continuing authorization. See Principle 9.

57 *Outsourcing in Financial Services*, Report of the Joint Forum, February 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf.

58 This note refers to Key Question 7(b).

Principle 11 The Regulator should have comprehensive enforcement powers.

While Principle 10 is limited to regulated entities, Principle 11 is intended to have wider application. As in the case of powers, reflecting a broad definition of enforcement, Principle 11 deals with courses of action, including investigations and proceedings, available to the regulator where a breach of relevant securities laws by *any person* is suspected or identified.[59]

The regulator or other competent authority should, therefore, be provided with comprehensive investigatory and enforcement powers including, but not limited to:

- The power to obtain information, records and statements from any entity or any persons involved, directly or indirectly, or who may possess information relevant to an investigation, and power to take actions to ensure compliance with these powers, e.g., seeking a court or judicial order.
- The power to impose effective, proportional and dissuasive administrative sanctions and/or seek orders from courts or tribunals and/or to initiate/refer matters for civil and/or criminal actions for this purpose.

It is not necessary that the responsibility for all aspects of enforcement of the securities law be given to a single body. There are several models that have been shown to be effective. These include models in which responsibilities are shared between several responsible authorities.

The international nature of securities markets and the fact that, frequently, misconduct may occur across several jurisdictions give rise to a number of particular issues.

Legislation and the enforcement powers of the regulator should be sufficient to ensure that it can be effective in cases of cross-border misconduct.[60]

Details about the powers that an enforcement authority should have are described more specifically in the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (the "IOSCO MMoU").[61]

The general topic of international cooperation and its importance to effective regulation is addressed in the Principles Relating to Cooperation.

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59 See *Resolution on Enforcement Powers*, Resolution of the Presidents´ Committee of IOSCO, November 1997; and *Resolution on Recordkeeping*.

60 See *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf (in particular, Key Recommendations 14 – 16 and text); *Securities Activity on the Internet II*, Report of the Technical Committee of IOSCO, June 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf; and *Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf.

61 See Article 7 of the *IOSCO MMoU*, May 2002.

Key Issues

1. The regulator or other competent authority should have comprehensive investigative and enforcement powers including the power: to seek court or judicial orders or to take action to enforce regulatory, administrative, or investigative powers; to impose effective sanctions, or to seek them; or to initiate criminal proceedings or refer matters to the criminal authorities.

2. The regulator or other competent authority should be able to obtain data, information, documents, books and records, and to take at least voluntary statements or testimony from any person, including third party entities and individuals (whether regulated or unregulated), that are either involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation.

3. Enforcement powers should not compromise private rights of action. Private persons should be able to seek their own remedies (including, for example, for compensation, damages or specific performance of an obligation).

4. Where the exercise of enforcement powers requires the action of more than one regulator or other competent authority, prompt cooperation, including information sharing between them, should be possible for investigative and enforcement purposes.[62]

Key Questions

1. Does the regulator or other competent authority have the investigative and enforcement power to enforce compliance with the laws and regulations relating to securities activities?

2. Does the regulator or other competent authority have the following powers:

   (a) Power to seek court or judicial orders, to refer matters for civil proceedings or to take other action to ensure compliance with regulatory, administrative, and investigative powers?

   (b) Power to impose effective, proportionate, and dissuasive administrative sanctions?[63]

   (c) Power to initiate criminal proceedings or to refer matters for criminal prosecution?

   (d) Power to order the suspension of trading in securities or to take other appropriate actions?[64]

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62 Principles 1 and 13.

63 Principle 10, Key Questions, supra. See also the *Resolution on Recordkeeping*, supra.

64 Other actions include the imposition of trading restrictions or requirements on individual market participants, e.g., position limits, reporting requirements, liquidation-only trading, special margin requirements or other corrective actions. Some jurisdictions also can seek compensatory remedies. The specific actions listed in question 2(d), and in this note, are exemplary and are not necessary to receive a *Fully Implemented* assessment provided the regulator can demonstrate that available sanctions are proportionate, dissuasive, and effective.

3. Does the regulator or other competent authority have the investigative and enforcement power to require and to obtain from any person, including third party entities and individuals (whether regulated or unregulated), that are either involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation:[65, 66]

   (a) Contemporaneous records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions?

   (b) Records for securities and derivatives transactions that identify:

      (i) The client:

         (1) Name of the account holder?

         (2) Person authorized to transact business?

      (ii) The amount purchased or sold?

      (iii) The time of the transaction?

      (iv) The price of the transaction?

      (v) The individual and the bank or broker and brokerage house that handled the transaction?

   (c) Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organized in its jurisdiction?[67]

   (d) Statements or testimony?[68]

   (e) Any other information including documents and bank records?[69]

4. Can private persons seek their own remedies for misconduct relating to the securities laws?[70]

5. Where an authority other than the regulator must take enforcement or other corrective action, can the regulator share information obtained through its regulatory or investigation activities with that authority?

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65 *Resolution on Recordkeeping*, supra, and the *IOSCO MMoU*, supra, and subsequent Questions.

66 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra. This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart. See also Principle 10 and Principle 13, Key Question 1.

67 *Resolution on Recordkeeping*, supra. See also *IOSCO MMoU*, supra.

68 A regulator should be enabled to obtain at least voluntary statements.

69 Including bank records; see Article 7(b)(ii) of the *IOSCO MMoU*.

70 Such actions need not be taken directly under the securities laws, but could be under provisions within the general law.

6. Where the regulator is unable to obtain information in its jurisdiction necessary to an investigation is there another authority that can obtain the information?[71]

7. If yes: Are there respective arrangements between the regulator and the other domestic authority as regards the respective exchange of information in place?[72]

Explanatory Notes

The assessor must determine how the jurisdiction's enforcement program is designed to use the powers accorded.[73] The sufficiency of the powers may depend on the ability to demonstrate that they are exercised effectively. The scope of the investigative and enforcement powers conferred on the regulator and/or on other authorities, including public prosecuting authorities, depends on the conduct under investigation and the legal system applicable in the jurisdiction. The assessor should inquire whether the system, as such is able effectively to detect, investigate and prosecute violations of the securities laws.

Regulators and other competent authorities should recognize in applying their investigative and enforcement powers that securities fraud or other securities misconduct often takes unusual, complex, or new forms. They should be prepared to apply their laws to such unusual forms of fraud and to contribute actively to develop their respective legislation and surveillance/inspection and investigation methodologies, where necessary.

The assessor also should inquire of the regulatory authority as to its view of the adequacy of available sanctioning powers and powers to take corrective action.

Examples of measures used to enforce securities regulatory requirements and to deter and sanction securities violations include: fines; disqualification; suspension and revocation of authority to do business; injunctions or cease and desist orders, directly or through court order; asset freezes, directly or through court order; action against unlicensed persons in conducting securities transactions or referral of such activities to the criminal authorities;[74] measures to enforce disclosure and financial reporting requirements for issuers; measures to enforce conduct of business, capital requirements and other prudential rules; and measures to enforce record keeping and reporting by market intermediaries,[75] operators of authorized exchanges, regulated trading systems and collective investment schemes, and other regulated securities entities.

Such sanctions are examples only and the regulator must demonstrate that there is a spectrum of sanctions available that are proportionate, dissuasive, effective, and sufficient to cover the spectrum of securities' violations.

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71 See Principle 15, Key Question 8.

72 A respective arrangement could be an undertaking or an MOU.

73 Principle 12.

74 "Enforcement program" may be broadly understood as all the measures that are taken by a regulator in order to use the powers it has.

75 An example of a measure to enforce reporting requirements would be the power to require an amended financial report or disclosure statement.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions and, where cooperation among another authority and the regulator is necessary to take action, that such action is responsive to the priorities of the securities regulator and timely.

Broadly Implemented

There is no 'Broadly Implemented' rating for this Principle. [76]

Partly Implemented

Requires affirmative responses to all applicable Questions, except to Question 4.

Not Implemented

Inability to withdraw or suspend a licence or inability to respond affirmatively to one or more of Question 1, 2(a), 2(b), 2(c), 2(d), 3(a), 3(b), 3(c), 3(d), 3(e), 5, 6, or 7 or demonstrated failures in cooperation arrangements.

[76] Nevertheless, the grade "broadly implemented" could be applied on the basis of the "Assessment Measures" described in the Introduction, page 18.

Principle 12 **The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.**

Principle 12 requires the regulator to demonstrate how the regulatory system in place, and its own organization, provides for an effective and credible use of supervisory and enforcement powers. In particular, the regulator should be able to demonstrate that there is a system to take effective inspection, investigation and enforcement actions, and that, where necessary, such actions, have been undertaken to address misconduct or abuses. An effective program, for example, could combine various means to identify, detect, deter, and sanction such misconduct. A wide range of possible sanctions could meet the standards according to the nature of the legal system assessed. The regulator, however, should be able to provide documentation that demonstrates that sanctions available (whatever their nature) are effective, proportionate and dissuasive. Sections of the Principles that address specific functions also address possible sanctions.

The regulator should be able to demonstrate that an effective and credible use of inspection, surveillance, and enforcement powers has been made and will be made in the future. The effective and credible use of powers depends on adequate powers, proper resources and the capacity to perform its functions and exercise its powers. Whereas Principle 3 addresses resources in general, Principle 12 covers the use of the resources by the regulator in the performance of its functions and exercise of its enforcement powers.

In particular, the regulator should be able to demonstrate and explain how its powers are exercised by:

- The regulatory actions undertaken in the jurisdiction and the compliance programs in place at regulated entities.
- The type of on-going and *ad hoc* monitoring activities (including onsite inspections) performed in the jurisdiction.
- The investigation and enforcement actions undertaken in the jurisdiction.
- The sanctions imposed with respect to misconduct detected within the jurisdiction.

Key Issues

1. In order to have an effective and credible enforcement system, it is not sufficient for a regulator simply to have the statutory powers set out in the Principles. The regulator should be able to:

   (a) Detect suspected breaches of the law in an effective and timely manner.

   (b) Gather the relevant information necessary for investigating such potential breaches.

   (c) Be able to use such information to take action where a breach of the law is identified.

(d) Demonstrate that it has programs in place and utilizes its resources in order to effectively exercise activities according to Key Issues 1(a) to (c).

2. In addition, the regulator should require a compliance system to be in place for regulated entities aimed at preventing, detecting and correcting securities law violations, which includes:

   (a) Inspections or self-reviews using methodologies and techniques which are adequate, but which may vary from jurisdiction to jurisdiction.

   (b) Other monitoring or surveillance techniques.

Key Questions

Detecting Breaches

1. Is there an effective system of inspection in place whereby the regulator carries out inspections:

   (a) On a routine periodic basis?

   (b) Based upon a risk assessment?

   (c) On a non-periodic basis in response to intelligence received (e.g. investor complaints and tips and complaints from other sources)?

2. Is there an automated system which identifies unusual transactions on authorized exchanges and regulated trading systems?

3. Can the regulator demonstrate adequate mechanisms and procedures to detect and investigate:

   (a) Market and/or price manipulation?

   (b) Insider trading?

   (c) Misrepresentations of material information or other fraudulent or manipulative practices relating to securities and derivatives?

   (d) Failure of compliance with other regulatory requirements, for example: conduct of business, capital adequacy, disclosure, or segregation of client assets?[77]

4. Does the regulator have an adequate system to receive and respond to the intelligence that it receives?

Compliance System

5. Does the regulator require regulated entities to have in place supervisory and compliance procedures reasonably designed to prevent securities laws violations?

[77] *IOSCO MMoU*, supra.

6. Does the regulator monitor how compliance procedures are executed and communicated to employees of such entities?

7. Can the regulator take measures against or discipline or sanction regulated entities for failure to supervise reasonably subordinate personnel whose activities violate the securities laws?

8. Does the regulator require market surveillance mechanisms that permit an audit of the execution and trading of all transactions on authorized exchanges and regulated trading systems?[78]

Effectiveness

9. Based on articulated criteria, does the regulator or other competent authority have an effective enforcement program in place in order to enforce securities laws?

Explanatory Notes

In assessing this Principle, the assessor also should refer to Principles 10 and 11 with respect to powers, Principles 13 and 15 with respect to cooperation and Principles 2 and 3 with respect to adequacy of resources, procedures and accountability of regulators.

The assessor should assess whether there is evidence of an effective system in place to detect breaches, gather and use information, promote compliance and sanction non-compliance, using surveillance, inspection, investigation, enforcement and intervention powers. There should be effective and credible use of these powers in respect of the various areas of securities regulation.

The regulator or third party, including a SRO, should be able to demonstrate to the assessor records and other material evidence that describe enforcement activities including legislative provisions, published guidance, and illustrative press releases covering relevant enforcement cases, complaints and dispositions, if public.

In assessing a risk-based inspection program, the assessor should determine how priorities are set and how they are adjusted or updated, for example, by use of review of periodic financial reports or other mechanisms. It is sufficient that a system for the redress of complaints under the regulatory framework be addressed through an ombudsman, external dispute-resolution provision or other third party scheme or through oversight of individual firm arrangements.

In assessing the effectiveness of an enforcement program, the assessor should assess whether the regulator uses the powers set forth in Principle 11, Key Question 2(a) to 2(d).

The lack of skilled staff to operate an automated system referred to in Key Question 2 is a strong indicator that the respective Question should be answered in the negative.

There is a strong indication that Key Question 3(a) and 3(b) cannot be answered affirmatively, if Key Question 2 is answered negatively.

[78] Assessors must check whether auditing of transactions is provided for and in fact has been performed.

In relation to Key Question 9, assessors must articulate the metrics used to arrive at their conclusions about the effectiveness of an enforcement program. These metrics could, but not need necessarily, include: (1) resources dedicated to an enforcement program; (2) level of fines imposed per annum; (3) cost of capital in the jurisdiction as a proxy for investor confidence in the enforcement program; (4) the number of cases filed per annum; and (5) number and type of investigations conducted per year.

Benchmarks

Fully Implemented

> Requires affirmative responses to either 1(a) or 1(b) and to all other applicable Questions provided that, in the case of an affirmative response only to 1(b), there must be some means to identify changes in risk priorities or status of firms potentially subject to inspection and the ability to demonstrate effective coverage.

Broadly Implemented

> Requires affirmative responses to either 1(a) or 1(b) and to all other applicable Questions, except to Questions 2, 4 and 8 and/or an investigation, surveillance and enforcement system is in place but more resources need to be committed to ensure effective management, adjustments in operation of the system may be necessary, or certain desirable powers (see Principle 10) are necessary to augment the system to make it more effective.

Partly Implemented

> Requires affirmative responses to either Questions 1(a), or 1(b) and to Question 1(c), 3(a), 3(b), 3(c), 3(d), 5, 6, 7, and the regulator can demonstrate that it has an active enforcement and compliance program, although there are some deficiencies in timeliness or coverage.

Not Implemented

> Inability to respond affirmatively to both Question 1(a) and 1(b) or one or more of Questions 1(c), 3(a), 3(b), 3(c), 3(d), 5, 6, 7 or 9.

D. PRINCIPLES RELATING TO COOPERATION

1. Preamble

Principles 13, 14 and 15 address cooperation amongst regulators and their domestic and foreign counterparts for investigations, enforcement and for other regulatory purposes.[79]

The increasing internationalization of financial activities and the globalization of markets can put information beyond the immediate jurisdictional reach of one individual regulator. This puts an additional emphasis on the need for international cooperation.

Fraud, market manipulation, insider trading and other illegal activities, such as the unauthorized provision of financial services that crosses jurisdictional boundaries can and does occur more and more frequently in a global market aided by modern telecommunications.

Cooperation is vital to ensuring that investigations and enforcement actions are not impeded unnecessarily by jurisdictional boundaries. Principle 13 measures the extent of a regulator's ability to share information. Principle 14 deals with whether the regulator has mechanisms in place to establish when and how the regulator will share information with its counterparts. Principle 15 relates to the types of assistance that a regulator may provide to a counterpart.

There may be an important need to share information at a domestic level. Where there is more than one regulator or where the securities law overlaps with the general law of a jurisdiction, the need for domestic cooperation may extend beyond matters of enforcement and include information relevant to authorization to act in a particular capacity and to the reduction of systemic risk, for example, where there are divisions in responsibility for the securities, banking and other financial sectors.[80]

The IOSCO MMoU is designed to facilitate, among other things, the implementation of Principles 13, 14 and 15. Thus an authority which is not able to sign the IOSCO MMoU cannot be fully implemented with regard to at least one of these Principles. Conversely, accession to the IOSCO MMoU is a strong indicator that these Principles are fully implemented since the authority has the requisite legal authority to meet the international standards articulated in the IOSCO MMoU. However, accession to the IOSCO MMoU does not automatically lead to the conclusion that the Principles are fully implemented since – for example - the authority concerned may lack the resources and/or practical ability to assist properly at the time of the Principles assessment.

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79 Information sharing for other regulatory purposes may require, for example, among other things: routine sharing of information on questionable activities and proven frauds; information on any concern about an applicant in regard to licensing, authorization or eligibility determinations; listing or registration of securities; information about the current circumstances of a licence holder or issuer; information that may be needed to minimize the adverse effects of market disruptions, including contingency plans, contact persons and structural measures to address market disruptions; and information on market conditions, such as actions taken by market authorities, prices, trading activities, market data, etc.

80 Principles 1 and 3.

International cooperation between regulators is also necessary for the effective regulation and supervision of domestic markets. The inability to provide regulatory and supervisory assistance can seriously compromise efforts towards effective securities regulation. Domestic laws need to remove impediments to international cooperation.[81]

2. Scope

The regulator should identify with which other agencies within the jurisdiction it needs to cooperate with, pursuant to what arrangements and for what purposes. For example, in some jurisdictions it may be necessary to obtain information from another authority within the jurisdiction or to rely on another authority to bring or to initiate an enforcement action. The regulator should be able to demonstrate the gateways or channels through which required information can be made available and that those channels work when needed. Additionally, the regulator should identify the laws of the jurisdiction, such as blocking, bank secrecy, or other types of legislation or judicial decisions, that can affect its ability to cooperate with others.

The ability of a regulator to cooperate is closely related to its powers to obtain and keep confidential the information requested by its foreign counterparts, as provided in the Principles for the Regulator, for SROs as well as in the IOSCO MMoU.

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81 See *Report on the Self-Evaluation Conducted by IOSCO Members Pursuant to the 1994 IOSCO Resolution on "Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance*", Report of IOSCO, November 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD76.pdf; *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf (in particular at Key Recommendations 21 - 24 and text); and *Principles for the Oversight of Screen-Based Trading Systems for Derivatives Products - Review and Additions*, Report of the Technical Committee of IOSCO, October 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD111.pdf. See also *Resolution on Enforcement Powers*, Resolution of the Presidents´ Committee of IOSCO, November 1997, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf; *Resolution on Recordkeeping*, *supra*; *IOSCO Multilateral MOU*, IOSCO, May 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf; and *Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf.

3. Principles 13 through 15

Principle 13	**The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.**

This Principle addresses the power of the regulator(s) to share public and non-public information within its files, or available to it through inspection and investigation, *without other external process*. When sharing non-public information, care must be taken by the requested regulatory authority to ensure that the use of such information is consistent with the purpose for which it is shared and to preserve its confidentiality subject to such uses.

There may be an important need to share information at a domestic level with other domestic authorities. Cases of fraud or money laundering that involve dealings in securities may require close cooperation between two or more domestic agencies including law enforcement, regulatory and judicial authorities. The need for domestic cooperation is also important in the context of supervision and will include information relevant to authorization to act in a particular capacity and the reduction of systemic risk, especially where there are divisions in responsibility for the securities, banking, and other financial sectors.

International cooperation between regulators is necessary for the effective regulation and supervision of domestic markets. The inability to provide regulatory and supervisory assistance can seriously compromise efforts towards effective securities regulation. Domestic laws need to remove impediments to international cooperation.[82]

The removal of any "dual illegality" conditions to information sharing and regulatory cooperation is essential. As a transitional matter, while a jurisdiction moves towards the removal of dual illegality conditions, it is essential that any conditions be interpreted flexibly and in a manner that minimizes impact on international cooperation.

While regulators have different supervisory approaches, each has a common interest in information-sharing and cooperation based on earned trust in each other's regulatory and supervisory systems.[83]

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82 See *Report on the Self-Evaluation Conducted by IOSCO Members Pursuant to the 1994 IOSCO Resolution on "Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance*", Report of IOSCO, November 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD76.pdf; *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf (in particular at Key Recommendations 21 - 24 and text); and *Principles for the Oversight of Screen-Based Trading Systems for Derivatives Products - Review and Additions*, Report of the Technical Committee of IOSCO, October 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD111.pdf. See also *Resolution on Enforcement Powers*, Resolution of the Presidents´ Committee of IOSCO, November 1997, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf; *Resolution on Recordkeeping, supra*; *IOSCO Multilateral MOU*, IOSCO, May 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf; and *Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf.

83 *Principles Regarding Cross-Border Supervisory Cooperation*, Final Report, Report of the Technical Committee of IOSCO, May 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf.

The form and content of the cooperation will vary from case to case.[84] It is essential that assistance can be provided not only for use in investigations but also for other types of inquiries, for example as part of a compliance program for the purpose of preventing illicit activities within the scope of securities regulation or to assist in providing or sharing enforcement techniques between regulators.

Information that was provided to a regulator for investigation and enforcement purposes should be able to be shared directly or indirectly through authorities in their jurisdiction for use in investigation and prosecution (administrative, civil and criminal) of securities violation.

Cooperation in the context of supervision is also important. There is a need to exchange general and more specific information about matters of regulatory concern, including financial and other supervisory information, technical expertise, surveillance, and investor education. The sharing of information related to systemic risks should also be central to cooperation between jurisdictions, as it is in Principle 6.

Globally active regulated entities, particularly with regard to their compliance culture, financial condition, and risk exposure, must be subject to information sharing on an *ad hoc* basis and in a more organized and specific manner.

Key Issues[85]

1. A regulator should be able to share both public and non-public information with other domestic authorities.

2. A regulator should be able to share public and non-public information with its foreign counterparts.

3. Domestic laws should not impede international cooperation through sharing of information for regulatory, surveillance, technical assistance, or enforcement purposes.

4. Where confidential information gathered by the regulator in the exercise of its functions or powers is shared with another competent Authority, either domestically or internationally, the regulator should be able to ensure that the information is provided subject to conditions which, to the extent consistent with the purpose of the release, preserve the confidentiality of that information.

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84 Cooperation may require: routine sharing of information on questionable activities and proven frauds; information on any concern about an applicant for licensing, listing or registration; information about the current circumstances of a licence holder or issuer; information that may be needed to minimize the adverse effects of market disruptions, including contingency plans, contact persons and structural measures to address market disruption; and information on market conditions such as actions taken by market authorities, prices, trading activities, and market data, *Multi-jurisdictional Information Sharing for Market Oversight*, Final Report, Report of the Technical Committee of IOSCO, April 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf.

85 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra.

Key Questions

1. For each of the regulators identified,[86] does the regulator have authority to share with other *domestic* regulators and authorities information on:

   (a) Matters of investigation and enforcement?

   (b) Determinations in connection with authorization, licensing or approvals?

   (c) Surveillance?

   (d) Market conditions and events?

   (e) Client identification including persons who beneficially own or control non-natural persons organized in the regulator's jurisdiction?

   (f) Regulated entities?

   (g) Listed companies and companies that seek a listing of their securities?[87]

2. Can the regulator share the information described in Key Question 1 for regulatory and enforcement purposes with other domestic authorities without the need for external approval[88] such as from a relevant government minister or attorney?

3. Does the regulator have the authority to share information with foreign counterparts with respect to each of the matters listed in Key Question 1?[89]

   (a) Matters of investigation and enforcement?

   (b) Determinations in connection with authorization, licensing or approvals?

   (c) Surveillance?

   (d) Market conditions and events?

   (e) Client identification including persons who beneficially own or control non-natural persons organized in the regulator's jurisdiction?

   (f) Regulated entities?

   (g) Listed companies and companies that seek a listing of their securities?

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86 That is, the regulators which have responsibility for securities enforcement identified as part of the assessment process.

87 *Resolution on International Equity Offers*, Presidents´ Committee of IOSCO, September 1989, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES41.pdf; *Guidance on Information Sharing,* Report of the Technical Committee of IOSCO, March 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD86.pdf. See also, *IOSCO MMoU*, supra.

88 If such approval is purely formalistic and occurs immediately, the regulator could receive a *Fully Implemented* assessment even though such approval is required. For example, in some jurisdictions, the Attorney General or similar official signs off on actions as the chief legal authority in the system. Ideally, in domestic circumstances some sharing would be pre-approved.

89 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra. This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart.

4. Can the regulator share the information identified in Key Question 3 above, for enforcement and regulatory purposes with *foreign* counterparts without the need for external approval,[90] such as from a relevant government minister or attorney?

5. Can the regulator provide information to other *domestic* and *foreign* authorities on an unsolicited basis?

6. Can the regulator share information with *foreign* counterparts even if the alleged conduct would not constitute a breach of the laws of the regulator's jurisdiction if conducted within that jurisdiction?[91]

7. Can the regulator share with *domestic* and *foreign* counterparts information and records identifying the person or persons beneficially owning or controlling bank accounts related to securities and derivatives transactions and brokerage accounts as well as the necessary information to reconstruct a transaction, including bank records?[92]

8. Does the regulatory system provide enough assurance that the confidential information gathered by the regulator in the exercise of its functions or powers that is shared with another competent authority, either domestically or internationally, is subject to appropriate rules of confidentiality?

Explanatory Notes

An application for a licence may be received from a person known to be registered in another jurisdiction, or registration may be sought for the same offer documents in several jurisdictions. Similarly, threats to systemic stability are not confined to domestic factors and may include the behaviour of individual financial institutions in another jurisdiction.

Further, an increasing number of companies have securities listed in more than one jurisdiction and it is common for a significant part of an issuer's commercial activity to take place in a country other than the one in which its stock is listed. Investors frequently invest in foreign markets and securities either directly or in managed funds. An increasing number of collective investment schemes are marketed across jurisdictional boundaries. It is also common for scheme promoters, managers, and custodians to be located in several different jurisdictions and they may not be in the same jurisdiction as investors to whom the scheme is promoted.

Similar financial products may be traded on various markets in several countries; moreover, there are many derivatives in which the underlying product or reference price is traded, produced, or derived on foreign markets.

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90 If such approval is purely formalistic and occurs immediately, the regulator could receive a *Fully Implemented* assessment even though such approval is required. See previous example in footnote 88.

91 *Principles for Memoranda of Understanding*, Report of the Technical Committee of IOSCO, September 1991, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf; the *IOSCO MMoU*, supra.

92 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra.

Notwithstanding the obligation to cooperate domestically, when information is passed through an international channel, the uses of such information may be restricted to the uses specified in the information sharing arrangement. When information is obtained by a foreign counterpart, it is not allowed to use this information outside the uses contemplated by the IOSCO MMoU. If there is a necessity to use this information in a way which is not covered by the IOSCO MMoU the requesting Authority must obtain the consent of the requested Authority.

If there are bank secrecy, confidentiality or blocking statutes, the regulator should be able to demonstrate whether there are exceptions to these statutes that allow the regulator to obtain and share information with foreign counterparts.[93] Assessors should ask whether there have been court cases or other developments that cast doubt as to whether the powers granted to the regulator are in fact enforceable.

The Principles recognize that the regulator can legitimately impose conditions when it shares information, particularly non-public information, with its domestic and foreign counterparts. Conditions might include ensuring appropriate use of the information and ensuring the confidentiality of the information except pursuant to the uses permitted, such as in a public enforcement action for which the information was requested. See also Principle 14, which addresses confidentiality safeguards more generally.

A request for assistance may be denied by a requested authority:

1. where the request would require the requested authority to act in a manner that would violate domestic laws;

2. on grounds of public interest or essential national interest;

3. where a criminal proceeding has already been initiated in the jurisdiction of the requested authority based upon the same facts and against the same persons, or the same persons have already been the subject of final punitive sanctions on the same charges by the competent authorities of the jurisdiction of the requested authority, unless the requesting authority can demonstrate that the relief or sanctions sought in any proceedings initiated by the requesting authority would not be of the same nature or duplicative of any relief or sanctions obtained in the jurisdiction of the requested authority; or

4. where the request is not made in accordance with the provisions of the IOSCO MMoU.

Where a request for assistance is denied, or where assistance is not available under domestic law, the requested authority will provide the reasons for not granting the assistance and consult with the requesting authority.

93 See also *IOSCO MMoU*, supra.

Benchmarks

Fully Implemented

Requires an affirmative response to all applicable Questions.

Broadly Implemented

Requires an affirmative response to all applicable Questions except to Questions 2 and 4, provided that information sharing still can occur in a timely fashion.

Partly Implemented

Requires an affirmative response to all applicable Questions except to Question 3(c) provided that information can be made available in specific cases, Questions 2 and 4 if the conditions for *Broadly Implemented* are not met, and Question 5.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d), 1(e), 1(f), 1(g), 3(a), 3(b), 3(c), 3(d), 3(e), 3(f), 3(g) or 6, 7, 8 or such a significant inability to act in a timely manner that the Principle cannot be regarded as implemented.

Principle 14 **Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts**

Securities regulators have long used Memoranda of Understanding (MoUs) to facilitate consultation, cooperation and the exchange of information in securities enforcement matters. These enforcement MoUs permit regulators who suspect there has been a violation of their laws and/or regulators to seek *ad hoc* assistance from their overseas counterparts when evidence of the possible violation may lie outside their jurisdictions. Most of these MoUs have been entered into on a bilateral basis; since 2005 the IOSCO MMoU has become the mandatory global minimum standard for enforcement cooperation among securities regulators.

More recently, securities regulators have come to recognize that effective supervision and oversight in today's global environment requires that regulators be equipped with tools not only for assistance in securities enforcement (which are by nature *ad hoc*, and focus on sharing information related to a particular possible violation), but also both *ad hoc* and ongoing regulatory cooperation in the supervision of regulated entities. Such cooperation is critical to help ensure the seamless and efficient regulation of globally active regulated entities, in a manner fully consistent with the laws and requirements of all the jurisdictions involved. Much of this collaboration and cooperation has developed on an *ad hoc* basis but more established forms, including MoUs and supervisory colleges, have also been established.

MoU's facilitate the process of information exchange by making clear permitted uses, confidentiality arrangements, and other operational procedures between the parties.

Key Issues[94]

1. The design of information-sharing mechanisms should take into account the following factors:

   (a) Which market authority or regulator has access to and is able to provide the information or assistance.

   (b) How such access can be obtained under applicable law.

   (c) Confidentiality under applicable law.

   (d) Permitted use under applicable law.

   (e) The form and timing of the assistance or information sharing.

   (f) The applicability of other arrangements, including MOUs between such authorities for sharing investigative and financial information.

[94] *Principles for Memoranda of Understanding*, supra. See also *IOSCO MMoU*, supra. *Principles Regarding Cross-Border Supervisory Cooperation* Chapter 8 Supervisory Report.

2. Where confidential information gathered by the regulator in the exercise of its functions is shared with another authority, particular care must be taken to ensure that the information is provided subject to conditions, which, to the extent consistent with the purpose of its release, preserve the confidentiality of that information.

3. The regulator should be able to maintain the confidentiality of the request consistent with Article 11 of the IOSCO MMOU.

Key Questions

1. Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with other domestic authorities?

2. Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with foreign counterparts?

3. Is the regulator a signatory to the IOSCO MMoU (in the affirmative, please skip Question 4(a)[95])?

4. Has the relevant regulator developed information-sharing mechanisms to:

   (a) Facilitate the detection and deterrence of cross-border misconduct?

   (b) Assist in the discharge of licensing, surveillance and enforcement responsibilities?[96]

5. Where warranted by the scope of cross-border activity and the ability to provide reciprocal assistance, does the regulator actively try to establish information-sharing arrangements with *foreign* regulators?

6. Are these arrangements documented in writing?

7. Does the regulator take steps to assure safeguards are in place to protect the confidentiality of information transmitted consistent with its uses?[97]

8. Can the regulator maintain the confidentiality of the request for information received from a foreign regulator consistent with Article 11 of the IOSCO MMOU?

9. Can the regulator demonstrate that it shares information, where appropriate safeguards are in place, when it is requested by another domestic authority or foreign counterpart?

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95 See Article 4 of the *IOSCO MMoU*.

96 When the person that is the subject of the inquiry is known to the requested authority.

97 *Principles for Memoranda of Understanding*, supra. See also *IOSCO MMoU*, supra.

Explanatory Notes

This principle can be satisfied through the use of a range of mechanisms for sharing entity-specific information and market-wide intelligence – each address different, albeit overlapping, types of information-sharing. Each mechanism also buttresses the others, making all of them more effective when used in conjunction as part of a single overarching supervisory cooperation strategy among IOSCO members. All of these different mechanisms, however, are likely to be useful to securities regulators for different purposes.[98]

Memoranda of understanding or other documented arrangements can help to add certainty, and in some cases, expedition, to the process of information exchange. Nonetheless, the mere formality of an arrangement is no substitute for a close and cooperative arrangement.

The assessor should be able to provide actual evidence of the usefulness of existing arrangements for cooperation. For example, the jurisdiction should be able to demonstrate that it can and does share information when requested to do so by another authority. If this is not possible, then the assessor should question the efficacy of either formal or informal arrangements. The assessment does not address whether the regulator obtains the information directly or indirectly.[99]

The regulator should identify responses to requests for assistance and should provide examples of successful and substantive responses. The regulator should provide a list of the number of requests for assistance received, the type of assistance requested for each request, and provide examples of successful and substantive responses by the regulator[100]. The regulator should also provide information if there are instances where cooperation was denied and provide the rationale for such denial. If practical cases have not occurred, the regulator should be able to demonstrate that there are internal processes in place that address the aforementioned issues.

In the context of the IOSCO MMoU, the regulator should be able to demonstrate its practical ability to share information required under the IOSCO MMoU and show actual instances in which information required under the IOSCO MMoU was shared with foreign counterparts.

Under the IOSCO MMoU, each authority will keep confidential requests made under the IOSCO MMoU, the contents of such request, and any matters arising under the IOSCO MMoU, including consultations between or among Authorities, and unsolicited assistance. After consultation with the requesting Authority, the requested Authority may disclose the fact that the requesting Authority has made the request if such disclosure is required to carry out the request. In this context confidentiality with regard to requests and information received from another authority is very important. In accordance with Article 11(b) of the IOSCO MMoU, the Authority that has made a request will keep confidential non-public documents and information received under the MMoU, except as contemplated by Article 10(a) of the IOSCO MMoU or in response to a legally enforceable demand. In the

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98 See preamble to *Principles Regarding Cross-Border Supervisory Cooperation*, supra (Chapter 8 Mechanisms for Supervisory Cooperation).

99 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra. This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart.

100 Consistent with confidentiality obligations (including Article 11 of the *IOSCO MMoU*), the regulator, in providing examples of successful and substantive responses, should consider masking references that identify its counterpart and any individuals or firms.

latter case the requesting authority should notify the Requested Authority prior to complying with the demand and assert such appropriate legal exemptions of privileges with respect to the information concerned as may be available.

The assessor should assess the extent to which the regulator has to comply with demands for disclosure of other domestic authorities; see Articles 10 and 11 of the IOSCO MMoU.

Although the regulator may not be a signatory to the IOSCO MMoU, the assessor should still seek to assess the extent to which the regulator can still facilitate the detection and deterrence of cross-border misconduct.

Benchmarks

Fully Implemented

Requires an affirmative response to all applicable Questions.

Broadly Implemented

Requires an affirmative response to all applicable Questions except to Question 6.

Partly Implemented

Requires an affirmative response to all applicable Questions except to Question 6 and that an affirmative response to one or more of Questions 4(a), 4(b) and 5 is not required if the regulator's jurisdiction does not do substantial cross border business and the need for information sharing is infrequent and *ad hoc*.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3, 7, 8 or 9 or Questions 4(a), 4(b) or 5 if the regulator's jurisdiction does more than an insubstantial cross border business, or there is evidence that information cannot be, and is not being, shared in appropriate cases in a timely manner.

Principle 15 **The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.**

Effective regulation and supervision can be compromised when necessary information is located in another jurisdiction and is not available or accessible.[101] Thus, a regulator should be empowered to assist and provide information necessary to foreign regulators in the discharge of their mandate and mission. Without this ability, information gathering powers would be insufficient to ensure proper regulation, supervision, and enforcement of markets.

Fraud, market manipulation, insider trading and other illegal conduct that crosses jurisdictional boundaries can and do occur more and more frequently in a global market aided by modern telecommunications.

The MMoU was put in place by IOSCO with the goal of ensuring that a cooperative mechanism exists among IOSCO Members at the international level to facilitate the detection and deterrence of cross-border misconduct. The IOSCO MMoU is considered to be the minimum standard for international enforcement and cooperation. It is therefore essential for IOSCO members to have the legal authority to meet this minimum standard. The IOSCO MMoU is a benchmark for international cooperation, but should not be considered as limiting the ability of members to sign other agreements that may go beyond what is prescribed in the IOSCO MMoU.

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[101] See *Resolution on Cooperation in Matters of Surveillance and Enforcement*, Resolution of the Presidents´ Committee of IOSCO, September 1987, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES44.pdf; *Resolution on International Equity Offers*, Resolution of the Presidents´ Committee of IOSCO, September 1989, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES41.pdf; *Resolution on Information Sharing Between SROs*, Resolution of the SRO Consultative Committee of IOSCO, November 1990, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES40.pdf; *Resolution on Principles for Memoranda of Understanding*, Resolution of the Presidents´ Committee of IOSCO, September 1991, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES42.pdf; *Resolution on Money Laundering*, Resolution of the Presidents´ Committee of IOSCO, October 1992, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES5.pdf; *Resolution on Transnational Securities and Futures Fraud*, Resolution of the Presidents´ Committee of IOSCO, October 1993, available at: http://www.iosco.org/library/resolutions/pdf/IOSCORES8.pdf; *Resolution Concerning Cross-Border Transactions*, Resolution of the Presidents´ Committee of IOSCO, July 1995, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES12.pdf; *Recommendation on the Recognition of Bilateral Netting Agreements in the Calculation of Capital Requirements for Securities Firms*, Recommendation of the Technical Committee of IOSCO, March 1996, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES38.pdf; and *Resolution on Recordkeeping*, *supra*. See also *Resolution on Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance* (*Self-Evaluation*), Resolution of the Presidents´ Committee of IOSCO, October 1994, available at https://www.iosco.org/library/resolutions/pdf/IOSCORES11.pdf; *Principles for the Oversight of Screen-Based Trading Systems for Derivatives Products - Review and Additions*, Report of the Technical Committee of IOSCO, October 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD111.pdf; and *Guidance on Information Sharing*, Report of the Technical Committee of IOSCO, March 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD86.pdf.

Assistance in taking substantive action may also be necessary. When it is within their powers,[102] regulators can more effectively enforce securities laws when they are able to prevent the concealment of the proceeds of fraud or other misconduct, thus facilitating the return of money to injured investors.[103]

Supervisory assistance and cooperation is also essential in the context of activities of regulated entities and issuers on markets across the world.

Key Issues[104]

1. A *domestic* regulator should be able to provide effective assistance to *foreign* regulators who need to make inquiries under their competence, with respect to securities and derivatives matters, including bank and brokerage records and client identification information, regardless of whether the *domestic* regulator has an independent interest in the matter.

2. Assistance, including compulsory assistance, in obtaining records should be provided to *foreign* regulators in securing compliance with securities and derivatives laws.

3. Regulators should be able to provide assistance, including obtaining court orders, to the full extent of their powers.

4. Regulators should be able to provide information on financial conglomerates subject to their supervision.

5. Regulators should be able to share information and provide assistance for effective regulation and supervision of markets and market participants.

Key Questions

1. Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining:[105]

   (a) Contemporaneous records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions?

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102 Regulators are encouraged by the Resolution of the IOSCO Presidents' Committee of June 2006 to examine the legal framework under which they operate and strive to develop, through law reform or otherwise, mechanisms by which they or another authority within their jurisdiction could, on behalf of a foreign regulator, freeze assets derived from suspected and established cross-border securities violations and thereby deny wrongdoers the benefit of their ill-gotten gains.

103 *Measures Available on a Cross-Border Basis to Protect Interests and Assets of Defrauded Investors*, Report of the Technical Committee of IOSCO, July 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD55.pdf.

104 *Principles for Memoranda of Understanding*, supra. See also *IOSCO MMoU*, supra.

105 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra. This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart. See also Principle 13.

(b) Records for securities and derivatives transactions that identify:

(i) The client:

(1) Name of the account holder?

(2) Person authorized to transact business?

(ii) The amount purchased or sold?

(iii) The time of the transaction?

(iv) The price of the transaction?

(v) The individual and the bank or broker and brokerage house that handled the transaction?

(c) Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organized in its jurisdiction?[106]

2. Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in securing compliance with laws and regulations related to:

(a) Insider dealing, market manipulation, misrepresentation of material information and other fraudulent or manipulative practices relating to securities and derivatives, including solicitation practices, handling of investor funds and customer orders?

(b) The registration, issuance, offer, or sale of securities and derivatives, and reporting requirements related thereto?[107]

(c) Market intermediaries, including investment and trading advisers who are required to be licensed or registered, collective investment schemes, brokers, dealers and transfer agents?

(d) Markets, exchanges and clearing and settlement entities?

3. Is the *domestic* regulator able, according to its domestic laws and regulations, to provide effective and timely assistance to *foreign* regulators regardless of whether the *domestic* regulator has an independent interest in the matter?[108]

4. Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining information on the regulatory processes[109] in its jurisdiction?

5. Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in requiring or requesting:

(a) The production of documents?

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106 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra.

107 *Resolution on Recordkeeping*, supra. See also the *IOSCO MMoU*, supra.

108 *Principles for Memoranda of Understanding*, supra; the *IOSCO MMoU*, supra.

109 "Regulatory processes" refer to formal processes, such as licensing procedures or audit procedures which could be relevant to enforcement.

(b) Taking a person's statement or, where permissible, testimony under oath?[110]

6. Is the *domestic* regulator able to offer effective and timely assistance to *foreign* regulators in obtaining court orders, if permitted, for example, urgent injunctions?[111]

7. Is the *domestic* regulator able to provide effective and timely assistance to *foreign* regulators regarding information about financial conglomerates subject to its supervision and more precisely assistance in relation, for example, to:

(a) The structure of financial conglomerates?

(b) The capital requirements in conglomerate groups?

(c) Investments in companies within the same group?

(d) Intra-group exposures and group-wide exposures?

(e) Relationships with shareholders?

(f) Management responsibility and the control of regulated entities?[112]

8. If the regulator cannot directly obtain the information set out in Key Question 1, can the regulator obtain that information from another domestic authority and share that information with the requesting regulator?[113]

9. May the requesting authority use the information furnished by the domestic authority for the purposes set forth under Article 10(a) of the IOSCO MMoU?

Explanatory Notes

In assessing this Principle, the assessor should refer to Principles 10, 11, and 12 to assess if the regulator has the appropriate power to gather information needed by the foreign regulator.

With respect to injunctions or other remedies, such as asset freezes, where permitted, it is understood that the regulator may need the assistance of another authority. Although the power to assist in obtaining such court orders is not required if not permitted for a *Fully Implemented* rating, where such assistance is in fact permitted, the failure to cooperate could result in a *Partly Implemented* rating.

The regulator should be able to demonstrate the timeliness of assistance or cooperative effort by providing records, logs or other supporting evidence.

The regulator should also provide evidence of the type of requests for assistance received, the type of assistance requested for each request, and provide examples of successful and substantive responses by the regulator. The regulator should also provide information if there are instances where cooperation was denied and provide the rationale for such denial.

110 See the *IOSCO MMoU*, supra.

111 The regulator should be able to compel the production of documents.

112 See *Principles for Memoranda of Understanding*, supra.

113 See Article 10(a) of the *IOSCO MMOU*.

The form of international assistance may include:[114]

- Assistance in obtaining public or non-public information, for example, about a licence holder, listed company, shareholder, beneficial owner or a person exercising control over a licence holder or company.
- Assistance in obtaining banking, brokerage, or other records.
- Assistance in obtaining voluntary cooperation from those who may have information about the subject of an inquiry.
- Assistance by providing examination reports.
- Assistance by providing risk analysis assessments and information to support the identification, assessment, and mitigation of hidden risks to markets and investors.
- Assistance in inspection of visits to market participants.
- Assistance in obtaining information or in the compulsion of documents and, at least voluntary testimony or statements.
- Assistance in providing information on the regulatory processes in a jurisdiction, or in obtaining court orders, for example, urgent injunctions.[115]

The particular procedures used for the supervision of financial conglomerates must reflect the domestic law of the places in which they operate and must take account of the possibility that relevant regulatory responsibility may continue to be shared between agencies. It is nevertheless possible to identify some general issues that should be considered as matters requiring close supervisory cooperation:

- structure of financial conglomerates;
- capital requirements in conglomerate groups;[116]
- investments in companies within the same group;
- intra-group exposures and group-wide exposures;[117]
- relationships with shareholders;
- management responsibility and the control of regulated entities.

Derivatives are specifically identified in this section, because some jurisdictions can share information with respect to securities, but not with respect to certain derivatives transactions. The assessor should make this explicit when this is the case.

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114 *Report on Issues Raised for Securities and Futures Regulators by Under-Regulated and Uncooperative Jurisdictions*, Report of the Technical Committee of IOSCO, October 1994, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD41.pdf.

115 See *Principles Regarding Cross-Border Supervisory Cooperation*, Final Report, Report of the Technical Committee of IOSCO, May 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf.

116 See generally *Risk Concentration Principles*, Report of the Joint Forum, December 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD102.pdf.

117 See generally *Intra-Group Transactions and Exposures Principles*, Report of the Joint Forum, December 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD101.pdf.

In the case where there is not power to provide specific assistance, the assessor also should inquire as to whether the regulator is making efforts to seek further powers or taking other steps to enhance its capacity to cooperate. In circumstances where the authorities require a court order to obtain certain information e.g., bank records, an inability to obtain in a timely fashion court orders for that purpose may indicate that the authority is unable to cooperate.

Benchmarks

Fully Implemented

Requires an affirmative response to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all Questions except in respect to Questions 7(a), 7(b), 7(c), 7(d), 7(e) and 7(f).

The regulator can only provide some of the types of information listed and this limitation does not affect its ability to provide information on the entity subject to its supervision or oversight, and provided however, that the authority takes steps to provide assistance within its powers and such assistance is not so untimely as to be tantamount to being denied.

Partly Implemented

Requires affirmative responses to all Questions except to Questions 6, 7(a), 7(b), 7(c), 7(d), 7(e) and 7(f), provided, however, that the authority takes steps to provide assistance within its powers and such assistance is not so untimely as to be tantamount to being denied.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b)(i), 1(b)(ii), 1(b)(iii), 1(b)(iv), 1(b)(v), 1(c) 2(a), 2(b), 2(c), 2(d), 3, 4 or 5(a), 5(b), 8 and 9 or assistance does not occur or is so untimely as to be tantamount to being denied.

E. PRINCIPLES RELATING TO ISSUERS

1. Preamble

These Principles are about the information that issuers should disclose to investors when they invest in securities and on an ongoing basis.

The Principles seek to support the Objectives of Securities Regulation in the following ways:

- they enhance investor protection by requiring issuers to provide investors with information about the issuer, the risks of investing in its securities, and other matters to support better investment decisions;
- they support the operation of fair, orderly, efficient and transparent markets by providing investors and therefore the markets with accurate and relevant information; and
- they support the reduction of systemic risk as it may be affected by investor confidence by enhancing transparency in the market.

Principles 16, 17 and 18 are closely interrelated. While Principle 16 focuses primarily on full, timely and accurate disclosure of financial and non-financial information, these same qualities of disclosure are essential for the purposes of Principles 17 and 18. For example, it should be impossible to conclude under Principle 17 that holders of securities are treated in a fair and equitable manner if they are not provided with full, timely and accurate disclosure in connection with the voting decisions and change of control transactions addressed in that Principle. Similarly, it should be impossible to conclude under Principle 18 that accounting standards are of a high and internationally acceptable quality if full and accurate disclosure would not be reflected in the financial statements to which such standards have been applied. It also should be impossible to conclude that audited financial statements required in prospectuses, listing documents and annual reports reflect full, timely, and accurate disclosure under Principles 16 or full disclosure to shareholders under Principle 17, if accounting standards of a high and internationally acceptable quality have not been applied to such financial statements.

To determine whether Principles 16, 17 and 18 are implemented in a manner that achieves the objectives of investor protection, fair, orderly, efficient and transparent markets and reducing systemic risk it may also be necessary to consider a jurisdiction's general legal framework and laws that complement securities regulation. Annexure 1 indicates the complementary laws, such as the law of contracts, insolvency and company law, which may constitute part of the legal framework.

Finally, an assessment of implementation of Principles 16, 17 and 18 is also essential for purposes of assessing implementation of Principle 26 regarding collective investment schemes.

2. Scope

Principles 16 and 18 are intended to apply to issuers making "public offerings" of securities and also to issuers whose securities are "listed and/or publicly traded."[118] Principle 17 is intended to apply to companies whose securities are listed, publicly offered, or traded.

Most jurisdictions separately regulate public offerings, thereby ensuring general protection of the public while reducing the regulatory burden in the case of non-public undertakings. The definition of what amounts to an offer to the public varies, as does the threshold for what constitutes public trading.

The term "issuer" should be understood broadly to include all entities and persons who offer or sell their own securities. The Principles do not apply to the issuing of debt by Government or entities created by statute which perform a public function or deliver a public service pursuant to a statutory mandate provided that they are backed by the guarantee of the government.

In assessing implementation of these Principles, however, the assessor should bear in mind that the terms 'publicly traded' and 'public offerings' are not defined in the Principles. Accordingly, the universe of issuers and transactions to which these three Principles apply may be expected to vary among jurisdictions. The assessor should not attempt to substitute his or her judgment in lieu of the law of the jurisdiction as to what constitutes a public offering, but should indicate what public offerings are covered by the law. This may affect the extent to which these Principles are applicable.[119]

With respect to what constitutes "publicly traded" securities to which the Principles should apply, the Principles relating to Secondary Markets provide useful guidance. These Principles indicate that the concept of a secondary market is not limited to traditional organized exchanges, but is also intended to include various regulated forms of "off-exchange" market systems that trade equity and debt securities, as well as options and certain derivative products. That section, however, is directed principally to authorized exchanges and regulated trading systems as defined therein. Regulation appropriate to a particular secondary market will depend upon the nature of the market and its participants.[120]

Bearing in mind that Principles 16, 17 and 18 set forth requirements for disclosure and reporting primarily by issuers, that the objective of these Principles is investor protection, and that the objective of authorized exchanges and regulated trading systems[121] is fairness,[122] efficiency and transparency,[123] the assessor should determine the exchanges and trading systems within a jurisdiction that are deemed to be exchanges and trading systems subject to regulation under Principles 33 through 38 and which provide trading services in corporate equity and debt securities for retail investors. Implementation of Principles 16, 17 and 18

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118 These Principles do not apply to private offerings, except where the offering is made through a private placement and the investor then resells to the public.

119 Principle 1.

120 Refer to Principles on Market Intermediaries, Principles 29 – 32.

121 See Principle 33.

122 See Principle 34.

123 See Principle 35.

should be assessed with respect to issuers whose securities are listed and/or traded on those authorized exchanges and regulated trading systems.[124]

Even with this guidance, an assessor may have to exercise judgment in assessing whether Principles 16, 17 and 18 have been implemented with respect to publicly traded securities in a particular market.

For greater clarification, these principles apply to the following types of securities in the following ways:[125]

- Principles 16 and 18 apply to the issuing of equity securities and of debt securities (other than debt securities issued by Government or entities created by statute which perform a public function or deliver a public service to a statutory mandate) including publicly traded asset-backed securities[126] and structured financial products and derivatives that are securities. They do not apply to the issue of sovereign debt.
- Principle 17 applies only to equity securities.
- Principles 16 to 18 also apply to rights issues to existing security holders.[127]

If a publicly offered, listed, or traded security has features of a derivative (for instance where price is determined by reference to other instruments), these Principles will apply to the issue of that instrument.

The Principles also apply to structured financial products (which may be described as highly complex) that are securities. Adequate disclosure of the risks that the underlying assets of these securities face and the possible effect that these risks may have on the security itself is particularly important. Issuer's disclosure should also include checks, assessments, duties, and risk practices performed by underwriters, sponsors and originators; and asset pool performance.[128]

The Principles, however, do not apply to [issuers in] other markets such as currency, bullion, or physical commodity markets, except to the extent that securities intermediaries deal for customers in such markets.

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124 References to listing documents in Principles 16 - 18 apply only where the securities are listed on an authorised exchange or, where relevant, a regulated trading system.

125 The list of securities to which these Principles apply is not intended to be exhaustive.

126 *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf, defines asset-backed securities (at p.4) as 'those securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets that by their terms convert into cash within a finite period of time, such as RMBS (residential mortgage-backed securities) and CMBS (commercial mortgage-backed securities), among others.' These Principles are not intended to apply to 'securities backed by assets pools that are actively managed (such as some securities issued by investment companies), or that contain assets that do not by their terms convert to cash (such as collateralized debt obligations)'.

127 See *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuer*, Report of IOSCO, September 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf, at pp.9 - 10.

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In assessing the regulatory framework for issuers that make 'public offerings', the assessor should consider the requirements with respect to content of advertising, and information about issuers, offerings, listing, periodic reports and reports of material events, bids or the change in control or change of interest associated with the holding of a publicly offered or traded security.

In assessing implementation of Principles 16, 17 and 18, the assessor also should recognize that the source of disclosure and reporting requirements will not necessarily be limited to securities law and regulations. For example, in some jurisdictions, timely disclosure and other requirements are imposed by marketplace listing rules. In such circumstances, there should be appropriate oversight by the regulator. In assessing implementation of these Principles, the assessor also should recognize that regulatory requirements may be tailored based on the nature of the issuing entity, the securities issued, or the initial investor.

Finally, the assessor should determine the extent to which a jurisdiction's secondary market and publicly traded issues are subject to, or are realistic candidates for, cross-border listing and/or trading activity, since this may affect the importance of certain of the Key Questions.[129]

In general, the appropriate framework for issuer regulation includes adequate company, accounting, commercial and contract law. While the assessor should be informed about the legal framework, in general, the specific objectives of non-securities-specific law are addressed explicitly in the Key Issues, Key Questions, and Benchmarks to this section.

[129] Principle 16, Key Question 9. See also Principle 17, Key Question 6. See also Principle 18, Key Question 7, infra.

3. Principles 16 through 18

Principle 16	**There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.**

Issuers should disclose to investors current and reliable information necessary to make informed investment decisions on an ongoing basis. The principle of full, timely and accurate disclosure of current and reliable information material to investment decisions is directly related to the Objectives of investor protection and fair, efficient and transparent markets.[130]

This Principle requires consideration of the adequacy, accuracy, and timeliness of both financial and non-financial disclosures as well as disclosure of risks that are material to investors' decisions. These disclosures may pertain to specified transactions, periodic reports and ongoing disclosure and reporting of material developments.

This Principle applies to issuers of securities, as defined in the Scope to these Principles.

Disclosure requirements set out in this Principle may extend beyond the issuing entity itself to include others, such as directors and senior officers of the company, participating underwriters, material shareholders and other parties playing a material role in issuing securities.[131] It will be apparent from the text where others have a relevant obligation.

Key Issues

Full Disclosure

1. The regulatory framework should ensure full, timely, and accurate disclosure of risks, financial results and other information that is material to investors making informed investment decisions on an ongoing basis.

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130 *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf. See also *Insider Trading – How Jurisdictions Regulate it*, Report of the Emerging Markets Committee of IOSCO, May 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf.

131 See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf, p.9, Principle III; See also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; and *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

2. Disclosure rules should include rules about the following (with the list being illustrative):[132]

   (a) The conditions applicable to an offering of securities for public sale.

   (b) The content and distribution of prospectuses, listing particulars documents or other offering documents.

   (c) Supplementary documents prepared in the offering.

   (d) Advertising in connection with the offering of securities.

[132] See *International Equity Offers - Changes in Regulation Since April 1990*, Report of IOSCO, September 1991, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD16.pdf; *International Equity Offers - Changes in Regulation Since April 1992*, Report of IOSCO, October 1994, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD38.pdf; *International Equity Offers - Changes in Regulation Since April 1994*, Report of IOSCO, September 1996, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD61.pdf; *International Equity Offers - Changes in Regulation Since April 1996*, Report of the Technical Committee of IOSCO, September 1997, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD71.pdf. See also *Report on Disclosure Requirements*, Report of the Development Committee (now called the Emerging Markets Committee) of IOSCO, October 1992, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD24.pdf; *Report on Disclosure*, Report of the Emerging Markets Committee of IOSCO, October 1993, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD32.pdf; *Report on Disclosure and Accounting*, Report of the Technical Committee of IOSCO, October 1994, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD39.pdf; and *Reporting of Material Events in Emerging Markets*, Report of the Emerging Markets Committee of IOSCO, September 1996, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD62.pdf. See also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; *Adapting IOSCO International Disclosure Standards for Shelf Registration Systems*, Report of the Technical Committee of IOSCO, March 2001, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD118.pdf; *Resolution on IOSCO Endorsement of Disclosure Standards to Facilitate Cross-Border Offerings and Listings by Multinational Issuers*, Resolution of the Presidents´ Committee of IOSCO, September 1998, available at https://www.iosco.org/library/resolutions/pdf/IOSCORES17.pdf; *Resolution on IASC Standards*, Resolution of the Presidents´ Committee of IOSCO, May 2000, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES19.pdf; and *General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Condition and Results of Operations*, Report of the Technical Committee of IOSCO, February 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD141.pdf; *Insider Trading – How Jurisdictions Regulate it*, Report of the Emerging Markets Committee of IOSCO, May 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf; *Statement on the Development and Use of International Financial Reporting Standards*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD182.pdf; and *International Disclosure Principles for Cross Border Offerings and Listing of Debt Securities by Foreign Issuers*, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf; *Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements*, Report of the Technical Committee of IOSCO, February 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD262.pdf; and *Disclosure Principles for Public Offerings and Listings of Asset-backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf.

(e) Information about those who have a significant interest in an issuer.[133]

(f) Information about those who seek control of an issuer (discussed in greater detail below).

(g) Information material to the price, or value, of a security.[134]

(h) Periodic reports.

(i) Shareholder voting decisions.

(j) Material related party transactions and transactions including transactions involving directors and senior managers of the issuer;[135]

(k) Periodic disclosure of information about director and senior management compensation and risk management practices.[136]

(l) The most significant risks material to the offering.[137]

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133 See *Principles for Periodic Disclosure by Listed Entities*, Final Report, Report of the Technical Committee of IOSCO, February 2010, at pp.16-17, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf; see also *Protection of Minority Shareholders in Listed Issuers*, Final Report, Report of the Technical Committee of IOSCO in consultation with the OECD, June 2009 at pp.10-14, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD295.pdf; see also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; *Disclosure Principles for Public Offerings and Listings of Asset-backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf; and *International Disclosure Principles for Cross Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

134 If there are classes of shares or other structural features that would affect share price, these should be disclosed. This information also would include the release of price sensitive information.

135 See *Principles for Periodic Disclosure by Listed Entities*, Final Report, Report of the Technical Committee of IOSCO, February 2010, at p.11, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf.

136 The reference to 'risk management practices' is in the context of disclosure on compensation. The information about director and senior management compensation and risk management practices is important to investors so that they can assess the incentives created by this use of the issuer's resources, whether the incentives of the compensation are aligned with investors' interests, and how performance may be oriented to the returns generated for shareholders. This assessment can be facilitated by disclosure of, among other things, the most important design characteristics of the compensation system including how those characteristics may be tied to performance and, where appropriate, risk. See *Principles for Periodic Disclosure by Listed Entities*, Final Report, Report of the Technical Committee of IOSCO, February 2010, at pp.11-13, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf.

137 See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, Principle XI at p. 32, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf; see also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; and *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

General Disclosure

3. Specific disclosure requirements should be augmented by a general disclosure requirement.

Sufficiency, Accuracy, Timeliness and Accountability for Disclosure

4. Disclosure should be accurate, sufficiently clear and comprehensive, and reasonably specific and timely.[138]

5. Regulation should ensure that proper responsibility is taken for the content of information and, depending on the circumstances, those persons who take liability for such disclosures may include the issuer, underwriters, promoters, directors, authorizing officers of the issuer, experts and advisers who consent to be named in the documentation or provide advice.

Derogations

6. The circumstances under which derogation from full and timely disclosure is permitted should be limited and the safeguards that apply in such circumstance should be clear.

Key Questions

Full Disclosure

1. Does the regulatory framework have clear, comprehensive and reasonably specific disclosure requirements that apply to:

   (a) Public offerings, including the conditions applicable to an offering of securities for public sale, the content and distribution of prospectuses and other offering documents (and, where relevant, short form profile or introductory documents) and supplementary documents prepared in the offering?[139]

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138 See *International Equity Offers*, Report of IOSCO, September 1989, at pp.7-8, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD2.pdf; and *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, at pp.5-6, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf. See also *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, (in particular, Key Recommendation 5 and text), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf; *Securities Activity on the Internet II*, Report of the Technical Committee of IOSCO, June 2001, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf; *Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf; *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, pp.3-4, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf; and *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf.

139 The term "conditions" refers to both any restrictions, or any stipulations, with respect to an offer and the transaction terms.

(b) Annual reports?

(c) Other periodic reports?

(d) Shareholder voting decisions?

(e) Advertising of public offerings outside the prospectus?

2. Does the regulatory framework require accurate, sufficiently clear and comprehensive, and reasonably specific and timely disclosure of:

(a) events that are material to the price or value of securities;

(b) the most significant risks of investing in the security;[140] and

(c) important relevant information about the issuer and its activities?

3. Does the regulatory framework require:

(a) Financial information and other required disclosure in prospectuses, listing documents, annual and other periodic reports, and, where applicable, in connection with shareholder voting decisions, to be of sufficient timeliness to be useful to investors?

(b) Periodic information about financial position and results of operations (which may be in summary form) to be made publicly available to investors?

(c) Appropriate measures to be taken (for example, provision of more recent unaudited financial information) when the audited financial statements included in a prospectus for public offerings are not current?

General Disclosure

4. In addition to specific disclosure requirements, is there a general requirement to disclose either all material information or all information necessary to keep the disclosures made from being misleading?

Sufficiency, Accuracy, Timeliness and Accountability for Disclosure

5. Are there measures available to the regulator (e.g., review, certification,[141] supporting documentation, sanctions) to address concerns with the sufficiency, accuracy and timeliness of the required disclosures?

6. Does regulation ensure that issuers and others involved in the issuing process, which may include underwriters, directors, authorizing officers, promoters, experts and advisers, are liable for the content of disclosures they make?

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140 See Footnote 16.

141 "Certification" is generally used in conjunction with internal audits of financial statements, but the list is intended to be exemplary and certification could also refer to other certifications.

Derogations

7. Are the circumstances where disclosures may be omitted or delayed limited to trade secrets, similar proprietary information, or other valid business purposes, such as incomplete negotiations?

8. Where there are derogations from disclosure, is regulation sufficient to provide for fulfilment of the objective of full and timely disclosure by allowing for:[142]

   (a) Temporary suspensions of trading?

   (b) Restrictions on, or sanctions regarding, the trading activities of persons with superior information?

Cross-Border Matters

9. If public offerings or listings by foreign issuers are significant within the jurisdiction, are the jurisdiction's disclosure requirements for such offerings or listings of equity and debt securities by foreign issuers consistent with IOSCO's International Disclosure Standards for (i) Cross-Border Offerings and Initial Listings by Foreign Issuers and (ii) Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers?[143]

Explanatory Notes

With respect to a jurisdiction's disclosure framework, the Key Questions envision that the assessor should take into consideration not only whether the information required to be disclosed is sufficiently clear, comprehensive, reasonably timely, and specific, but also whether the disclosure is made available under circumstances that encourage investors to use this information to make investment and voting decisions. For example, the assessor should take into consideration whether the regulatory regime addresses sales practices, such as "touting" advertising outside of the required disclosure documents that may detract from investors' reliance upon the required disclosure documents.

With respect to what may constitute full disclosure in Key Question 2, specific disclosures would be expected to be included for material pieces of information relevant to investors being able to make informed investment decisions. This information should address the most

[142] In the case of price-sensitive information.

[143] *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; and *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

significant risks of investing in the security.[144] Important information about the issuer should include information about:

- those who have a significant interest in an issuer, including certain significant security holders of the issuer;
- those who seek control of an issuer;
- material related party transactions, including transactions involving directors and senior managers of the issuer; and
- director and senior management compensation and risk management practices.

Assessors should assess implementation of Key Question 2 in relation to derivatives which are securities taking into account the specific features of those securities (including the risks related to gearing or leverage).

With respect to what may constitute comprehensive and specific disclosure requirements for offerings and listings of listed asset backed securities for Key Question 2, assessors should consider whether issuers (or service providers where specified below) are required to do the following:

- Disclose the identities of all parties involved in the transaction and the functions and responsibilities of significant parties.[145]
- Disclose all checks and assessments that have been performed or risk assurance practices that have been undertaken by the underwriter, sponsor, and/or originator in respect of the underlying asset pool.[146]
- Service providers revisit and maintain reports over the life of the product.[147]
- Provide initial and ongoing information about underlying asset pool performance;[148] the composition and characteristics of the asset pool;[149] details regarding significant

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144 See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, Principle XI at p. 33, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf; see also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, Report of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf; *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

145 Id Principles II and III.

146 See *Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, Recommendation #1.2, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf.

147 Id Recommendation #1.4

148 See *Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, Recommendation #2.1, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf; and *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, Principle IV, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf.

149 Id Principle V.

obligors of pool assets;[150] and the creditworthiness of the person(s) with direct or indirect liability to the issuer.[151]

- Disclose the structure of the transaction,[152] credit enhancements,[153] and the use of derivatives.[154]

- Disclose all exchanges or regulated markets on which the security is or is intended to be traded.[155]

With respect to what may constitute "timely disclosure" for purposes of Key Question 2, the Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities issued by the IOSCO Technical Committee provide that the listed entity shall disclose ongoing information on a timely basis, which could require disclosure on an immediate basis for disclosure of material developments, where such a term could be defined to mean "as soon as possible", promptly or prescribed as a maximum of specified days.[156]

These principles also indicate under the general ongoing obligation approach, disclosure may be subject to delay, which may be granted in some jurisdictions by the competent authority, if the information:

- is confidential under legislation; and

- concerns an incomplete proposal or negotiations or the disclosure of particular information is such as to prejudice the legitimate interests of the entity's investors; in such cases the listed entity must ensure that the information is kept strictly confidential.[157]

Finally, in referring to disclosures required on a periodic basis prescribed by law or listing rules, such as quarterly or annual reports, these principles note that "[t]he disclosure obligation may require disclosure of relevant information on an immediate basis even when it belongs to periodic reporting."[158]

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150 Id Principle VI.

151 See *Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, Recommendation #2.1, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf.

152 See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, Principle VIII, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf.

153 Id Principle IX.

154 Id Principle X.

155 Id Principle XII.

156 *Principles for Ongoing Disclosure and Material Development Reporting by Listed*, Report of the Technical Committee of IOSCO, October 2002, pp. 4-5, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf.

157 Id.

158 Id.

With respect to what may constitute appropriate delivery of periodic financial information in Key Question 3(b), practices vary among jurisdictions as to the frequency and timing of disclosure of periodic financial information. An affirmative response to Key Question 3(b) is warranted if the periodic financial information is made available on at least a semi-annual basis.

With respect to what may constitute general disclosure in Key Question 4, a general disclosure requirement will provide that all material information relevant to a particular security or issuer is required to be disclosed. Another approach for such a general disclosure requirement is that disclosure is required of all material information that is necessary to keep disclosures made from being misleading.[159]

With respect to assessing Key Question 6, and depending on the circumstances, persons taking responsibility may include the issuer, underwriters, directors, authorizing officers, promoters, and experts and advisers consenting to be named as such.[160]

With respect to what may constitute Derogations in Key Questions 7 and 8, assessors should recognize that there are circumstances in which it may be necessary to the proper functioning of the market to allow something less than full disclosure: for example, of trade secrets or incomplete negotiations. In the limited circumstances where the market requires some derogation from the objective of full and timely disclosure, there may need to be temporary suspensions from trading or restrictions on the trading activities of those who possess more complete information. In such circumstances, trading should be prohibited in the absence of full disclosure.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions. If there are no derogations to disclosure, then Questions 7, 8(a) and 8(b) can be considered inapplicable.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 1(e) and 3(c).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 1(c), 1(e), 3(c), 7 (where derogations are provided for) and 9.

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159 Reference should also be made to so-called "merit based" regulation in which the regulator takes some responsibility for assessing the quality of a proposed offering. This approach is generally associated with developing markets and may be of particular benefit where a market lacks a group of analysts and advisers who could analyse information if it were made publicly available. It is therefore, generally regarded as transitional and not necessary in a fully developed market.

160 For more guidance about the internal control mechanisms that could be implemented by an issuer, see *Issuer Internal Control Requirements – A Survey*, Report of the Technical Committee and the Emerging Markets Committee of IOSCO, December 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD229.pdf.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(d), 2(a), 2(b), 2(c), 3(a), 3(b), 4, 5, 6, 8(a) or 8(b) (where derogations are provided for).

Principle 17 Holders of securities in a company should be treated in a fair and equitable manner.

By seeking to safeguard the fair and equitable treatment of shareholders (particularly in connection with voting decisions and change of control transactions), this Principle supports investor protection and fair, efficient and transparent markets.

This Principle requires an assessment as to whether the basic rights of shareholders are protected and whether shareholders within a class are treated equitably.

Principle 17 addresses many of the same issues that are covered by Principles I and II of the *Principles of Corporate Governance* of the Organization for Cooperation and Development (OECD) regarding the rights and equitable treatment of shareholders, particularly in connection with voting decisions, takeover bids, and other transactions that may result in a change in control or that may consolidate control.[161]

Regulation which safeguards the fair and equitable treatment of shareholders should require disclosure of the security holdings of management and of those persons who hold a substantial beneficial ownership interest in a company. This is generally regarded as information necessary to make informed investment decisions.

The level at which disclosure is required varies from jurisdiction to jurisdiction, but is generally set at a level well below that which would be characterized as a controlling interest. More stringent disclosure requirements may be appropriate for persons contemplating exercise of control.

The nature of the disclosure required also varies, but full public disclosure is generally thought to best meet the underlying policy rationale of disclosure where a change in control of a company has occurred or is contemplated. Regulation should have regard to the information needs of the shareholders of the subject company.

The information necessary to enable informed decision-making will vary with the nature of the transaction but the general objective remains true for cash offers, offers by way of tender and exchange, business combinations and privatizations.

Generally, in the circumstances described in the preceding sentence, this will require that shareholders of a company:

- have a reasonable time in which to consider any offer under which a person would acquire a substantial interest in the company;
- are supplied with adequate information to enable them to assess the merits of any proposal under which a person would acquire a substantial interest in the company;
- as far as practicable, have reasonable and equal opportunities to participate in any benefits accruing to the shareholders under any proposal under which a person would acquire a substantial interest in the company;

[161] This could include issuer bids as well as tender offers.

- receive fair and equal treatment (in particular, minority shareholders) in relation to the proposal; and
- are not unfairly disadvantaged by the treatment and conduct of the directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal.

The relationship between Principles 16 and 17 requires some explanation. While Principle 16 seeks to ensure that investors are provided with timely disclosure about changes in corporate control (as set out in the Explanatory Notes on Key Question 2), Principle 17 seeks to ensure shareholders are provided with sufficient and timely information about transactions which involve a change of control in a way that enables them to exercise rights in relation to those transactions.

Key Issues

Rights of Shareholders

1. The basic rights of equity shareholders are:

   (a) The right to document[162] and transfer ownership.

   (b) The right to participate on an informed basis in voting decisions (if the securities have voting rights).

   (c) The right to participate equitably in dividends and other distributions, when, as and if declared, including distributions upon liquidation.

   (d) The right to pass upon changes in the terms and conditions of rights attaching to their shares.

   (e) The right, as far as practicable, to have reasonable and equitable opportunities to participate in any benefits accruing to the shareholders under any proposal under which a person would acquire a substantial interest in the company.

   (f) The right to hold a company's management accountable for their actions including their involvement or oversight which results in breaches of the law.

   (g) The right to receive fair and equitable treatment (in particular, treatment of minority shareholders) including in relation to proposals described in 1(e) and in relation to bankruptcy or insolvency of the company.

Control

2. To safeguard fair and equitable treatment of shareholders, regulation should require disclosure of:

   (a) Changes in controlling interests and substantial shareholdings above a specified threshold and transactions which result or may result in changes in controlling interest and substantial shareholdings above a specified threshold.

[162] Register or perfect.

(b) Information necessary to informed decision-making with respect to tender offers, takeover bids, and other transactions intended to effectuate a change of control or that potentially may result in a change of control, or that may consolidate control.

(c) Shareholdings of directors and senior management.[163]

(d) Shareholdings of those persons who hold a substantial beneficial ownership interest in a company.

Key Questions

Rights of Shareholders

1. Does the regulatory and legal frameworks address the rights and equitable treatment of shareholders in connection with the following:

   (a) Voting:

      (i) For election of directors?

      (ii) On corporate changes affecting the terms and conditions of their securities?

      (iii) On other fundamental corporate changes?

   (b) Timely notice of shareholder meetings and voting decisions?

   (c) Procedures that enable beneficial owners to give proxies or voting instructions efficiently?

   (d) Ownership registration (in the case of registered shares) and transfer of their shares?

   (e) Receipt of dividends and other distributions, when, as, and if declared?

   (f) Transactions involving:

      (i) A takeover bid?

      (ii) Other change of control transactions?

   (g) Holding the company, its directors, and senior management accountable for their involvement or oversight resulting in violations of law?

   (h) Bankruptcy or insolvency of the company?[164]

2. Is full disclosure of all information material to an investment or voting decision required in connection with shareholder voting decisions generally and the transactions referred to in Questions 1(a)(iii), 1(f)(i) and 1(f)(ii) specifically?

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163 See definition in the Explanatory Notes.

164 This may affect the value of a listed security, shareholders should be able to determine and to exercise their rights in the event of a liquidation or insolvency.

Control

3. With respect to transactions referred to in Question 1(f)(i) and 1(f)(ii), are shareholders of the class or classes of securities affected by the proposal:

   (a) Given a reasonable time in which to consider the proposal?

   (b) Supplied with adequate information to enable them to assess the merits of the proposal?

   (c) As far as practicable, given reasonable and equitable opportunities to participate in any benefits accruing to the shareholders under the proposal?

   (d) Given fair and equitable treatment (in particular, minority security holders) in relation to the proposal?

   (e) Not unfairly disadvantaged by the treatment and conduct of directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal?

4. With respect to substantial holdings of voting securities:

   (a) Is information about the identity and holdings of persons who hold a substantial (well below controlling) beneficial ownership interest in a company required to be timely disclosed:

      (i) In public offering and listing particulars documents?

      (ii) Once the ownership threshold requiring disclosure has been reached?

      (iii) At least annually (e.g., in the issuer's annual report)?

   (b) Is it mandatory for material changes in such ownership and other required information to be disclosed in a timely manner?

   (c) Are these disclosure requirements applicable to two or more persons acting in concert even though their individual beneficial ownership might not have to be disclosed?

5. With respect to holdings of voting securities by directors and senior management:

   (a) Is information about the beneficial ownership interest and material changes in beneficial ownership in a company required to be timely disclosed?

   (b) Is such information available:

      (i) In public offering and listing particulars documents?

      (ii) At least annually (e.g., in the issuer's annual report)?

   (c) Is the legal infrastructure sufficient to ensure enforcement of and compliance with these requirements?

Cross-Border

6. If public offerings or listings by foreign issuers are significant within the jurisdiction, does the jurisdiction require disclosure in foreign issuers' offering and listing particulars documents of any governance provisions or information relating to the foreign issuer's jurisdiction that may materially affect the fair and equitable treatment of shareholders?[165]

Explanatory Notes

Concerns regarding the issues treated by this Principle often arise in connection with potentially disparate treatment of majority and minority shareholders, or takeover bids and other change in control transactions where shareholders' rights are affected.

Key Issue 1 sets forth the basic rights of shareholders which should be protected. Corporate governance may be addressed by general law, authorized exchange, or regulated trading system rules, or a code of practice as well as securities laws and regulations.[166]

The term "directors and senior management" includes (a) the company's directors, (b) members of the administrative, supervisory and management bodies, and (c) nominees to serve in any of the aforementioned positions. The persons covered by the term "administrative, supervisory or management bodies" vary in different countries, and for purposes of complying with the disclosure standards, will be determined by the host country.[167]

With respect to Key Questions 4(a)(i), 4(a)(ii), 4(a)(iii) and 4(b), practices vary among jurisdictions regarding the threshold that constitutes substantial ownership required to be disclosed (e.g., 5% or 10%) as well as the timeliness (e.g., 7 or 10 calendar or business days) and frequency of disclosure and the thresholds for, and frequency and timeliness of disclosure of, change in substantial ownership. Nevertheless, when such disclosures involve an actual or proposed change in control transaction, it is appropriate to look to the Explanatory Notes under Principle 16 for guidance regarding timely disclosure in such circumstances.

With respect to Key Questions 4(a)(i), 4(a)(ii), 4(a)(iii), 5(b)(i) and 5(b)(ii), the timeliness of the ownership disclosure called for obviously will be affected by the timeliness of filing and/or public availability of the document in which the information is included. However, the assessor also should consider whether the ownership information disclosed in such a document is as of a date reasonably close to the date of filing and/or public availability of the document.

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165 *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers,* supra, Part IX A and X A and B.

166 See also OECD's *Principles on Corporate Governance*.

167 *International Disclosure Standards for Cross-Border Offerings and Initial Listings for Foreign Issuers,* supra. Disclosure of holdings of directors and senior management in a group is sufficient in lieu of disclosure of individual holdings, provided, however, that Key Question 4 would apply regarding separate disclosure of substantial ownership interests of individual directors and senior management.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 1(c).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 1(b), 1(c), 1(g), 1(h), 3(e), 4(a)(iii), 4(c), 5(b)(ii) and 6.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a)(i), 1(a)(ii), 1(a)(iii), 1(d), 1(e), 1(f)(i), 1(f)(ii), 2, 3(a), 3(b), 3(c), 3(d), 4(a)(i), 4(a)(ii), 4(b), 5(a), 5(b)(i) or 5(c).

Principle 18 Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.

This Principle supports the objectives of investor protection and fair, efficient, and transparent markets. It does this by requiring that financial statements[168] are prepared in accordance with high quality and internationally acceptable accounting standards. Use of these standards, in turn, seeks to ensure the information provided in financial statements is comprehensive, consistent, relevant, reliable and comparable and so supports investors in making investment decisions, regardless of the geographic location of the entity concerned.[169]

Regulation should seek to ensure the following:

- Financial statements are prepared by issuers.
- Those statements are prepared in accordance with accounting standards which are of a high quality and are internationally acceptable.
- An appropriate mechanism exists for the setting of these standards for use in preparing financial statements such that where there is some dispute or uncertainty; standards can be the subject of authoritative and timely interpretation that fosters consistent application.[170]
- A regulatory framework for enforcing compliance with accounting standards.[171]

This Principle should be considered and assessed in conjunction with Principle 16, which requires full, timely, and accurate disclosure of financial information material to investment decisions. The assessor should establish under Principle 16 whether the financial statements required in public offering and listing particulars documents and periodic reports are sufficient to meet the full, accurate, and timely disclosure requirement, and then assess, under Principle 18, the quality of the accounting standards used in their preparation and verification.

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168 Financial statements provide information about the financial position, financial performance (including results of operations and cash flow) and other information (such as changes in the ownership equity of an enterprise) that is useful to a wide range of users for decision making purposes.

169 Financial statements also show the accountability of management for the resources entrusted to them.

170 See *Resolution on Harmonization of Accounting and Auditing Standards* (2) Resolution of the Presidents´ Committee of IOSCO, November 1988, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES39.pdf. See also *Resolution on IASC Standards*, Resolution of the Presidents´ Committee of IOSCO, May 2000, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES19.pdf; *Statement on the Development and Use of International Financial Reporting Standards*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD182.pdf; *Outsourcing in Financial Services*, Report of the Joint Forum, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf.

171 *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf.

In relation to Principles 16-18, assessors should assess how the Methodology applies to the set of disclosure and accounting requirements which prevail and thus have broad application in the jurisdiction in respect of public offerings, and publicly listed and traded securities. Specific accounting or disclosure requirements which apply to specialised markets or limited categories of market participants should not affect how a jurisdiction is assessed with respect to these Principles. Such differing requirements could be associated with, for example: the overall level of disclosure; individual versus consolidated financial statements; financial statement footnotes; or reporting on internal controls.

Key Issues

1. Regulation should require that issuers prepare audited financial statements in accordance with accounting standards which are of a high quality and are internationally acceptable. High quality, internationally acceptable accounting standards are essential to enhance the comparability and reliability of financial statements for informed decision-making.

2. There should be an appropriate mechanism for the setting and interpretation of high quality internationally acceptable accounting standards.

3. These high quality, internationally acceptable accounting standards should be enforceable and enforced.

Key Questions

1. Are issuers required to include audited financial statements in:

   (a) Public offering and listing documents?[172]

   (b) Publicly available annual reports?

2. Do the required audited financial statements include:

   (a) A balance sheet or statement of financial position?

   (b) A statement of the results of operations?

   (c) A statement of cash flow?

   (d) A statement of changes in ownership equity or comparable information included elsewhere in the audited financial statements or footnotes?

3. With respect to the financial statements required in public offering and listing documents and publicly available annual reports:

   (a) Are these required to be prepared and presented in accordance with a comprehensive body of accounting standards?

[172] There may be some circumstances, e.g., in a CIS that has not yet raised funds and an offering of a securitized product, where financial statements are unnecessary. In such circumstances, the regulator may require other information deemed relevant to the terms of such offerings.

(b) Do these accounting standards require financial statements to

(i) Be comprehensive?

(ii) Be designed to serve the needs of investors?

(iii) Reflect consistent application of accounting standards?

(iv) Be comparable if more than one accounting period is presented?

(c) Are the prevailing accounting standards of an internationally acceptable quality?

4. Where unaudited financial statements are used, for example, in interim reports, and interim period financial statements in public offering and listing documents, in full or summary format, are the financial statements presented in accordance with accounting standards that are of a high and internationally acceptable quality?

5. In regard to oversight, interpretation and independence with respect to accounting standards:

(a) Does the regulatory framework provide for an organization responsible for the establishment and timely interpretation of accounting standards?

(b) If yes, are the organization's processes open and transparent, and, if the organization is independent, is the standard setting or interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

6. Is there a system for enforcing compliance with accounting standards?

7. If public offerings or listings by foreign issuers are significant within the jurisdiction, does the regulator permit the use of high quality, internationally acceptable accounting standards by foreign companies that wish to list or offer securities in the country?[173]

Explanatory Notes

In order to be considered comprehensive for the purposes of Key Question 3(a), the accounting standards under which annual financial statements are prepared should require footnotes that (a) present information about the basis of preparation of the financial statements and the significant accounting polices used in preparing them, and (b) include all material information required to be disclosed by such standards that is not presented

[173] See also discussion under Principle 16 regarding timeliness and full disclosure of financial information material to investment decisions and shareholder voting decisions. See also *Resolution on IASC Standards*, Resolution of the Presidents´ Committee of IOSCO, May 2000, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES19.pdf; *Statement on the Development and Use of International Reporting Standards in 2005*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD182.pdf; *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf; and *IOSCO Statement on International Auditing Standards*, Tel Aviv, June 2009, available at https://www.iosco.org/library/statements/pdf/statements-7.pdf.

elsewhere in them.[174] The assessor should determine whether and how the standards are enforced.

The accounting standards referred to under Key Question 3 and parts of Key Question 5 need not be standards that are established or interpreted by an organization within the jurisdiction. Some jurisdictions may wish to adopt and rely upon standards established and/or interpreted by international or other standards-setting organizations. In such circumstances however, it is essential that a jurisdiction have a regulatory framework in place that provides a mechanism to ensure effective implementation and enforcement of these standards. A jurisdiction's implementation and enforcement mechanisms need not rely upon the regulator or other enforcement authorities organized within the jurisdiction; however, if third party enforcement is utilized, it is essential that the regulatory framework within the jurisdiction provides that the regulator or another body that acts in the public interest is capable of overseeing the enforcement process and ensuring that the process is binding upon companies whose securities are publicly offered or publicly traded within the jurisdiction, and external auditors practising within the jurisdiction.

In assessing whether adequate mechanisms are in place for enforcing compliance with accounting standards under Key Question 6, assessors may take into account requirements that where financial statements deviate from accepted standards they must be restated or otherwise corrected.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 5(b) and 7.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 2(c), 4, 5(b), and 7.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), 2(b), 2(d), 3(a), 3(b) 3(c), 5(a) or 6.

174 See *Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements*, Report of the Technical Committee of IOSCO, February 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD262.pdf.

F. PRINCIPLES FOR AUDITORS, CREDIT RATING AGENCIES, AND OTHER INFORMATION SERVICE PROVIDERS

1. Preamble

These principles are about information that investors may rely on when making investment decisions. They differ from the principles on issuers in that they relate to information that is not generally prepared by issuers themselves. Within modern financial markets, entities exist that analyze, evaluate, or provide assurance of information for investors about issuers, or their securities, in order to help investors with their investment decisions.

For the purposes of the IOSCO Objectives and Principles, such entities are called "information service providers". These analytical, evaluative or audit services can take the form of opinions on:

- the fair presentation or true and fair view of issuers' financial statements,
- the issuers' credit worthiness or expected financial performance, or
- other important aspects of issuers' operations, that investors consider material to making investment decisions.

Accordingly, auditors, credit rating agencies, and sell-side research analysts are covered by the Principles in this section. Other information service providers may also fall within the scope of these Principles as well.

Principles 19, 20, and 21 relate to auditors and audit standards, and are closely inter-related. They are intended to assist securities market regulatory authorities and other authorities with responsibility for auditor oversight, in developing and enhancing regulatory audit-related structures and requirements. In the jurisdictions where the securities regulator does not have primary responsibility for auditor oversight and standards, it will have an interest in promoting the existence of an oversight system that is consistent with maintaining and enhancing investor confidence in financial statements.

Comprehensiveness, consistency, relevance, reliability, and comparability of financial statements are crucial to informed decision making. Investors need credible and reliable financial statements when making decisions about capital allocations. The public's perception of the credibility of financial reporting by public issuers is influenced significantly by the perceived effectiveness of external auditors in examining and reporting on financial statements. The reliability of financial information is also enhanced by audits performed by independent auditors, who attest whether the financial statements prepared by management fairly present or provide a true and fair view of the financial position and financial performance of the issuer in accordance with the standards under which they are prepared. The audit report should give an audit opinion concerning compliance with the requirements of the accounting framework, including accounting standards and any "present fairly" or "true and fair view" requirements. Audits should be conducted in accordance with a comprehensive body of high and internationally accepted auditing standards and by auditors that are subject to effective oversight and that are independent of the entities they audit, in both fact and appearance.

Principles 22 and 23 relate respectively to Credit Rating Agencies (CRAs) and other information service providers but are not closely inter-related. CRAs can play an important role in modern capital markets by opining on the credit risk of issuers of securities and their financial obligations. Because CRAs can play an important role in securities markets, the activities of CRAs are of interest to investors, issuers, market intermediaries, and financial regulators. Securities regulators, in particular, frequently have a dual interest in the activities of CRAs, both because CRAs may have an effect on market transparency and because some jurisdictions allow CRA ratings to be used for regulatory purposes.

In addition to CRAs, other entities exist which provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. An example of one such entity that provides analytical or evaluative services is "sell-side" securities analysts employed by the research departments of full-service investment firms such as broker-dealers and investment banks who offer research to both retail and institutional investors. Such sell-side securities analysts can face conflicts of interest that may compromise their abilities to offer investors independent, unbiased opinions. Other types of entities that provide analytical or evaluative services may also face conflicts of interest as well, which may be similar or quite different, depending on the nature of the provider and/or the information services they provide.

2. Scope

Principles 19 to 21 are intended to apply to those that provide auditing services for issuers whose securities are listed, publicly offered or traded (public issuer).

Principle 22 is intended to apply to all CRAs that provide rating services in respect of issuers' securities that are sold to investors. CRAs should be subject to adequate levels of oversight, the nature of which may depend on the structure of the market, the structure of the CRA industry in a given jurisdiction, how credit ratings are used in a given jurisdiction, and the corresponding regulatory risks CRAs may pose. Where credit ratings are used for regulatory purposes in a jurisdiction, "adequate levels of oversight" will mean some form of registration and ongoing supervision.

Principle 23 is intended to apply to entities other than auditors or CRAs that also provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. This would include sell-side analysts.

3. Principles 19 through 23

Principle 19 Auditors should be subject to adequate levels of oversight.

Effective oversight of those performing audit services is critical to the reliability and integrity of the financial reporting process, and helps reduce the risks of financial reporting and auditing failures in the public securities market. The ultimate purpose of such oversight is to protect the interests of investors and further the public interest in the preparation of informative, true, fair, and independent audit reports.

There are benefits to an auditor oversight system that is not based exclusively or predominantly on self-regulation. Oversight of auditors can occur in several ways, including within audit firms, by professional organizations and public or private sector oversight bodies, and through government oversight. Within a jurisdiction, auditors should be subject to oversight by a body that acts, and is seen to act, in the public interest.[175] Regulation should, among other things, seek to ensure:

- audit work is conducted pursuant to high and internationally acceptable standards;
- rules are designed to promote the independence of the auditor;[176]
- there are mechanisms for enforcing compliance with auditing standards; and
- audits are performed with a high degree of objectivity.[177]

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175 See Introduction to *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf.

176 *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf. See also *IOSCO Statement on International Auditing Standards*, November 2007; *Survey Report on Regulation and Oversight of Auditors*, Report of the Technical Committee and Emerging Markets Committee of IOSCO, April 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD199.pdf; *Issuer Internal Control Requirements – A Survey*, Report of the Technical Committee and Emerging Markets Committee of IOSCO, December 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD229.pdf; *Survey on the Regulation of Non-Audit Services Provided by Auditors to Audited Companies*, Summary Report of the Technical Committee and Emerging Markets Committee of IOSCO, January 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD231.pdf; and *Board Independence of Listed Companies*, Final Report of the Technical Committee of IOSCO in consultation with the OECD, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf.

177 See also *Survey Report on Regulation and Oversight of Auditors*, Report of the Technical Committee and Emerging Markets Committee of IOSCO, April 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD199.pdf.

Key Issues

1. Auditors should be subject to oversight by a body that acts, and is seen to act, in the public interest. While the nature of an auditor oversight body and the process through which it carries out its activities may differ among jurisdictions, effective oversight generally includes the following mechanisms or processes that:[178]

   (a) Require that the auditors have proper qualifications and professional competency before being licensed to perform audits.

   (b) Withdraw authorization to perform audits if proper qualifications and competency are not maintained.

   (c) Require that auditors are independent of the enterprises they audit, both in fact and in appearance.

   (d) Provide oversight over the quality of auditing, and implementation of auditing, independence and ethical standards, as well as quality control environments.[179]

   (e) Require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if the professional body acts as the oversight body, is overseen by an independent body.

   (f) Require that regular reviews be conducted by the auditor oversight body of audit procedures and practices of firms that audit the financial statements of public issuers. Reviews should be conducted on a recurring basis, and should be designed to determine the extent to which audit firms have and adhere to adequate quality control policies and procedures that address all significant aspects of auditing.

   (g) An auditor oversight body should also address other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients, consulting and other non-audit services, and other matters as deemed appropriate.

   (h) An auditor oversight body should have the authority to stipulate remedial measures for problems detected, and to initiate and/or to carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.

Key Questions

1. Does the regulatory system provide a framework for overseeing the quality and implementation of auditing, independence, and ethical standards, including the quality control environments in which auditors operate?

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178 See *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf.

179 See also *Board Independence of Listed Companies*, Final Report of the Technical Committee of IOSCO in consultation with the OECD, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf.

2. Are auditors required to be qualified and competent pursuant to minimum requirements before being licensed to perform audits, and to maintain professional competency?

3. Is there an oversight body that operates in the public interest, has an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding, such that the oversight responsibilities are carried out in a manner independent of the auditing profession?

4. Does the auditor oversight body have an established process for performing regular reviews of audit procedures and practices of firms that audit financial statements of public issuers?

5. Are there standards and processes for regular assessments by the oversight body to assess whether the auditor is and remains independent, both in fact and in appearance, of the enterprises that it audits?

6.

   (a) If the oversight process is performed in coordination with similar quality control mechanisms that are in place within the audit profession, does the oversight body: maintain control over key issues such as, the scope of reviews, access to, and retention of, audit work papers and other information needed in reviews; and follow up the outcome of reviews?

   (b) Are reviews conducted on a recurring basis, and designed to determine the extent to which audit firms have, and adhere to, adequate quality control policies and procedures that address all significant aspects of auditing?

7. Does the auditor oversight body have the authority to stipulate remedial measures for problems detected, and to initiate, and/or carry out, disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate?

Explanatory Notes

Oversight of auditors can occur in several ways, including within audit firms; by professional organizations; by public or private sector oversight bodies; or through government oversight.

The use of the term "oversight body" should be interpreted broadly. In some jurisdictions, there is a specific organization that is charged to act in the public interest to oversee auditors and which has been granted certain powers, including rule-making authority, as well as the power to carry out inspections and discipline auditors. In other jurisdictions, there may be two or more organizations that share responsibility for fulfilling the same objectives. Regardless of the structure, the auditor oversight framework should not be based exclusively or predominantly on self-regulation. A mechanism should exist to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body.

The "significant aspects of auditing" referred to in Key Question 6(b) include:

- Independence, integrity and ethics of auditors.
- Objectivity of audits.

- Selection, training, and supervision of personnel.
- Acceptance, continuation, and termination of audit clients.
- Audit methodology.
- Audit performance (i.e., compliance with applicable generally accepted auditing standards).
- Consultation on difficult, contentious, or sensitive matters and resolution of differences of opinion during audits.
- Second partner reviews of audits.
- Communications with management, supervisory boards, and audit committees of audit clients.
- Communications with bodies charged with oversight over the financial reporting process.
- Provisions for continuing professional education.
- Professional competency.
- Rotation of audit personnel.
- Employment of audit personnel by audit clients.
- Consulting and other non-audit services.[180]

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to 6(b).

Partly Implemented

Requires affirmative responses to all applicable Questions except to 4 and 6(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3, 5, 6(a) or 7.

[180] See *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, p.4, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf.

Principle 20 Auditors should be independent of the issuing entity that they audit

Independent auditors play a critical role in enhancing the reliability of financial information by attesting as to whether the financial statements prepared by management fairly present, or provide a true and fair view of, the financial condition and past performance of the issuer in compliance with accepted standards.

An external auditor plays a critical role in lending independent credibility to published financial statements used by investors, creditors, and other stakeholders as a basis for making capital allocation decisions. The public's perception of the credibility of financial reporting by public issuers is influenced significantly by the perceived effectiveness of external auditors in examining and reporting on financial statements. A fundamental element of this public confidence is that external auditors operate, and are seen to operate, in an environment that supports objective decision-making on key issues having a material effect on financial statements. For this to happen, auditors must be independent of the entities they audit, in both fact and appearance.

Standards of independence for auditors of public issuers should be designed to promote an environment in which the auditor is free of any influence, interest, or relationship that might impair professional judgment or objectivity or, in the view of the reasonable investor, might impair professional judgment or objectivity. Robust independence standards that are consistently applied and enforced are a necessary element in reassuring the investing public that auditors are in a position to exercise objective judgment in concluding on management's representations in an entity's financial statement.[181]

Key Issues

1. The regulatory framework should be designed to foster auditor independence and oversight of an auditor's independence.

2. Standards of external auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, which address at least the following threats to independence:

   (a) self-interest;

   (b) self-review;

   (c) advocacy;

   (d) familiarity; and

   (e) intimidation.

[181] See *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf.

3. Independence should include appropriate rotation of the auditor and/or the audit engagement team, such that senior member(s) of a team do not remain in key decision-making positions for an extended period.

4. In case of public issuers, regardless of the particular legal structure in a jurisdiction, a governance body that is in both appearance and fact independent of management of the company being audited (e.g., audit committee, board of corporate statutory auditors or other body independent of the entity's management) should oversee the process of selection and appointment of the external auditor.

5. Prompt disclosure to the public should be required when an auditor of a public issuer is replaced.

6. The governance structure of public issuers should contribute to the monitoring and safeguarding of the independence of its external auditor.

Key Questions

1. Does the regulatory framework set standards for the independence of external auditors?

2. Do the standards contain restrictions relating to audit firms and individuals within the audit firm regarding financial, business or other relationships with an entity that the firm audits?

3. Do the standards address the following:

   (a) self-interest?

   (b) self-review?

   (c) advocacy?

   (d) familiarity?

   (e) intimidation?

4. Are there regulatory standards that govern the provision of non-audit services to an entity that an audit firm audits?

5. Are auditors required to establish and maintain internal systems, governance arrangements, and processes for monitoring, identifying and addressing threats to independence, including the rotation of auditors and/or senior member(s) of the audit engagement team, and ensuring compliance with the standards?

6. From the perspective of public issuers:

   (a) Is the external auditor required to be independent in both fact and appearance of the entity being audited?

   (b) Is there a governance body independent in both fact and appearance of the management of the entity (e.g., audit committee, board of corporate statutory auditors or other body independent of the entity's management) that oversees the process of selection and appointment of the external auditor?

(c) Are governance standards intended to promote and contribute to the monitoring and safeguarding of the independence of the external auditor?

(d) Is prompt disclosure of information about the resignation, removal, or replacement of an external auditor required?

7. Is there an adequate mechanism in place for enforcing compliance with auditor independence standards, for example: to stipulate remedial measures for problems detected and to initiate and carry out disciplinary proceedings to impose sanction on auditors and audit firms as appropriate; to refuse to accept, or require revision of, audit reports; or for lack of independence?

Explanatory notes

When considering how the regulatory framework is designed to address auditor independence and adequate oversight of an auditor's independence, the following more specific points are relevant:

- Standards of independence should identify appropriate measures that the auditor should implement in order to address any threats to independence that arise within permissible activities and relationships.
- Standards of independence should be supported by rigorous requirements for audit firms to establish and maintain internal systems and processes for monitoring, identifying, and addressing threats to independence and ensuring compliance with relevant standards, regulations, prohibitions and restrictions.
- Standards of independence should require the auditor to identify and evaluate all significant, or potentially significant, threats to independence, including those arising from recent relationships with the entity being audited that may have preceded the appointment as auditor, and demonstrate how the auditor has addressed such significant threats.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to 5.

Partly Implemented

Requires affirmative responses to all applicable Questions except to 4 and 5.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3(a), 3(b), 3(c), 3(d), 3(e), 6(a), 6(b), 6(c), 6(d) and 7.

Principle 21 Audit standards should be of a high and internationally acceptable quality

High quality auditing standards help safeguard the integrity of an issuer's financial statements. Auditing standards are necessary safeguards of the reliability of financial information, such standards should be comprehensive, well-defined and of a high and internationally acceptable quality. They are a necessary counterpart to high quality and internationally accepted accounting standards and their application in audits contributes to providing investors with accurate and relevant information on financial performance.

Regulation regarding audit standards should require:

- An independent verification of financial statements and compliance with accounting principles through professional external auditing.
- An appropriate mechanism for the setting of quality standards and to ensure that where there is some dispute or uncertainty, standards can be the subject of authoritative and timely interpretation that is consistently applied.
- Any audit is conducted pursuant to standards of a high and internationally acceptable quality.

Key Issues

1. Regulation should require that financial statements prepared by public issuers be audited in accordance with a comprehensive set of auditing standards.
2. Such auditing standards should be of high and internationally acceptable quality in order to contribute to the quality of financial reporting and reliability of financial information, and thereby support investor confidence and decision-making.
3. There should be an appropriate mechanism for the setting and interpretation of the auditing standards.
4. There should be a regulatory framework for enforcing compliance with auditing standards.

Key Questions

1. Does the regulatory framework require that financial statements included in public offering and listing particulars documents, and publicly available annual reports, be audited in accordance with a comprehensive set of auditing standards?
2. Are the prevailing auditing standards of a high and internationally acceptable quality?

3.

(a) Does the regulatory framework provide for an organization responsible for the establishment and timely updating of auditing standards?

(b) If yes, are the organization's processes open, transparent and subject to public oversight, and, if the organization is independent, is the standard setting and interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

4. Is there an adequate mechanism in place for enforcing compliance with auditing standards?

Explanatory notes

This Principle should be considered and assessed in conjunction with Principle 16, which requires full, timely, and accurate disclosure of financial information material to investment decisions, and Principle 18, which requires the use of accounting standards of a high and internationally acceptable quality. The assessor should establish under Principles 16 and 18 whether the financial statements required in public offering and listing particulars documents, and periodic reports are sufficient to meet the full, accurate, and timely disclosure requirement, and then assess, under Principle 21, the auditing standards used in their verification.

The auditing standards referred to above need not be standards that are established or interpreted by an organization within the jurisdiction. Some jurisdictions may wish to adopt and rely upon standards established and/or interpreted by international or other standards-setting organizations.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 3(b).

Partly Implemented

Requires affirmative responses to all applicable Questions except to 3(a) and 3(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2 or 4.

Principle 22	**Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.**

Credit rating agencies (CRAs) can play an important role in modern capital markets. CRAs typically opine on the credit risk of issuers of securities and their financial obligations. Given the vast amount of information available to investors today – some of it valuable, some of it not – CRAs can play a useful role in helping investors and others sift through this information, and analyze the credit risks they face when lending to a particular borrower or when purchasing an issuer's debt and debt-like securities.

Because CRAs can play an important role in securities markets, the activities of CRAs are of interest to investors, issuers, market intermediaries, and financial regulators. Securities regulators, in particular, frequently have a dual interest in the activities of CRAs, both because CRAs may have an effect on market transparency and because some jurisdictions allow CRA ratings to be used for regulatory purposes.

Because CRAs can play an important role in helping market participants incorporate into their decision-making voluminous, diverse, and highly complicated information about a particular investment, regulators, market participants and CRAs themselves have an interest in ensuring that CRAs carry out this role in an honest and fair manner. Where credit ratings are used for regulatory purposes – for example, permitting regulated entities to use ratings of a security as part of a net capital assessment, or requiring that fund managers only include securities rated above a certain level in some types of funds – the regulator's interest in the activities of these CRAs may be even greater.

Accordingly, CRAs should be subject to adequate levels of oversight, the nature of which depends on:

- the structure of the market;
- the structure of the CRA industry in a given jurisdiction;
- how credit ratings are used in a given jurisdiction; and
- the corresponding regulatory risks CRAs pose.

Where credit ratings are used for regulatory purposes in a jurisdiction, "adequate levels of oversight" of the CRA issuing those ratings will mean some form of registration and ongoing supervision albeit, as noted below, not necessarily by the regulator in whose jurisdiction the ratings are used.

Key Issues

1. IOSCO has developed a Statement of Principles Regarding the Activities of Credit Rating Agencies (CRA Principles), which are designed to "be a useful tool for securities regulators, CRAs, and others wishing to improve how CRAs operate and how the opinions CRAs assign are used by market participants."[182] To take into account the varying size and business models of CRAs, the manner in which the principles were to be implemented was left open. The CRA Principles contemplate that a variety of mechanisms could be used, including both market mechanisms and regulation. Following publication of the CRA Principles, some commentators, including a number of CRAs, suggested that it would be useful if IOSCO were to develop a more detailed and specific code of conduct to provide guidance to CRAs for implementing the objectives of the CRA Principles. In response, IOSCO developed a *Code of Conduct Fundamentals for Credit Rating Agencies* (the "IOSCO Code") to which IOSCO Technical Committee members expect CRAs will give full effect.[183] As with the CRA Principles, the IOSCO Code is not designed to be rigid or formulaic, and is designed to offer CRAs a degree of flexibility in how its measures are incorporated into their individual codes of conduct, according to each CRA's specific legal and market circumstances. The IOSCO Code calls for CRAs to disclose how each provision of the IOSCO Code is adopted in the CRA's own code of conduct, explain if and how their own codes deviate from the IOSCO Code, and how such deviations nonetheless achieve the objectives set forth in the CRA Principles and IOSCO Code.

2. The IOSCO CRA Principles and the IOSCO Code "articulate four objectives that CRAs, regulators, issuers and other market participants should strive to achieve."[184] The four objectives are designed to encourage the adoption of procedures and mechanisms that promote:

   (a) the quality and integrity of the rating process;

   (b) CRA independence and avoidance of conflicts of interest;

   (c) providing investors with timely information about, and the procedures, methodologies and assumptions, behind a rating; and

   (d) the protection of non-public information from premature disclosure or use by the CRA or its employees that is unrelated to a CRA's rating activities.

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182 *IOSCO Statement Of Principles Regarding The Activities Of Credit Rating Agencies*, Statement of the Technical Committee of IOSCO, September 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf.

183 *Code of Conduct Fundamentals for Credit Rating Agencies*, Report of the Technical Committee of IOSCO, December 2004 (Revised May 2008), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf.

184 *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies*, Final Report, Report of the Technical Committee of IOSCO, February 2011 (the "2011 IOSCO CRA Regulatory Implementation Report"), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD346.pdf.

3. An oversight regime designed to achieve these objectives may take many different forms. In some cases, a jurisdiction may decide that these objectives may be best implemented through internal CRA mechanisms and promoted by borrowers, lenders and other market participants. In other cases, a jurisdiction may decide that the objectives may be best achieved through regulatory requirements. As a result, mechanisms for implementing the objectives may take the form of any combination of:

   (a) government regulation;

   (b) regulation imposed by non-government statutory regulators;

   (c) industry codes; and

   (d) internal rating agency policies and procedures.

4. Where a CRA's ratings are used for regulatory purposes, however, the regulatory system should establish mechanisms that seek to achieve the above objectives through registration and oversight requirements that impose binding and enforceable obligations on CRAs.

Key Questions

Registration:

1.

   (a) Does the jurisdiction have a definition of "credit rating" and/or "credit rating agency" or otherwise define a scope of activities for the purpose of imposing registration and supervision requirements on entities that engage in the business of determining and issuing credit ratings that are used for regulatory purposes?

   (b) Are CRAs located in the jurisdiction and whose ratings are used for regulatory purposes in the jurisdiction subject to registration ("regulated CRAs")?

   (c) Do the jurisdiction's registration requirements provide the regulator with the ability to obtain all information it deems necessary from a CRA seeking registration in order to determine whether the requirements for registration have been fulfilled?

   (d) If a CRA's ratings are used for regulatory purposes but the CRA itself is not located in the regulator's market and the regulator does not require registration or oversight of the CRA in question, has the regulator made a reasonable judgment to ensure that the CRA is subject to registration and oversight as required by Principle 22?

Ongoing Supervision:

2.

   (a) Do the jurisdiction's requirements provide the regulator with the ability to obtain all information about a regulated CRA that the regulator deems necessary to perform adequate oversight of the regulated CRA?

(b) Are CRAs whose ratings are used for regulatory purposes in the jurisdiction, and who are located in the jurisdiction:

(i) supervised on an ongoing basis;

(ii) subject to examination by the regulator; and

(iii) subject to enforcement of the jurisdiction's requirements?

Registering Authority:

3. Does the regulator have the power to:

(a) Refuse to register a CRA if the registration requirements have not been met, and to withdraw, suspend or condition a registration or authorization in the event of a failure of a regulated CRA to meet relevant requirements?

(b) Impose adequate measures and sanctions to address a failure of a regulated CRA to meet relevant requirements?

Oversight Requirements: Quality and Integrity

4. Does oversight of regulated CRAs incorporate requirements that address whether:

(a) Regulated CRAs adopt and implement written procedures and methodologies designed to ensure that:

(i) they issue initial credit ratings based on a fair and thorough analysis of all information known to the CRA that is relevant to its analysis according to the CRA's published rating methodology; and,

(ii) except for credit ratings that clearly indicate they do not entail ongoing surveillance, the regulated CRA updates credit ratings as new information becomes available in accordance with the regulated CRA's published rating methodology for monitoring credit ratings?

(b) Regulated CRAs maintain internal records to support their credit ratings?

(c) Regulated CRAs have sufficient resources to carry out high-quality credit assessments?

Oversight Requirements: Conflicts of Interest

5. Does oversight of regulated CRAs incorporate requirements that address whether:

(a) Regulated CRA credit rating decisions are independent and free from political or economic pressures and from conflicts of interest arising due to the regulated CRA's ownership structure, business or financial activities, securities or derivatives trading, or the financial interests of the regulated CRA's employees (including securities and derivatives trading by the employees and their compensation arrangements)?

(b) Regulated CRAs (1) identify, and (2) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence:

(i) the opinions and analyses regulated CRAs make; or

(ii) the judgment and analyses of the individuals the regulated CRAs employ, who have an influence on ratings decisions?

(c) Regulated CRAs disclose actual and potential conflicts of interest arising from the nature of compensation arrangements for producing credit ratings?

Oversight Requirements: Transparency and Timeliness

6. Does oversight of regulated CRAs incorporate requirements that address whether:

(a) Regulated CRAs distribute their credit ratings in a timely manner?

(b) Regulated CRAs disclose credit ratings on a non-selective basis?

(c) Regulated CRAs publish sufficient information about their procedures, methodologies, and assumptions, so that outside parties can understand how a rating was arrived at by the regulated CRA, and the attributes and limitations of such a rating?

(d) Regulated CRAs publish sufficient information about the historical default rates of their credit ratings, so that interested parties can understand the historical performance of their credit ratings?

Oversight Requirements: Confidential Information

7. Does oversight of regulated CRAs incorporate requirements that address whether CRAs protect non-public information:

(a) provided by issuers so that such information is only used for the purposes related to their rating activities; and

(b) with respect to pending rating actions?

Explanatory Notes

CRAs vary considerably in their size, scope of operations, and business models. Depending on these factors, not all regulatory issues may be present in every jurisdiction, and regulators should be afforded flexibility when assessing the regulatory issues CRAs raise in their own markets. Regulators also approach the regulatory issues raised by CRAs in different ways, with (for example) some approaching oversight of CRAs as a natural or de facto oligopoly that is regulated in a fashion similar to a "utility," while others may emphasize increasing competition in the CRA market. The approaches chosen by regulators may have an effect on the emphasis they place on the different regulatory issues outlined above.

Legal systems vary in structure and specific provisions throughout the jurisdictions. However, they embed in varying degrees of implementation measures in order to achieve the objectives of the four IOSCO CRA Principles (quality and integrity of the ratings process, management of conflicts, transparency, and treatment of confidential information).

In respect of Key Questions 4 - 7, there may be different ways of ensuring that these Questions can be answered affirmatively.[185] For example, regulated CRAs may be subject to: regulatory provisions on the national level that set forth the objectives themselves; conditions to become registered, or maintain registration, that promote the objectives; requirements to establish policies and procedures designed to achieve the objectives; or disclosure requirements that promote the objectives.[186]

In respect of Key Question 1(d), given the structure of the global CRA industry at the time of adoption of this methodology, there will be jurisdictions where credit ratings are used for regulatory purposes where the relevant CRA is located (in the sense of physical presence) in a different jurisdiction. In such cases, steps may have been taken to reduce the use of such credit ratings for regulatory purposes. Where the use of credit ratings for regulatory purposes has not been eliminated, the regulator should be able to demonstrate that it has made a reasonable judgment not to register or oversee the CRA, based on factors such as:

- the activities of the CRA in the jurisdiction;
- the regulatory arrangements in the home jurisdiction.

Alternatively, in place of a registration requirement, the regulator may impose some oversight or reporting requirements and make arrangements for supervisory cooperation with the regulator which registers the CRA.

In respect of Key Question 4(c), regulated CRAs should have sufficient resources to determine credit ratings according to their published and documented ratings methodologies, including sufficient personnel to properly assess the entities they rate, seek out information they need in order to make an assessment, and analyze all the information relevant to their decision-making processes.

In respect of Key Question 6(b), the non-selective disclosure of credit ratings means the disclosure of credit ratings consistent with the regulated CRA's business model. For example, a regulated CRA operating under the subscriber-pay model may disclose its credit ratings only to persons who pay to access the credit ratings.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except for Questions 4(a), 4(c), 5(c) and 6(a).

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185 The Key Questions are based on the principles set forth in the CRA Principles. The *2011 IOSCO CRA Regulatory Implementation Report* describes the implementation undertaken in regulatory programs in various, different jurisdictions in order to give effect to the IOSCO CRA Principles.

186 See *2011 IOSCO CRA Regulatory Implementation Report*.

Partly Implemented

Requires affirmative responses to all applicable Questions except for Questions 1(c), 4(a), 4 (b), 4(c), 5(c), 6(a), 6(b), 6(c), 6(d), 7(a), and 7(b).

Not Implemented

Inability to respond affirmatively to one or more of the following Questions: 1(a), 1(b), 1(d), 2(a), 2(b), 3(a), 3(b), 5(a), or 5(b).

Principle 23	**Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.**

Objective

In many markets, entities exist which provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. Depending on the degree to which the regulatory system relies on them, or the impact their activities have on the market, such entities may need to be subject to regulation or oversight. An example of one such entity that provides analytical or evaluative services is "sell-side" securities analysts employed by the research departments of full-service investment firms (such as broker-dealers and investment banks) who offer research to both retail and institutional investors. Such sell-side securities analysts can face conflicts of interest that may compromise their ability to offer investors independent unbiased opinions. Other types of entities that provide analytical or evaluative services may also pose risks to the users of these services, or to the integrity of the market, and therefore may warrant oversight and regulation. Oversight and regulation of these entities may also be warranted if the regulatory system relies on the services they provide.

Key Issues

1. Entities that provide analytical or evaluative services to investors, such as sell-side securities analysts, provide investors with valuable insights by distilling the wide range of information that is available to the markets. IOSCO has recognized that "sell-side" securities analysts, in particular, can face conflicts of interest that may compromise their ability to offer investors independent unbiased opinions. Biased research can harm investors and undermine the fairness, efficiency and transparency of the markets. Because of concerns that sell-side securities analyst conflicts of interest pose problems for investor protection and market integrity, IOSCO has developed principles regarding sell-side securities analyst conflicts of interest.[187]

2. Among the principle regulatory concerns regarding sell-side securities analysts, is the opportunity for fraud and deception, but also the risks posed to investors by hidden conflicts of interest.

3. The key issues the regulator should consider when determining whether entities that provide analytical or evaluative services should be subject to oversight and regulation include:

   (a) the type of analytical or evaluative services that these entities provide;

[187] See *IOSCO Statement of Principles for Addressing Sell-Side Analyst Conflicts of Interest*, Report of the Technical Committee of IOSCO, September 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf.

(b) the impact of their services on a given market with regard, in particular, to the potential risks that their activities pose to the users of these services or to the integrity of the market, specifically with respect to potential conflicts or the integrity of the service;

(c) whether the services offered by these entities are relied on for regulatory purposes and, if so, to what degree; and

(d) where the regulator determines that the services provided by a type of entity have enough impact on the market to warrant oversight, whether, and to what extent, regulation or oversight is necessary to help address identified risks.

Key Questions

1. Does the regulator periodically consider whether the different types of entities that provide analytical or evaluative services warrant regulation and oversight because of the impact of their activities on the market or because of the degree to which the regulatory system relies on them?

2. Where the regulator identifies the need for regulation and oversight, is the regulation and oversight put into place appropriate to the risks posed by these types of entities?

3. With respect to sell-side securities analysts:

   (a) Does regulation contain provisions directed at eliminating, avoiding, managing or disclosing conflicts of interest that can arise from:

      (i) Analysts' trading activities or financial interests?

      (ii) The trading activities or financial interests of the entities that employ them?

      (iii) The business relationships of the entities that employ them?

      (iv) The reporting lines for analysts and their compensation arrangements?

   (b) Does regulation contain provision directed at an entity's compliance systems and senior management responsibility:

      (i) Requiring written internal procedures or controls to identify and eliminate, manage or disclose actual and potential analyst conflicts of interest?

      (ii) Requiring procedures to eliminate or manage the undue influence of issuers, institutional investors and other outside parties upon analysts?

      (iii) Requiring complete, timely, clear, concise, specific, and prominent disclosures of actual and potential conflicts of interest?

(c) Does regulation contain provisions directed at integrity and ethical behaviour, such as requiring analysts, and/or the firms that employ analysts, to act honestly and fairly with clients?[188]

Explanatory Notes

The entities that could be covered by this principle could be quite broad. Jurisdictions will vary considerably in their assessments of the risks posed by different types of entities that provide analytical or evaluative services, and even in their determination of what type of entity would fall within this principle. Furthermore, depending on the jurisdiction's laws, some entities that provide analytical or evaluative services may be regulated by bodies other than the securities regulator. Likewise, some jurisdictions may restrict the authority of the government to regulate certain types of entities that provide analytical or evaluative services if the services they provide are viewed as particularly critical (possibly with laws against fraud rather than regulation used to shield against egregious conflicts of interest or deception).[189] These differences in approach to regulating such entities should be deemed acceptable.

With regard to Key Questions 1 and 2, to date, the only entities offering investors analytical or evaluative services that IOSCO's Technical Committee have identified, and for which it has developed principles or standards, are sell-side securities analysts.

There is overlap between Principle 23 and both Principle 7 (Perimeter of Regulation) and Principle 8 (Conflicts of Interest). Principle 23 can be viewed as a subset of both Principle 7 and Principle 8, insofar as conflicts of interest and other potentially problematic practices by information service providers can pose particular risks to investor protection and market integrity. Consequently, it is possible that a regulator addresses Principle 23 through its general review of the perimeter of regulation and conflicts of interest in the market.

There is also overlap between Principle 23 and Principle 7 insofar as the regulator does not have the legal authority to regulate an information service provider that it identifies as presenting a significant risk to the market's integrity. In such cases, Principle 7 is more applicable insofar as the regulator identifies the risk, and legislative authority to address it is sought.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

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188 Assessors should recognize that issues relating to ethics and integrity can be addressed by a variety of mechanisms, including "fit and proper" requirements, statutory disqualification, industry and SRO codes of conduct, etc.

189 For example, laws protecting freedom of the press or freedom of speech may limit the degree to which some entities are regulated in some jurisdictions.

Broadly Implemented

Requires affirmative responses to all applicable Questions, except 3(c).

Partly Implemented

Requires affirmative responses to all applicable Questions, except 3(b)(iii) and 3(c).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2 (where relevant because of the outcomes of the review in Question 1) and 3(a), 3(b)(i), and 3(b)(ii).

G. PRINCIPLES RELATING TO COLLECTIVE INVESTMENT SCHEMES AND HEDGE FUNDS

1. Preamble

Principles 24 to 27 relating to Collective Investment Schemes

The legal form taken by Collective Investment Schemes (CIS) varies between jurisdictions, but in all jurisdictions they play an important role, channelling resources to the securities markets and offering investors a means to achieve diversified exposure to investment opportunities. To the extent that investors place their money in CIS, appropriate regulation is increasingly important.

Proper regulation of CIS is critical to the objectives of investor protection and the preservation of confidence in the market.

CIS, like other investment vehicles, are subject to disclosure requirements.[190] However, investors in CIS rely upon operators of the CIS to manage the CIS and its investment portfolio and to act in their best interests. CIS are widely marketed to retail investors, who may place enhanced reliance on CIS operators and, therefore, may be vulnerable to misconduct by CIS operators. Regulation should promote and ensure a high level of compliance by entities involved in CIS operations.

Regulation of CIS should cover:

- the eligibility, governance, organization and operational conduct of the CIS operator;
- adherence to the terms of the prospectus and other constituent documents;
- the proper safekeeping of investors' funds and the assets of the CIS,

but not the wisdom of investment decisions (where these are within the terms of the constituent documents).

Supervision should seek to ensure that the assets of a CIS are managed in the best interests of its investors, and in accordance with the CIS objectives and the regulation to which it is subject. This will include:

- ensuring promotion of high standards of competence, integrity and fair dealing;
- that the assets are held in safekeeping on behalf of investors; and
- having mechanisms in place to confirm that the investments of the CIS are valued properly.

[190] Principles 16 to 18 and Principle 26; *Fees and Commissions within the CIS and Asset Management Sector: Summary of Answers to Questionnaire*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD157.pdf; *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD158.pdf.

Supervision of a CIS operator in this regard includes oversight of arrangements to ensure that investors are exposed to a level of risk that is consistent with the CIS' objectives, as well as to ensure that any regulatory minimum level of diversification is maintained.[191]

Principle 28 relating to Hedge Funds

Historically, IOSCO has not included hedge funds within the definition of CIS.[192] This approach recognizes the different ways in which IOSCO Members regulate hedge funds and that hedge funds traditionally have been offered to institutional or other sophisticated investors. Some IOSCO members regulate hedge funds as CIS and therefore apply some or all CIS Principles in the hedge fund field, while others do not. Therefore, Principle 28 deals separately with hedge funds.

Hedge funds play an important role in global capital markets. They can provide price efficiency, and risk distribution, can contribute to the further global integration of financial markets, and can offer diversification benefits. They are a source of continuous product change and innovation, potentially enhancing the liquidity and resilience of financial systems worldwide.[193]

Hedge funds may however pose a number of risks to market integrity, investor protection, and financial stability. This may be the result of different factors, including a lack of transparency regarding the fund, its strategy and asset allocation; conflicts of interest between fund managers and other market participants[194] and difficulties in valuing complex financial instruments employed or held by hedge funds.

Potential risks posed by hedge funds are magnified when financial markets are suffering from stress or instability. Hedge funds may use leverage and, should a problem arise, the concentrated unwinding of their positions could cause major dislocation and potential disorderly pricing of markets. Failures in hedge funds may have a contagion effect on the wider market through the banks/prime brokers that they use as counterparties. They may increase systemic risks and directly impact on the real economy through disruptions to payment and clearing services.

Potential risks posed by hedge funds need to be mitigated through appropriate oversight of hedge funds and/or hedge funds managers/advisers. Regulatory oversight should be more focused on systemically important and/or higher risk hedge fund managers in a risk based manner.

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191 *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf.

192 See, e.g., *The Regulatory Environment for Hedge Funds – a Survey and Comparison* (comparing hedge funds to "other types of funds, such as collective investment schemes"), Final Report, Report of the Technical Committee of IOSCO, November 2006, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD226.pdf.

193 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf; *Hedge Funds Oversight*, Consultation Report, Report of the Technical Committee of IOSCO, March 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD288.pdf; *Principles for the Valuation of Hedge Fund Portfolios*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD253.pdf.

194 See *Hedge Funds Oversight*, Consultation Report, Report of the Technical Committee of IOSCO, March 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD288.pdf.

2. Scope

Taking into account the different approaches mentioned in the Preamble above, separate principles have been established by IOSCO for the assessment of the regulation of CIS and the regulation of hedge funds and/or hedge fund managers/advisers.

Principles 24 to 27 relating to Collective Investment Schemes

Principle 24 requires regulation to set standards for those involved in the operation of a CIS and marketing CIS interests; Principle 25 is mainly devoted to client assets protection; Principle 26 addresses CIS focused-disclosure requirements; and Principle 27 deals with the issues of asset valuation and pricing and redemption of CIS units/shares.

Principles 24 to 27 are interrelated and complement each other and should be appropriately implemented to seek to ensure proper investor protection. In addition, assessment under Principle 26, dealing with disclosure, should be consistent with, and/or compared to, the assessment of disclosure obligations as set forth under the Principles for issuers.[195]

The term "CIS operator" is intended as the legal entity that has overall responsibility for management and performance of the functions of the CIS, which may include managing the CIS portfolio of assets and operational services.[196]

The term "CIS" includes open-ended funds that will redeem their units or shares (whether on a continuous or periodic basis). It also includes closed-ended funds whose shares or units are traded on regulated or organised markets. The rules governing the legal form and structure of CIS vary across jurisdictions.

In some jurisdictions, closed-ended funds are not subject to special licensing or supervisory requirements and are, instead, regulated according to the terms of relevant exchange listing rules. If this is the case in the assessed jurisdiction, the situation should be duly accounted for, and a detailed explanation and assessment of the applicable listing rules should be undertaken taking into account the investor protection objectives of the Key Issues in this section.

In many jurisdictions, the requirements relating to CIS vary according to whether the CIS is offered to the public. In fact, most jurisdictions tend to reduce regulatory oversight in relation to private placements. The definition of what amounts to an offer to the public varies. The assessor should not attempt to substitute his or her judgment for what constitutes a public offering but should indicate: which offerings are included and subject to the full panoply of requirements; and how regulatory oversight is different for private placements or non-retail offerings. The assessor should explain the differences in treatment and assess the consequences from an investor protection viewpoint, investor protection being the main objective of the CIS Principles.

Where appropriate, the assessor should make reference to the assessment of Principle 7.

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195 Principles 16 to 18.

196 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, 'Glossary of Terms', available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

PRINCIPLES RELATING TO COLLECTIVE INVESTMENT SCHEMES AND HEDGE FUNDS

An increasing number of CIS are marketed across jurisdictional boundaries. It is also common for CIS promoters, managers and custodians to be located in several different jurisdictions and not the same jurisdiction as investors to whom the CIS is promoted. Therefore, particular attention should be paid to the possible need for international cooperation and the interrelation with Principles 13, 14, and 15 relating to cooperation.

The assessor should determine the type and complexity of CIS in the jurisdiction, the number of CIS in existence, the assets under management, the types of permitted investments and level of gearing or leverage to gauge the regulatory challenge. It is possible that a specific jurisdiction will not have its own framework for the establishment of CIS. If a jurisdiction does not have its own CIS regulatory framework, it may not wish to admit offerings that do not meet the basic requirements as to legal format in these Principles. To the extent CIS established under other jurisdictions' laws, however, may be offered, the assessor should consider whether:

- the entity engaged in marketing should be authorized, recognized or otherwise eligible (Principle 24);
- there are requirements concerning the public offer of CIS products (Principles 24, 26 and 27);
- there is adequate information sharing between the jurisdictions of establishment and the jurisdiction being assessed.

The greater the level of CIS activity in a particular jurisdiction, the more likely it is that the principle (Principles 24 through 27) should be rated as *Not Implemented* rather than *Not Applicable* if no requirements are applied to cross-border business.

Securities law and regulation cannot exist in isolation from the other laws of a jurisdiction. Matters of particular importance to the legal framework in general are set out in Appendix 1. To determine whether Principles 24, 25, 26 and 27 are implemented in a manner that achieves their objectives, it is therefore necessary to consider the jurisdiction's legal framework in that regard and, in particular, laws and regulations on insolvency (having an impact on the treatment of CIS in default), as well as laws and regulations on dispute resolution mechanisms or other remedies (having an impact on investors' ability to seek redress or compensation).

Principle 28 relating to hedge funds

Principle 28 is the only principle of this section applicable to the assessment of hedge fund regulation. IOSCO acknowledges that there is no consistent or agreed-upon definition of the term "hedge fund". Previous IOSCO work recognized that an approach for identifying these types of entities is to look at the kinds of characteristics of, and strategies employed by, institutions that would consider themselves to be hedge funds. On this basis, IOSCO has considered as "hedge funds" investment schemes displaying a combination of some of the following characteristics:

- borrowing and leverage restrictions, which are typically included in collective investment schemes regulation are not applied, and many (but not all) hedge funds use high levels of leverage;
- significant performance fees (often in the form of a percentage of profits) are paid to the manager in addition to an annual management fee;

- investors are typically permitted to redeem their interests periodically, e.g., quarterly, semi-annually or annually;
- often significant "own" funds are invested by the manager;
- derivatives may be used, often for speculative purposes, and there is an ability to short sell securities; and
- more diverse risks or complex underlying products are involved.[197]

Hedge funds have traditionally been offered to non-retail investors but are offered to retail investors in some jurisdictions.

Despite the broad characteristics described above, it is difficult to define hedge funds on a universal basis, given their different legal and business structures – not only across different jurisdictions but even within a single jurisdiction. Therefore, the application of Principle 28 may vary depending on the manner in which each jurisdiction defines and regulates hedge funds.

[197] See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf; *The Regulatory Environment For Hedge Funds, A Survey And Comparison*, Final Report, Report of the Technical Committee of IOSCO, November 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD226.pdf; *Regulatory and Investor Protection Issues Arising from the Participation by Retail Investors in (Funds-of) Hedge Funds*, Report of the Technical Committee of IOSCO, February 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD142.pdf.

3. Principles 24 through 28

Principle 24	**The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.**

Investor protection is the key objective. CIS operators and CIS should meet clearly defined standards as set by the regulatory system, for both initial approval and continuing operation.[198]

The eligibility standards and operating conditions to act as CIS operators should seek to ensure that those who operate or market CIS are qualified to do so. This includes standards as set out by the regulatory system on honesty and integrity of the CIS operator and being experienced and competent to operate, or advise on the suitability of, a CIS. These standards should also cover CIS governance and internal organization of CIS operators, including having accounting procedures, an adequate risk management framework and resources and processes in place to ensure ongoing compliance.[199] There should be effective mechanisms to assess compliance with these standards and with the policies and procedures the CIS operator has in place.[200]

CIS governance should provide for a framework that seeks to ensure that a CIS is organized and operated in the interests of CIS investors and, where there might be conflict between the interests of CIS investors and persons connected with the CIS, not in the interests of the connected persons. In order to ensure that CIS operators do not breach their duties, it is fundamental that their organization and activity is subject to at least annual review by an independent auditor and/or ongoing review and oversight by an independent third party.

The appropriate identification, monitoring and management of risks and compliance or internal control policies and procedures by CIS operators should be ensured, and should be appropriate and proportionate to the size, complexity and risk profile of the CIS.

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198 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

199 Id. See *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods*, Report of the Technical Committee of IOSCO, November 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD136.pdf. For factors relevant to the honesty and integrity of the manager, see *Investment Management Risk Assessment: Management Culture and Effectiveness*, Report of the Technical Committee of IOSCO, November 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD137.pdf; and see *Investment Management Risk Assessment: Marketing and Selling Practices*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf. See also *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD158.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf; *Anti-Money Laundering Guidance for Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD205.pdf.

200 Although a CIS operator should comply with the eligibility criteria from the commencement of its activities, different approaches may be adopted by the regulator regarding when to assess compliance with those standards, provided that the mechanisms in place are effective in terms of investor protection. See also Explanatory Notes.

To assist in supervision and to promote compliance, there should also be clear responsibilities for maintaining records of the operations of the CIS.

The operation of a CIS raises the potential for conflict between the interests of investors in the CIS and those of CIS operators or their associates. The regulatory system should seek to ensure that CIS operators identify the potential conflicts of interest and properly manage any conflicts that do arise by taking corrective actions (including, where appropriate, through disclosure).

In all cases, CIS operators should act in the best interests of CIS investors and in accordance with the principle of fair treatment of investors. Generally, this will require regulation covering – in addition to the issues mentioned above (CIS governance, internal organization, accounting procedures, record-keeping, and risk management) - topics such as due diligence in the selection of CIS investments and conduct of business, including best execution, appropriate trading and timely allocation of transactions, commissions and fees, related party transactions and underwriting arrangements.[201]

Many CIS operators delegate certain CIS operational responsibilities to third-parties. The use of delegates should not, in any way, be permitted to diminish the effectiveness of the primary regulation and supervision of a CIS. A delegate should comply with all regulatory requirements applicable to the conduct of the principal's business activities. A CIS operator should remain responsible for the delegate's compliance.[202]

The regulatory system should require supervision throughout the life of a particular CIS. Supervision of a CIS operator should promote high standards of competence, integrity, and investor protection.[203] There should be clear powers with respect to:

- registration/authorization of a CIS;[204]

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201 See *Conflicts of Interests of CIS Operators*, Report of the Technical Committee of IOSCO, May 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD108.pdf; *Best Practice Standards on Anti Market Timing and Associated Issues for CIS,* Final Report, Report of the Technical Committee of IOSCO, October 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf; *Good Practices in Relation to Investment Managers' Due Diligence When Investing in Structured Finance Instruments*, Final Report, Report of the Technical Committee of IOSCO, July 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD300.pdf. For a discussion on fees and commissions, see *Fees and Commissions within the CIS and Asset Management Sector: Summary of Answers to Questionnaire*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD157.pdf; *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf. In relation to soft commissions, see *Soft Commission Arrangements for Collective Investment Schemes,* Final Report, Report of the Technical Committee of IOSCO, November 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf.

202 See *Delegation of Functions*, Report of the Technical Committee of IOSCO, December 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD113.pdf.

203 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

- inspections to be carried out in order to ensure compliance by CIS operators;
- investigations of suspected breaches;
- remedial action to be taken in the event of breach or default; and
- cooperation with foreign regulators for the purposes of registration/authorization of a CIS, supervision and enforcement.

These powers should be sufficient to allow action in respect of all supervised entities with responsibilities under the CIS.[205]

Key Issues

Eligibility Criteria

1. The regulatory system should require CIS operators and CIS to comply with clear criteria for both initial approval and continuing operation.[206] The eligibility[207] criteria to act as a CIS operator, as set out by the regulatory system, should comprise requirements on the internal organization of the CIS operator, including risk management mechanisms, internal controls and accounting procedures, and CIS governance. There should be effective mechanisms to assess compliance of the CIS operator with the eligibility criteria and with the policies and procedures it has in place.

2. The regulator should have clear responsibility and powers with respect to authorization/registration of CIS.[208] The authorization/registration of CIS should have regard to the possible need for international cooperation.

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204 The registration or authorization of CIS may take the form of document filing, CIS registration, or approval of the parties to the CIS (such as the operator and custodian) as appropriate to the overall regulatory system. See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

205 See *An Examination of the Regulatory Issues arising from CIS Mergers*, Report of the Technical Committee of IOSCO, November 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD179.pdf.

206 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf: operators and schemes must meet clearly defined standards as set out by the regulatory authority for both initial approval and continuing operation.

207 The term "eligibility" is intended to include authorization, licensing, registration or other preconditions to operating or marketing a CIS: see *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf. The CIS operator should comply with the eligibility criteria from the commencement of its activities (irrespective of whether the marketing of the CIS is made in an active or a passive way, or through private placement), but different approaches may be adopted regarding when compliance with those criteria is assessed by a regulator.

208 Includes the operator and/or the pool. See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

Supervision and Ongoing Monitoring

3. Records of the business and internal organization of the CIS operator should be maintained. The records should be made available to the regulator upon request.

4. The regulator should apply proper supervision throughout the life of a particular CIS. Supervision should promote high standards of competence, integrity, and investor protection.

5. There should be clear powers to allow action in respect of all supervised entities with responsibilities under the CIS and to share information with foreign securities regulators for both supervision and enforcement.

Conflicts of Interest and operational conduct

6. The regulatory system should set standards of conduct to be complied with on an ongoing basis by CIS operators, including due diligence in the selection of CIS investments.[209] CIS operators should act in the best interests of CIS investors and in accordance with the principle of fair treatment of investors.[210]

7. The regulatory system should seek to ensure that the risk of conflicts of interest arising is minimized and that any conflicts that do arise are properly identified and managed by taking appropriate actions, including where appropriate through disclosure.

Delegation

8. The use of delegates should not, in any way, be permitted to diminish the effectiveness of the primary regulation and supervision of a CIS. The CIS operator remains responsible for the functions it delegates. The CIS operator should not be allowed to delegate its functions to the extent that it becomes a letter box.[211]

9. A delegate should be accountable either directly or through the delegator for compliance with all regulatory requirements applicable to the conduct of the principal's business activities.[212]

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[209] An operator should act with due skill, care and diligence and has a duty to make decisions as to the investment portfolio structure and administrative procedures of the CIS so as to secure its objectives: *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

[210] See *Soft Commission Arrangements for Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf; *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

[211] See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

[212] See *Delegation of Functions*, Report of the Technical Committee of IOSCO, December 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD113.pdf.

Key Questions

Eligibility Criteria

1. Does the regulatory system set standards for the eligibility of those who wish to:

   (a) Market a CIS?[213]

   (b) Operate a CIS?[214]

2. Do the eligibility criteria for a CIS operator[215] include the following:[216]

   (a) Honesty and integrity of the operator?

   (b) Having appropriate and sufficient human and technical resources to ensure that is capable of carrying out the necessary functions of CIS operator?[217]

   (c) Financial capacity of the CIS or the CIS operator that would allow the launching and operation of the CIS in appropriate conditions?

   (d) Ability to perform specific powers and duties?[218]

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213 With respect to market intermediaries that may be involved in marketing or operating a CIS, such as brokers, dealers and investment advisers, see also Principles 29 to 32 on Market Intermediaries regarding approaches to regulation of such intermediaries. For a discussion pertaining to the marketing of a CIS, see *Investment Management Risk Assessment: Marketing and Selling Practices*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf.

214 For a discussion pertaining to the operation of a CIS, see *Best Practices Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf.

215 Includes the operator and/or the pool. Key Question 2 refers to the eligibility criteria that need to be complied with by a CIS operator from the commencement of its activities, whereas Key Question 3 refers to the assessment of the compliance with those criteria by the regulator.

216 Different regulatory approaches may be adopted on when to assess compliance with the eligibility criteria.

217 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

218 A CIS operator has a duty to make decisions as to the investment portfolio structure and administrative procedures of the CIS so as to secure its objectives. The CIS operator must not exceed the powers conferred on it by the CIS's constituting documents or particulars: see *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

(e) Having, or employing, appropriate identification, monitoring, and management of risks, based on, among other things, the size, the complexity and the risk profile of the CIS?[219]

(f) Having internal controls and compliance arrangements sufficient to ensure it can carry out its business diligently, effectively, honestly and fairly?[220]

3. Does the regulatory system provide for effective mechanisms to assess compliance with the criteria referred to in Questions 2(a) to 2(f)?[221]

4. Does the regulatory system set standards for the CIS governance[222] seeking to ensure that CIS are organized and operated in the interests of CIS investors, and not in the interests of CIS connected persons?

5. Does the authorization/registration of CIS take into account the possible need for international cooperation in the case of CIS marketed across jurisdictions or where promoters, managers, or custodians are located in several different jurisdictions?

Supervision and Ongoing Monitoring

6. Is the regulator responsible for monitoring ongoing compliance with the standards applicable to CIS and CIS operators? In particular, does the regulator have clear responsibilities and powers with respect to:

(a) Registration or authorization of a CIS?[223]

(b) Inspections to ensure compliance by CIS operators?

(c) Investigation of suspected breaches?

(d) Remedial action in the event of breach or default?

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219 See *Investment Management Risk Assessment: Marketing and Selling Practices*, Report of the Technical Committee of IOSCO, September 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf; *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods*, Report of the Technical Committee of IOSCO, October 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD136.pdf; *Investment Management: Management Culture and Effectiveness*, Report of the Technical Committee of IOSCO, October 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD137.pdf; *Risk Management and Control Guidance for Securities Firms and their Supervisors*, Report of the Technical Committee of IOSCO, May 1998, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD78.pdf.

220 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

221 There may be different approaches regarding when a regulator assesses compliance with the eligibility criteria: see Explanatory Notes.

222 See the IOSCO Technical Committee Reports *Examination of Governance for Collective Investment Schemes, Part I and Part II*, of June 2006 and February 2007 respectively, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD219.pdf (June 2006) and https://www.iosco.org/library/pubdocs/pdf/IOSCOPD236.pdf (February 2007).

223 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf. In relation to mergers of CIS please see *An Examination of Regulatory Issues arising from CIS Mergers*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD179.pdf.

7. Does the ongoing monitoring involve a review of reports submitted to the regulator with regard to CIS and entities involved in the operation of a CIS (CIS operators, custodians, etc.) on a routine basis or on a risk assessment basis?[224]

8. Does the ongoing monitoring involve, where appropriate, performance of on-site inspections of entities involved in operating CIS (CIS operators, custodians, etc.)?[225]

9. Do the regulatory authorities proactively perform investigative activities[226] in order to identify suspected breaches with respect to entities involved in the operation of a CIS?

10. Is the operator of a CIS subject to a general and continuing obligation to report to the regulatory authority or investors, either prior to or after the event, any information relating to: material changes in its management or organization, or in the by-laws of the CIS, or the CIS operator?

11. Does the regulatory system assign clear responsibilities for maintaining records on the organization and business of the CIS operator? Does the regulatory system provide for the keeping of books and records in relation to transactions involving CIS assets, and all transactions in CIS shares or units?

Conflicts of Interest and operational conduct

12. Are there provisions:

    (a) To prohibit, restrict or manage (including if appropriate by disclosure) certain conduct likely to give rise to conflicts of interest between a CIS and its operators or their associates or connected parties?

    (b) To require a CIS operator to seek to minimize potential conflicts of interest and ensure that any conflicts that do arise are identified and properly managed by taking appropriate actions (including, where appropriate, through disclosure) so that the interests of investors are not adversely affected?[227]

13.

    (a) Does the regulatory system require the CIS operator to comply with operational conduct standards?

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224 For example, financial results.

225 The regulatory authority may adopt a risk-based approach in the performance of inspections to ensure compliance by CIS operators.

226 This means activities not prompted by complaint such as risk-based or periodic inspections, audits or surveillance.

227 See *Examination of Governance for Collective Investment Schemes, Part I*, Final Report, Report of the Technical Committee of IOSCO, June 2006, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD219.pdf; *Best Practices Standards on Anti-Market Timing and Associated Issues*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf; *Conflicts of Interests of CIS Operators*, Report of the Technical Committee of IOSCO, May 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD108.pdf.

(b) In particular, is the CIS operator required to act in the best interest of investors and in accordance with the principle of fair treatment?[228]

14. Does the regulatory system address the regulatory issues associated with:

(a) Best execution?

(b) Appropriate trading and timely allocation of transactions?

(c) Churning?

(d) Related party transactions?

(e) Underwriting arrangements?

(f) Due diligence in the selection of investments?

(g) Fees and expenses, in order to ensure that no unauthorized charges or expenses are levied against a CIS, or CIS investors, and that: commission rebates; soft commission arrangements; and inducements, do not conflict with the CIS operator's duty to act in the best interest of investors?[229]

Delegation

15. Does the regulatory system provide for clear indication of circumstances under which delegation is allowed and is there prohibition of systematic and complete delegation of core functions of the CIS operator to the extent that there is a transformation, gradual or otherwise, into an empty box?[230]

16. If delegation is permitted, is the delegation done in such a way so as not to deprive the investor of the means of identifying the company legally responsible for the delegated functions? In particular:

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228 A CIS operator should act with due skill, care and diligence. See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; *Best Practices Standards on Anti-Market Timing and Associated Issues*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf; *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

229 *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf; *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf. As regards the due diligence requirements, see *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf. As regards investments in structured finance instruments, see also *Good Practices in Relation to Investment Managers' Due Diligence When Investing in Structured Finance Instruments*, Final Report, Report of the Technical Committee of IOSCO, July 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD300.pdf.

230 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf. See also *Delegation of Functions*, supra.

(a) Is the CIS operator responsible for the actions or omissions, as though they were its own, of any party, to whom it delegates a function, including compliance with the rules of conduct and other operating conditions?[231]

(b) Does the regulatory system require the CIS operator to retain adequate capacity and resources and have in place suitable processes to monitor the activity of the delegate and evaluate the performance of the delegate?[232]

(c) Can the CIS operator terminate the delegation and make alternative arrangements for the performance of the delegated function where appropriate?[233]

(d) Are there requirements for disclosure to investors in relation to the delegation arrangements and the identity of the delegates?[234]

(e) Does the regulatory system allow the regulator to take appropriate actions in case of delegations which may give rise to a conflict of interest between the delegate and the investors?[235]

17. If delegation is permitted, is the delegation done in such a way so as not to jeopardize the ability of the regulator to effectively access data related to the delegated functions, either directly through the delegate(s) or through the CIS operator?

Explanatory Notes

Consideration should be given to the ability of the regulator to perform ongoing supervision and to take action in respect of all supervised entities with responsibilities under the scheme for enforcement purposes and, more broadly, to ensure that the objectives of regulation are attained. To this end, where appropriate, the assessor should make reference to the assessment of Principles 10, 11 and 12.

Attention should also be paid to the international features of the CIS business of the assessed jurisdiction. According to the Principles, these elements should not hinder proper supervision. Assessors should take into account whether the regulatory system recognizes the need for possible international cooperation for a CIS' registration and supervision, in particular in the case of CIS marketed across jurisdictions or where promoters, managers, or custodians are located in several different jurisdictions. Where appropriate, cross reference should be made to the assessment of international cooperation Principles 13, 14, and 15.[236]

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231 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

232 The degree of monitoring would depend on the extent of the delegation, to whom the delegation was made (e.g., to authorized intermediaries or to others) and the type of jurisdiction in which the delegate is located.

233 See *Delegation of Functions*, supra.

234 Id.

235 Id.

236 See also the Preamble to this Section on CIS.

With respect to Key Question 2(e), assessors can consider, for example, the extent to which a CIS operator should have a risk management framework supported by appropriate and documented policies and procedures and by an independent risk management function, proportionate to the size, complexity, and risk profile of the CIS.

With respect to Key Question 2 and 3, assessors should take into account that the eligibility criteria need to be complied with (by a CIS operator) from the commencement of its activities, but there may be different regulatory approaches regarding when to assess eligibility for registration/authorization, including for example the honesty and integrity of CIS operators. Fit and proper testing is not the only means by which regulators can approach honesty and integrity of CIS operators (e.g., statutory disqualifications may offer an acceptable alternative approach). It is not necessary that a regulator assesses compliance with the eligibility criteria at the time of the initial approval in order to comply with Key Question 3. However, the mechanisms in place need to be effective in terms of investor protection so as to ensure that the CIS operator is qualified to market or operate a CIS. In this respect, assessors should consider the entire regulatory system; both the extent to which compliance with eligibility criteria is assessed, by the competent authority, prior to commencement of marketing of a CIS; as well as the existence of a rigorous inspection program designed to effectively monitor compliance with eligibility criteria on an ongoing basis.

With respect to Key Question 4, assessors can consider, for example, if the internal organization and activities of a CIS operator are required to be subject to independent review and oversight from an objective and informed perspective.

With respect to Key Question 6(d), assessors should consider whether the regulator has adequate powers to protect investors' interests, including taking actions to withdraw authorization/registration, freeze CIS assets or the CIS operator's assets, instigate administrative or civil proceedings and recommend criminal action where appropriate.[237] Remedial actions in the event of breach or default should include effective, proportionate, and dissuasive sanctions for unlicensed operation of a CIS and/or for violation of CIS operator obligations.

Assessors should also take into account whether the sanctions for unlicensed operation of a CIS and/or for violation of CIS operator obligations are consistently applied in the assessed jurisdiction.

With respect to Key Questions 8 and 9, assessors should take into account that, where an entity involved in the operations of a CIS is not subject to the regulation of a securities regulator, the relevant on-site inspections, and investigations may be conducted through cooperation with other relevant financial regulators.

With respect to Key Question 11, assessors should also consider whether or not proper books and records in relation to the internal organization and business of the CIS are required to be maintained for an appropriate time and in the event of a winding-up.[238]

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237 See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

238 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf.

Benchmarks

Fully Implemented

Requires an affirmative response to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 9, 16(d) and 16(e).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 5, 7, 8, 9, 10, 14(a), 14(b), 14(c), 14(d), 14(e), 14(f), 14(g), 15, 16(d), 16(e) and either Question 12(a) or 12(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), 2(b), 2(c), 2(d), 2(e), 2(f), 3, 4, 6(a), 6(b), 6(c), 6(d), 11, 13(a), 13(b), 16(a), 16(b), 16(c) or 17 and to both Questions 12(a) and 12(b).

Principle 25	**The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.**

The legal form and structure of CIS vary among jurisdictions however they are important to the protection of investors. The legal form and structure affects the interests and rights of the participants in the CIS, and enables the pool of investors' funds to be distinguished and segregated from the assets of other entities and of the operator.

The legal form and structure chosen for CIS has implications for the risk of default or breach associated with the scheme. The regulatory system should require that: the legal form and structure of CIS; and the implication thereof on the risks associated with the CIS, are disclosed to investors, and ensure that these risks to investors are addressed either through statute, conduct rules, or mandatory covenants in the constituent documents of a CIS.

The regulatory system should ensure adequate segregation and protection of client assets, including through use of custodians and/or depositories that are, in appropriate circumstances, independent. Client assets should be interpreted as, assets that are held or controlled on behalf of investors in a CIS, including securities, positions, and, in the case of derivatives, where appropriate collateral and margin payments.

The regulatory system should recognize the benefits for investor protection and confidence in financial markets of effective mechanisms to protect client assets from the risk of loss and the insolvency of CIS operators.[239]

As part of its ongoing supervision, the regulator should seek to ensure that within its jurisdiction there are mechanisms which best achieve the overall objective of client asset protection, taking into account its insolvency and investment services laws, regulations and practices, and the needs of market efficiency and investor protection.[240.]

The regulator should take into account that failure of a CIS operator and/or CIS may also have systemic consequences to the financial system and on the wider economy.

Key Issues

Legal Form/Investors' Rights

1. The regulatory system should address the legal form of CIS and the nature of the rights and interests of investors. Appropriate disclosure of such form and rights should be provided to investors. Such rights should not be left to the discretion of the CIS operator.

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239 See *Client Asset Protection*, Report of the Technical Committee of IOSCO, August 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

240 Id.

2. Supervision should seek to ensure that any restrictions on type, or level, of investment, or borrowing, are being complied with.[241]

Separation of Assets/Safekeeping

3. The regulatory system should ensure adequate segregation of the pool of investors' assets from the assets of the CIS operator and of other entities.

4. The regulatory system should ensure that effective mechanisms are in place to protect client assets from the risk of loss and insolvency of the CIS operator and, where third party custodians are used, that client assets are identified as such to any third party custodian and equivalent protection is afforded to such assets.[242]

5. The risks arising from a default or a breach associated with the legal form and structure chosen for a given CIS should be disclosed to investors.

6. The regulatory system should ensure that the above risks to investors are duly addressed through statutes, rules, or mandatory arrangements.

Key Questions

Legal Form/Investors' Rights

1. Does the regulatory system provide for requirements as to the legal form and structure of CIS that delineates the interests of participants and their related rights?

2. Does the regulatory system provide that the legal form and structure of a CIS, as well as the implications thereof for the nature of risks associated with the CIS, be disclosed to investors in such a way that they are not dependent upon the discretion of the CIS operator?[243]

3. Is there a regulatory authority responsible for ensuring that the form and structure requirements are observed?[244]

4. Does the regulatory system provide that where material changes are made to investor rights that do not require prior approval from investors, notice is given to them before the changes take effect?[245]

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241 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

242 See *Client Asset Protection*, Report of the Technical Committee of IOSCO, August 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

243 See *Investment Management Risk Assessment: Marketing and Selling Practices*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf.

244 Id.

245 Id.

5. Does the regulatory system provide that where material changes are made to investor rights, notice is given to the relevant regulatory authority?[246]

6. Does the regulator have powers aimed at ensuring that any restrictions on type, or level, of investment, or borrowing, are being complied with?[247]

Separation of Assets/Safekeeping

7. Does the regulatory system require adequate segregation of CIS assets from the assets of the CIS operator and its managers or other entities?[248]

8. Does the regulatory system provide for requirements governing the safekeeping of CIS assets such as:

   (a) the obligation to entrust the assets to custodians and/or depositaries that are in appropriate circumstances independent; or

   (b) special legal or regulatory safeguards in cases where the functions of custodian and/or depositary are performed by the same legal entity as is responsible for investment functions (or related entities);[249] or

   (c) adequate protection of client assets from losses or insolvency of the CIS operator, and the obligation that, where third party custodians are used, client assets are identified as such to any such custodian and equivalent protection is afforded to the client assets, including when the custodian has entrusted all or some of the assets in its safekeeping to a the third party?[250]

9. Does the regulatory system adequately provide for an orderly winding up of CIS business, if needed?

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246 Id.

247 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; IOSCO Public Document No. 45, *Report on Investment Management*, IOSCO Technical Committee (July 1995).

248 *Guidance on Custody Arrangements for Collective Investment Schemes*, Discussion Paper of the Technical Committee of IOSCO, September 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD60.pdf; *Client Asset Protection*, Report of the Technical Committee of IOSCO, August 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

249 *Guidance on Custody Arrangements for Collective Investment Schemes*, supra; *Client Asset Protection*, supra.

250 Where third party custodians are used, there should be separation of the assets of a CIS from the assets of the custodian itself. The liability of a custodian for any losses suffered by the investors as a result of its unjustifiable failure to perform its obligations or its improper performance of them cannot be affected by the fact that it has entrusted to a third party all or some of the assets in its safekeeping: see *Guidance on Custody Arrangements for Collective Investment Schemes*, supra; *Client Asset Protection*, supra; *Report on Investment Management*, supra.

Explanatory Notes

In evaluating safekeeping, consideration should be given by an assessor to whether the supervisory system in the assessed jurisdiction is capable of ensuring that all CIS investments, including cash deposits, are properly held in safekeeping.

Consideration also should be given to the ability of the system to ensure that the risks of default or breach associated with the scheme are properly addressed. It is important that the interests of CIS investors are duly protected not only while the CIS is a going concern, but also when its continuity is affected by circumstances which require it to be wound up.

The assessor should verify that the regulatory system requires the rights of investors in CIS, or impediments to investors exercising their rights, to be clearly disclosed. The Principles do not comprehensively address collective investment arrangements involving derivatives, many of which are privately offered.

The assessor should also take into account whether supervision of CIS promotes financial stability. To this end, where appropriate, the assessor should make reference to the assessment of Principle 6.

With respect to Key Question 3, assessors should consider also whether there is any evidence that the requirements relating to the form and structure of a CIS are enforced in the assessed jurisdiction.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 4.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 4 and 5.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3, 6, 7, 8(a), 8(b), 8(c) or 9.

Principle 26	**Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.**

This Principle is intended to ensure that matters material to the value of an investment in a CIS are the subject of disclosure to investors and potential investors. Disclosure about a CIS should assist investors in understanding the nature of the investment vehicle and the relationship between risk and return, so that investors evaluating CIS performance do not focus solely on return, but also on the risk assumed to produce the return.[251] However, investors should be free to choose the level of market risk to which they are exposed.

The goal of disclosure should be to provide investors with sufficient information on a timely basis, in a language and a format that are easy to understand having regard to the type of investor, to evaluate whether and to what extent the CIS is an appropriate investment vehicle for them.[252]

Disclosure should promote comparability among various CIS.[253]

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251 See *Best Practice Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the IOSCO Technical Committee, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf; *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD158.pdf; *Investor Education*, Report of the Emerging Markets Committee of IOSCO, January 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD140.pdf; *Discussion Paper on the Role of Investor Education in the Effective Regulation of CIS and CIS Operators*, Report of the Technical Committee of IOSCO, March 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD117.pdf; *Disclosure of Risk - A Discussion Paper*, Report of the Technical Committee of IOSCO, September 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD59.pdf.

For a discussion of the obligation to disclose fees and expenses, see below.

252 See *Investor Disclosure and Informed Decisions: Use of Simplified Prospectuses by Collective Investment Schemes*, Report of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD131.pdf.

253 See *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf.

One particular aspect of disclosure requiring close attention is the disclosure of all fees and other charges that may be levied under the CIS. Information on fees and charges should be disclosed to both prospective and current investors in a way that enables the investors to understand their nature, structure and impact on the CIS's performance.[254] There should also be clear disclosure of investment policies.[255]

Advertisements concerning CIS should not contain inaccurate, untrue, or misleading statements.

Key Issues

1. Disclosure should assist investors in understanding the nature of the investment vehicle and the relationship between risk and return.

2. All matters material to a valuation of the CIS, including fees and charges, should be disclosed to investors and potential investors.

3. Information should be provided on a timely basis and in an easy to understand format and language, having regard to the type of investor.

4. There should be clear disclosure of investment policies.

5. Supervision should seek to ensure that the stated investment policy or trading strategy, or any policy required by regulation, is being followed.

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254 See *Soft Commission Arrangements for Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf; *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf; *Fees and Commissions within the CIS and Asset Management Sector: Summary of Answers to Questionnaire*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD157.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, February 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD144.pdf; *Performance Presentation Standards for Collective Investment Schemes*, Consultation Report of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD130.pdf; *Performance Presentation Standards for Collective Investment Schemes*, Report of the Emerging Markets Committee of IOSCO, December 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD114.pdf.

255 For a discussion of the obligations to disclose voting practices, see *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Consultation Report of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD129.pdf; *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD158.pdf; see also *An Examination of the Regulatory Issues arising from CIS Mergers*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD179.pdf. For a discussion on risk, see *Investment Management Risk Assessment: Marketing and Selling Practice*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf.

6. Advertisements concerning CIS should not contain inaccurate, false, or misleading statements and should not detract the investors' ability to make their own judgment about investing in the CIS.

Key Questions

1. Does the regulatory system require that all matters material to the valuation of a CIS are disclosed to investors and potential investors on a timely basis?

2. Does the regulatory system require that the information referred to in Question 1 above be disclosed to investors and potential investors in an easy to understand format and language having regard to the type of investor?[256]

3. Does the regulatory system require the use of standard formats for disclosure of offering documents and periodic reports to investors?

4. Does the regulatory system include a general disclosure obligation to allow investors, and potential investors, to evaluate the suitability of the CIS for that investor or potential investor?

5. Does the regulatory system specifically require that the offering documents, or other publicly available information, include the following:

   (a) The date of issuance of the offering document?

   (b) Information concerning the legal constitution of the CIS?

   (c) The rights of investors in the CIS?

   (d) Information on the operator and its principals?

   (e) Information on the methodology of asset valuation?

   (f) Procedures for purchase, redemption, and pricing of units/shares?

   (g) Relevant, audited financial information concerning the CIS?

   (h) Information on the custodial arrangements (if any)?[257]

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256 *Disclosure of Risk – A Discussion Paper*, Report of the Technical Committee of IOSCO, September 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD59.pdf; and *Performance Presentation Standards for Collective Investment Schemes*, Consultation Paper of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD130.pdf; *An Examination of Regulatory Issues arising from CIS Mergers*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD179.pdf; *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf; and *Soft Commission Arrangements for Collective Investment Schemes*, Final Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf.

257 See *Client Asset Protection*, Report of the Technical Committee of IOSCO, August 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

(i) The investment policy(ies) of the CIS?

(j) Information on the risks involved in achieving the investment objectives?

(k) The appointment of any external administrator or investment managers or advisers who have a significant and independent role in relation to the CIS (including delegates)?

(l) Fees and charges in relation to the CIS, in a way that enables investors to understand their nature, structure, and impact on the CIS' performance?[258]

6. Does the regulatory authority have the power to hold back, or intervene, with regard to offering documents? For example, are there regulatory actions available in the event that the information is inaccurate, misleading, or false, or does not satisfy the filing/approval requirements?

7. Does the regulatory system cover advertising material outside of the offering documents? In particular, does it prohibit inaccurate, false, or misleading advertising? Are there regulatory actions available to the regulator with regard to advertising material outside of the offering document?

8. Does the regulatory system require that the offering documents be kept up to date to take account of any material changes affecting the CIS?

9. Does the regulatory system require a report to be prepared in respect of a CIS's activities either on an annual, semi-annual, or other periodic basis?

10. Does the regulatory system require the timely distribution of periodic reports?[259]

11. Does the regulatory system require that the accounts of a CIS be prepared in accordance with high quality, internationally acceptable accounting standards?

12. Does the regulator have powers to ensure that the stated investment policy or trading strategy, the authorized investments that the CIS is able to undertake, or any policy required by regulation, is being followed?[260]

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258 See *Soft Commission Arrangements for Collective Investment Schemes*, Final Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf; *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf; *Fees and Commissions within the CIS and Asset Management Sector: Summary of Answers to Questionnaire*, Report of the Technical Committee of IOSCO, October 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD157.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Consultation Report of the Technical Committee of IOSCO, February 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD144.pdf; *Performance Presentation Standards for Collective Investment Schemes*, Consultation Report of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD130.pdf; *Performance Presentation Standards for Collective Investment Schemes*, Report of the Emerging Markets Committee of IOSCO, December 2000, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD114.pdf.

259 See also Explanatory Notes.

260 See *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf.

Explanatory Notes

The assessor should cross reference to assessment under Principles 16 to 21 as appropriate. CIS normally target retail investors therefore, particular attention should be paid to assure the regulatory system is structured to prevent investors being misled by inappropriate presentation of elements such as, risks associated with the investment policies and trading strategies of the scheme, reference to past performance, and fees and other charges that may be levied under the scheme. The information should be provided in an easy to understand format and language, having regard to the type of investor. Proper consideration should be given by the assessor to the retail nature of CIS business.

For the purposes of Question 5(g), the offering documents, or other publicly available information, may refer to relevant, audited financial information concerning the CIS previously or simultaneously provided or made available.

For the purposes of Questions 6, 7 and 12, assessors should also take into account whether there is any evidence of actions taken by the regulator in those areas.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3 or 10.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3, 5(b), 10 and 11.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 4, 5(a), 5(c), 5(d), 5(e), 5(f), 5(g), 5(h), 5(i), 5(j), 5(k), 5(l), 6, 7, 8, 9 or 12.

Principle 27 **Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.**

Proper valuation of CIS assets is critical to ensure investor confidence in CIS as a reliable and robust investment vehicle, and for proper investor protection, especially in cases where a market price is unavailable. Regulation should seek to ensure that all property of a CIS is fairly and accurately valued, and that the net asset value ("NAV") of the CIS is correctly calculated.[261]

The regulatory system should permit the responsible authority to ensure compliance with the relevant rules.

Regulation should require the CIS operator to publish or disclose the price of the CIS on a regular basis to enable the investor, or potential investor, to assess performance over time.

The law or rules governing CIS should enable investors to redeem units or shares on a basis that is made clear in the constituent documents and/or the prospectus. The regulatory system should address the general or specific circumstances in which there may be suspension, or deferral, of: routine valuation and pricing; or regular redemption, of CIS units or shares.

Key Issues

Asset Valuation

1. Regulation should ensure that all property of a CIS is fairly and accurately valued, and that the net asset value (NAV) of the CIS is correctly calculated. The interests of the investor are generally better protected by the use of value based reporting[262] wherever reliable market or fair values can be determined.[263]

2. CIS should be valued regularly at specified intervals.

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261 *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf; *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, May 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD91.pdf; *CIS Unit Pricing*, Report of the Emerging Markets Committee of IOSCO, May 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD92.pdf; and *A Comparison Between the Technical Committee Report and the Emerging Markets Committee Report on Valuation and Pricing of Collective Investment Schemes*, Joint Report of the Technical Committee and Emerging Markets Committee of IOSCO, May 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD93.pdf.

262 Value-based reporting is understood as marking financial assets to market or using market prices (values) where these are available and reliable.

263 A mandatory requirement in some jurisdictions. *Best Practice Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf.

3. CIS operators should be responsible for publishing or disclosing the price of the CIS on a regular basis to enable investors or potential investors to assess the performance of the CIS over time.

4. Valuation methods should be applied consistently unless change is desirable in the interest of investors.

Pricing and Redemption Issues

5. Regulation should require that the basis upon which investors may redeem units or shares is made clear in the constituent documents and/or the prospectus.

6. Incoming, continuing, and outgoing investors should be treated equitably, such that purchases and redemptions of CIS interests are affected in a non-discriminatory manner.

7. Regulation should ensure that rights of suspension protect the interests of investors rather than the interests of the CIS operator.

8. Regulators should be kept informed of any suspension of redemption rights.

Key Questions

Asset Valuation

1. Are there specific regulatory requirements in respect of the valuation of CIS assets?[264]

2. Are there regulatory requirements that the NAV of CIS be calculated:

   (a) On a regular basis?

   (b) In accordance with high-quality, accepted accounting standards used on a consistent basis?[265]

3. Are there specific regulatory requirements in respect of the fair valuation of assets where market prices are not available?[266]

4. Are independent auditors required to check the valuations of CIS assets?[267]

Pricing and Redemption Issues

5. Does the regulatory system:

   (a) Require the basis upon which investors may redeem units/shares to be made clear in the constituent documents and/or the prospectus?

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264 See also *Principles for the Supervision of Operators of Collective Investment Schemes*, supra. In addition, there should be some arrangement for valuing illiquid holdings if any. See also Key Issue 3.

265 Id.

266 Id.

267 See the Explanatory Notes. See also *Guidance on Custody Arrangements for Collective Investment Schemes*, supra.

(b) Provide for specific regulatory requirements in respect of the pricing upon redemption or subscription of units/shares in a CIS?

6. Does regulation ensure that the valuations made are fair and reliable?

7. Does regulation require the price of the CIS be disclosed or published on a regular basis to investors or prospective investors?

8. Are there regulatory requirements, rules of practice, and/or rules addressing pricing errors? Are the relevant regulatory authorities able to enforce these rules?

9. Does the regulatory system address the general or specific circumstances in which there may be suspension, or deferral, of: routine valuation and pricing; or regular redemption, of CIS units or shares?

10. Does the regulator have the power to ensure compliance with the rules applicable to asset valuation and pricing?

11. Does the regulatory system require that the regulator:

(a) Be kept informed of any suspension or deferral of redemption rights?

(b) Have the authority to address situations where the CIS operator: is failing to honour redemptions; or is imposing a suspension of redemptions in a manner that is not consistent with the CIS constitutive documents and prospectus, or the contractual relationship between the CIS participants and the CIS operator; or is otherwise deemed to be in violation of national law?

Explanatory Notes

The valuation of the property of a CIS and the calculation of the NAV are extremely important, as the NAV[268] reflects the price which an investor pays when investing in a CIS (subject to any additional up-front charges) and the price an investor will receive (subject to any additional exit charges) should a holding be liquidated. Assessors should pay proper attention to the calculation modalities and to the timing, and frequency, of publication of the CIS NAV. Assessors should also evaluate whether the supervision of the CIS confirms that the operator has systems and controls in place to ensure a fair and accurate valuation of the property of a CIS, and that calculations of the NAV are correct at each valuation point, as indicated in Key Issue 2 above.

The type, and frequency of valuation may depend on the availability and timing of redemption rights, the types of interests that may be held within a CIS, and the permitted legal structure of a CIS.

[268] NAV is calculated by dividing the total value of the investments in a CIS by the number of units in issue, plus or minus adjustments for accrued fees, expenses and other liabilities.

The right to redeem units/shares is a key feature of open-ended CIS. The assessor should evaluate whether the rules in place are sufficient to prevent fees or charges payable by an investor, in the case of redemption, from being conceived so as to prevent investors from exercising their rights. Assessors should take into account that the rights of suspension, available to the CIS operator, may not be exerted in ways that impair the protection of investors' interests, and that regulators are able to enforce decisions aimed at protecting investors' interests. In the case of closed-end funds, assessors may consider how regularly such CIS are priced.

With respect to Key Question 6, assessors should consider whether the accuracy of the CIS NAV calculation is required to be checked by auditors, which are subject to adequate levels of oversight and independent in accordance with Principles 19 to 21. **[**It is not necessary that independent auditors check each individual valuation of a CIS for a positive answer to Key Question 6**]**.

With respect to Key Question 10, assessors should also consider whether there is any evidence that the requirements on asset valuation and pricing are enforced in the assessed jurisdiction.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 8.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3, 4, 8, and 10.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 5(a), 5(b), 6, 7, 9, 11(a) or 11(b).

Principle 28 **Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.**

Although some jurisdictions may regulate hedge funds as CIS, Principle 28 is the only principle in this section applicable in the assessment of hedge funds and/or hedge fund managers/advisers regulation.

In previous work,[269] IOSCO has recognized that there is no universal definition of hedge funds and that a variety of approaches to regulation of hedge funds and/or hedge fund managers/advisers are possible. The important point to note is that the regulatory system should set standards for the authorization/registration and the regulation and supervision of those who wish to operate hedge funds (managers/advisers) (and/or - where relevant[270] – for the registration of the hedge fund).

The relevant regulatory requirements should allow the regulator at the funds level to get an overall picture of the risks posed by the hedge funds.[271] The information supplied through the registration/authorization process could also be made available to all prospective investors prior to the execution of a subscription agreement or other investment management agreement.[272]

Hedge fund managers/advisers which are required to register should be subject to appropriate entry and ongoing regulatory requirements[273] and should be supervised/monitored on an on-going basis. In previous work,[274] IOSCO has recommended that regulatory oversight should be more focused on systemically important and/or higher risk hedge fund managers/advisers. For example, a *de-minimis* cut-off is one of the possible approaches. A possible cut-off could be determined taking into account certain characteristics such as leverage, economic exposure etc. Another possibility, which takes into account the principle of proportionality, is to require the registration of all hedge fund managers/advisers but consider a lower level of ongoing supervision for managers below a certain *de-minimis* cut-off.[275] In assessing the

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269 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

270 Some securities regulators may have regulatory requirements at the level of the funds themselves to facilitate obtaining fund specific information and to get an overall picture of the risks posed by the funds. Such a direct regulation at the fund level could involve a registration/authorisation of the fund as well as on-going supervision of the fund. Whether this additional layer of regulation is required to address systemic and market integrity risks will reflect local conditions and industry structure. Nothing in this Methodology should be interpreted to *require* the registration of the fund.

271 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

272 Id.

273 If the hedge fund is organised as an investment company, which does not appoint an external manager, the requirements referring to the "hedge fund manager" should be complied with by the investment company itself and by its managers.

274 Id.

275 Id. As noted above, there is no consistent or agreed-upon definition of the term "hedge fund". The determination of what investment vehicles will be characterized as "hedge funds" is committed to the regulator.

implementation of Principle 28, assessors should determine whether the jurisdiction regulates and supervises hedge fund managers/advisers according to the risks they pose.

Key Issues

1. Regulatory oversight of hedge fund managers/advisers should reflect the risks posed by hedge funds and be risk-based and proportional (i.e., to the size and complexity of the hedge fund managed) and so, should be more focused on systematically important and/or higher risk hedge fund managers/advisers.[276]

2. Hedge funds and/or hedge fund managers/advisers that are required to register should be subject to relevant entry standards. The information supplied through the registration/authorization process should provide adequate transparency into the business of the hedge fund manager/adviser and/or on the hedge funds managed.[277]

3. Hedge fund managers/advisers which are required to register should be subject to appropriate ongoing regulatory requirements relating to:

   (a) organizational and operational standards:

   (b) conflicts of interest and other conduct of business rules;

   (c) disclosure to investors; and

   (d) prudential requirements.[278]

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276 Id.

277 Id.

278 Id. Prudential regulation may vary from one jurisdiction to the other. Each jurisdiction may decide what form of prudential regulation is appropriate to the risks posed by hedge funds. See Explanatory Notes. See also the Joint Forum issued recommendations regarding minimum prudential requirements for hedge fund operators: *Review of the Differentiated Nature and Scope of Financial Regulation*, Report of the Joint Forum, January 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD315.pdf. Further relevant work of IOSCO: in relation to valuation please see *Principles for the Valuation of Hedge Fund Portfolios*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD253.pdf; on fund of hedge funds see: *Elements of International Regulatory Standards on Funds of Hedge Funds Related Issues Based on Best Market Practices*, Final Report, Report of the Technical Committee, September 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD305.pdf; *Regulatory and Investor Protection Issues Arising from the Participation by Retail Investors in (Funds of) Hedge Funds*, Report of the Technical Committee of IOSCO, February 2003, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD142.pdf. See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. See also Explanatory Notes.

4. Securities regulators should be able to obtain – if necessary through working with other regulators – non-public reporting of information on the prime brokers' and banks' most systemically significant and/or higher risk hedge fund counterparties.[279]

5. Hedge fund managers/advisers should provide to the regulator information for systemic risk purposes (including the identification, analysis, and mitigation of systemic risks).[280]

6. Regulators should have the authority to co-operate and share information, where appropriate, with each other, in order: to facilitate efficient and effective oversight of globally active hedge fund managers/advisers, and/or hedge funds; and to help identify systemic risks, market integrity and other risks arising from the activities or exposures of hedge funds, with a view to mitigating such risks across borders.[281]

Key Questions

Registration/authorization of hedge fund managers/advisers and/or, where relevant, the hedge fund

1. Does the regulatory system set standards for:

   (a) The registration/authorization and the regulation of those who wish to operate hedge funds (managers/advisers)?

   (b) And/or the registration of the hedge fund?[282]

2. Does the regulatory system specify the information contemplated by Key Issue 2 that must be provided to the regulator at the time of the registration/authorization?[283]

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279 The objective of information gathering by securities regulators from hedge fund managers is to obtain information on the hedge fund's prime brokers and custodians and the hedge fund's risk exposures that could be made available for systemic risk purposes (including the identification, analysis and mitigation of systemic risk). See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. The IOSCO *Hedge Funds Oversight Report* also makes recommendations with respect to information gathering from prime brokers and banks by their relevant prudential regulators. As noted in the *Hedge Funds Oversight Report*: "The main objectives of this information gathering [by prudential regulators] through prime brokers/banks are to gauge risk appetite (funds and banks), identify the emergence of large and highly leveraged funds, to assess banks ability to aggregate counterparty exposure across business lines, and to build a prime brokerage - soft network". The relevant concern is that: "Prime brokers and banks which provide funding and other services to hedge funds can be the main transmission mechanism through which the significant distress or failure of a single fund or cluster of hedge funds may result in systemic effects, and potentially impact on the real economy. This may result through a curtailing of the provision of credit or disruptions to payment and clearing services, which could then impact directly on the real economy".

280 Id. See also Explanatory Notes.

281 Id. See also Explanatory Notes.

282 Id. See also Explanatory Notes on exempted/lower regulated hedge funds and/or hedge fund managers/advisers.

283 Id. See also Explanatory Notes.

Standards for internal organization and operational conduct

3. Does the regulatory system set (in view of the risk posed) standards for internal organization and operational conduct to be observed, on an on-going basis, by the hedge fund manager/adviser, including appropriate risk management and protection, and segregation of client money and assets?[284]

Conflicts of interests and other conduct of business rules

4. Does the regulatory system set standards for hedge fund managers/advisers to appropriately manage conflicts of interest,[285] and provide full disclosure and transparency to the regulator and investors (including potential investors) about such conflicts and how they manage them?

Disclosure to the regulator and to investors

5. Is the regulator able to obtain from hedge fund managers/advisers appropriate information about their operations and about the hedge funds that they manage that allow it to assess the risks that hedge funds pose to systemic stability?[286]

6. Does the regulatory system, in view of the risks posed, set standards for the proper disclosure by hedge fund managers/advisers, or the hedge fund, to investors?[287]

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284 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. In assessing the application of Key Question 3, the assessors should consider at least the issues mentioned in the Explanatory Notes.

285 Hedge fund managers like other fund managers are subject to significant conflicts of interest (institutional and personal). The first category includes conflicts that affect the hedge fund manager as an institution, such as investment/trade/brokerage allocation practices; undisclosed compensation arrangements with affiliates; undisclosed compensation arrangements with counterparties, etc. The second category includes individual conflicts, such as personal trading; personal investing; personal or business relationships with issuers, etc. See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. As regards compensation/remuneration structures and practices, they should be subject to strong governance mechanisms and to manage conflict of interest issues and to counter the short-term profit motives that are often inherent in hedge funds´ operations: see *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. See also Principle 8.

286 This information gathering would help regulators to identify current or potential sources of systemic risk that hedge funds may pose, either individually or collectively and consequently help regulators in better understanding: the leverage used in different strategies and the size of funds "footprints"; the scale of any asset/liability mismatch; substantial market or product concentration and liquidity issues; and hedge fund counterparty risks. See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. See also Explanatory Notes.

287 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf. The timing of such disclosure is determined by the regulator. See also Explanatory Notes.

Prudential regulation

7. Are hedge fund managers/advisers, which are required to register, subject to appropriate ongoing prudential requirements that reflect the risks they pose?

Supervision and enforcement

8.

(a) Does the regulatory system provide for on-going supervision of the hedge fund managers/advisers which are required to register?

(b) Does the regulator have the power to access and inspect the hedge fund managers/advisers and their records and/or the hedge funds?[288]

(c) Does the regulator have the authority to enforce against wrongdoers?[289]

9. Subject to appropriate confidentiality safeguards and national law restrictions, from the point of view of supervision and enforcement, does the regulator have the power to:

(a) Collect where necessary relevant information from hedge fund managers/advisers and/or hedge funds (and through cooperation with other domestic regulators from hedge fund counterparties) also on behalf of a foreign regulator?

(b) Exchange information on a timely and on-going basis, as deemed appropriate, with other relevant regulators on internationally active hedge funds that may pose systemic or other significant risks?

10. Is the securities' regulator able to obtain from the hedge fund operator/adviser - if necessary working with other regulators - non-public reporting of information on the hedge funds' exposure to counterparties, (which may include prime brokers, banks or OTC derivative counterparties)?

Explanatory Notes

In assessing implementation of this Principle, assessors should consider the regulatory framework in the context of the risks that hedge funds (individually and collectively) pose to investor protection, fair and efficient markets, and the reduction of systemic risk, and how the regulatory framework addresses these risks. This will require assessors to consider the risks that hedge funds pose in the relevant jurisdiction and the risks they may pose to global and regional markets.

[288] Id.

[289] Id. See also Explanatory Notes.

Assessors should also recognize that industry standards and Codes of Conduct may be used in implementing this Principle, provided, however, that whatever method of implementation is chosen is enforceable to the extent necessary to achieve its objectives and takes into account the Benchmarks. For instance, disclosure and conduct standards may be developed by industry, with regulation requiring those standards to be applied. In these cases, assessors may also consider how compliance with those standards is enforced.

With respect to Key Question 1, assessors should also consider whether the regulator has the power to refuse registration/authorization if the entry standards are not met.

With respect to Key Question 2, there may be differences in how the jurisdictions handle this Question, the type of information that could be considered as possible requirements, at registration/authorization of the manager/adviser, includes:

- background of key management and investment personnel, organization and ownership;
- business plan;
- services offered;
- hedge fund investors targeted;
- fees charged;
- policy on related parties investments;
- investment strategies utilized;
- risk tools or parameters employed;
- identification of key service providers, such as independent auditors, sub-advisers, administrators, custodians, prime brokers and credit providers;
- delegation and outsourcing arrangements; and
- Conflicts of interest and procedures to identify and address them.[290]

With respect to Key Question 3, there may be differences in how the jurisdictions handle this Question. Jurisdictions will determine what, and under what circumstances, standards for internal organisation and operational conduct will be imposed on the hedge fund managers/advisers.

Assessors should consider whether the standards for internal organization and operational conduct to be observed on an on-going basis by the hedge fund manager/advisers (in view of the risks posed) take into account at least the following:[291]

(a) A comprehensive risk management framework supported by an independent risk management function, appropriate to the size, complexity and risk profile of the hedge fund manager/adviser.

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290 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

291 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

(b) An independent compliance function, appropriate to the size, complexity, and risk profile of the hedge fund manager/adviser, supported by: sound and controlled operations and infrastructure; adequate resources; and checks and balance operations.

(c) Adequate segregation of responsibilities for valuing and investing hedge fund assets, and thorough written valuation policies.[292]

(d) Adequate segregation and protection of client monies and assets through use of custodians and depositaries that are, in appropriate circumstances, independent, and ensure investors' funds are protected.

(e) Appropriate records of the trades performed on behalf of each hedge fund.[293]

(f) Independent audit, on an annual basis, of the financial statements of the fund manager/adviser and/or each of the hedge funds managed.

With respect to Key Question 5, regulators should be able to obtain from hedge fund managers/advisers information about the hedge funds in their portfolio, which could include, for example, the information listed in the explanatory notes relating to Key Question 2 above.

In addition, regulators should be able to obtain from hedge fund managers/advisers appropriate information on an on-going basis, for example:

- information on their prime brokers, custodian, and background information on the persons managing the assets;
- information on the manager's/adviser's larger hedge funds including, the NAV, predominant strategy/regional focus and performance;
- leverage and risk, including concentration risk of the manager's/adviser's larger hedge funds;
- asset and liability information for the manager's/adviser's larger hedge funds;
- counterparty risk, including the biggest sources of credit;
- product exposure for all of the hedge fund manager/adviser assets e.g., equities, structured/securitized credit, investment grade corporate bonds etc; and
- identification of investment activity known to represent a significant proportion (in terms of liquidity/volume) of such activity in important markets or products.

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[292] Id. See also *Principles for the Valuation of Hedge Fund Portfolios,* Final Report, Report of the Technical Committee of IOSCO, November 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD253.pdf.

[293] Records should be maintained by the hedge fund managers (and where appropriate hedge funds themselves), like other market participants. Such information should be available to the regulators upon request e.g., for market abuse inspections. See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

Hedge fund managers/advisers must be able to obtain all the necessary information from the hedge funds they manage – irrespective of the location of those hedge funds – so that hedge fund managers/advisers are able to effectively evaluate the risks they are taking in their portfolio.[294]

With respect to Key Question 6, hedge fund managers/advisers, or the hedge fund, should provide proper disclosure to investors, amongst other things on:

(a) the risks posed;
(b) the conditions and/or the limits for redemption;
(c) the existence and conditions of any side letters and gating structures;
(d) the hedge fund's strategy and performance, including audited financial statements of the hedge fund manager/adviser and/or the hedge funds managed.[295] The timing of such disclosure is determined by the regulator.

With respect to Key Question 7, there may be differences in how jurisdictions handle this Question, since not all securities regulators are also prudential regulators.

Each jurisdiction will determine what, and under what circumstances, prudential requirements will be imposed on hedge fund managers/advisers.

For a positive assessment of Key Question 7, assessors should consider whether the regulatory system as a whole ensures that hedge fund managers/advisers, which are required to register, are subject to prudential requirements that reflect the risks they take (and which are most likely to be akin to other asset manager requirements), e.g., operational risk, client money, etc.

Jurisdictions also have different approaches to prudential regulation. Some jurisdictions see prudential regulation as being primarily about capital requirements. Others see it more broadly as also including risk management frameworks. Standards for internal organization and operational conduct will also be relevant to this question. Differences in approach reflect different institutional and market conditions. Nothing in the Principles or this Methodology should be interpreted to imply a negative assessment of Key Question 7 when the jurisdiction imposes prudential requirements for the managers or advisers of hedge funds other than capital requirements.

Assessors should take differences in approach to prudential regulation into account in assessing whether appropriate prudential requirements are in place.

With respect to Key Questions 8(a), 8(b) and 8(c), the regulator should have comprehensive inspection, investigation, surveillance, and enforcement powers in relation to hedge funds/hedge fund managers/advisers. The regulatory system should ensure an effective and credible use of these powers and implementation of an effective compliance program, as explained in Principles 10 to 12.

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294 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

295 See *Hedge Funds Oversight*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf.

In case of failure to comply with the ongoing regulatory requirements, the regulator should have the authority to impose measures (including withdrawing; suspending; or applying conditions to a registration/authorization) and to impose effective, proportionate and dissuasive sanctions.

With respect to Key Questions 9(a) and 9(b), the regulator should be able to co-operate and share information with other foreign authorities for the purposes of supervision and enforcement in the same way as explained under Principles 13 to 15 on cooperation.

Assessors should take into account any obstacles the regulator may face when asked to cooperate with foreign securities regulators, including whether the regulator is able to exercise the powers listed in Key Questions 9(a) and 9(b) with respect to exempted or lower regulated entities.

With respect to Key Question 10, the ability of a regulator to obtain non-public reporting of information on the prime brokers' and banks' most systemically significant and/or higher risk hedge fund counterparties is enhanced if the latter are supervised entities. In previous work,[296] IOSCO has recommended that "Prime brokers and banks which provide funding to hedge funds should be subject to mandatory registration/regulation and supervision. They should have in place appropriate risk management systems and controls to monitor their counterparty credit risk exposures to hedge funds".

Exempted/lower regulated hedge funds and/or hedge fund managers/advisers

The assessors should take into account whether the regulator has discretion to grant exemptions from the registration/authorization of those that wish to operate hedge funds and/or – where relevant – of hedge funds, or the regulatory system provides for lighter entry requirements compared to other assets pools or other assets pools' operators (e.g., notification requirements or cut-off). In such a case, assessors should consider if the reason why the exemption is conferred and the process by which it is conferred are: transparent; give similar results for similarly situated persons or sets of circumstances; and explainable in the context of this Principle 28. Assessors should consider the entry requirements, if any, applicable to exempted/lower regulated hedge fund managers/advisers, including: the type of information that the regulator is able to collect, and any ongoing regulatory requirements applicable to them relating to organizational and operational standards; conflicts of interest and other conduct of business rules; disclosure toward the regulator and investors; and prudential regulation.

Where appropriate, the assessor should make reference to the assessment of Principle 7.

Assessments of Principle 28 should be consistent with any findings under the assessment of Principle 6 on systemic risk.

To determine whether Principle 28 is implemented in a manner that achieves its objectives it is also necessary to consider whether the regulatory framework provides for mechanisms to address current and potential systemic risks arising from the operation of hedge funds.

[296] Id.

In particular, assessors should assess whether the securities regulator is able, either directly or through working with other regulators, to obtain non-public reporting of information on the prime brokers' and banks' most systemically significant and/or higher risk hedge fund counterparties.[297]

Benchmarks

Fully Implemented

Requires affirmative responses to Question 1(a) and/or 1(b) and to all other applicable Questions.

Broadly Implemented

Requires affirmative responses to Question 1(a) and/or 1(b) and to all other applicable Questions except to Questions 7.

Partly Implemented

Requires affirmative responses to Question 1(a) and/or 1(b) and to all other applicable Questions except to Questions 7, and 10.

Not Implemented

Inability to respond affirmatively to both Questions 1(a) and 1(b) or to one or more of Questions 2, 3, 4, 5, 6, 8(a), 8(b), 8(c), 9(a) and 9(b).

[297] Id. See footnote 280 above.

H. PRINCIPLES RELATING TO MARKET INTERMEDIARIES

1. Preamble

The Principles relating to Market Intermediaries seek to support the IOSCO Objectives by setting requirements related to entry criteria, capital and prudential requirements, conduct of business, ongoing supervision, and discipline of entrants, and the consequences of default and financial failure.

Market intermediaries should conduct themselves in a way that protects the interests of their clients and helps to preserve the integrity of the market. Fundamental principles include:

- A firm should observe high standards of integrity and fair dealing.
- A firm should act with due care and diligence in the best interests of its clients and the integrity of the market.
- A firm should observe high standards of market conduct.
- A firm should not place its interests above those of its clients and should give similarly situated treatment to similarly situated clients.
- A firm should comply with any law, code or standard relevant to securities regulation as it applies to the firm.

In addition, regulation of the various types of market intermediaries should aim to provide for:

- Proper ongoing supervision with respect to market intermediaries.
- The right to inspect the books, records, and business operations of a market intermediary.[298]
- A full range of investigatory powers and enforcement remedies available to the regulator or other competent authority in cases of suspected or actual breaches of regulatory requirements.
- A fair and expeditious process leading to discipline and, if necessary, suspension or withdrawal[299] of a licence.
- The existence of an efficient and effective mechanism to address investor complaints.

[298] Inspection powers should be available to a regulator to ensure compliance with all relevant requirements, even in the absence of a suspected breach of conduct. There must be complementary requirements for the maintenance of comprehensive records. See also Principle 10.

[299] The term "withdrawal" would include revocation.

Principles 29 to 32 deal with market intermediaries. Principle 29 addresses authorization and the standards for authorization; Principle 30 addresses ongoing monitoring and the initial and ongoing capital requirements and prudential standards for intermediaries; Principle 31 addresses other operational standards for market intermediaries and standards for conduct of business to protect the interests of clients and their assets and for ensuring proper management of risks; and Principle 32 addresses procedures for minimizing the consequences to investors and markets of the failure of a market intermediary. These Principles should be assessed in conjunction with each other.

The oversight of market intermediaries should primarily be directed to the areas where their capital, client assets and public confidence may most be put at risk. These include the risks of:

- Incompetence, poor risk management, or risk management that fails to be adequate in the context of an extraordinary event. Any of these may lead to a failure (1) to provide best execution; (2) to obtain prompt settlement; and/or (3) to provide appropriate advice.
- Breach of duty, laws, and regulations (which may lead to misappropriation of client funds or property, the misuse of client instructions for the intermediary's own trading purposes - i.e., "front running" or trading ahead of clients).
- Manipulation, insider trading, and other trading irregularities; or fraud, money laundering, or terrorist financing taking place at the intermediary.
- Conflicts of interest.
- Insolvency of an intermediary (which may result in loss of client money, securities or trading opportunities, and may reduce confidence in the market in which the intermediary participates).

In assessing the adequacy of regulation, assessors should consider both the activities regulators perform directly, as well as those activities performed by self-regulatory organizations (including an assessment of the adequacy of the supervision of such self-regulatory activities by the regulator).

2. Scope

The Principles under this section apply to market intermediaries. Some or all of the Principles may also apply to investment advisers, depending on the nature of the investment adviser's business, as explained below.

"Market intermediaries" generally include those who are in the business of managing individual portfolios, executing orders and dealing in, or distributing, securities. A jurisdiction may also choose to regulate as a market intermediary an entity that engages in any one or more of the following activities:[300]

- Receiving and transmitting orders.
- Proprietary trading/dealing on own account.
- Providing advice regarding the value of securities or the advisability of investing in, purchasing, or selling securities.
- Securities underwriting.
- Placing of financial instruments without a firm commitment basis.

"Investment advisers" are those principally engaged in the business of advising others regarding the value of securities or the advisability of investing in, purchasing, or selling securities. This does not mean that they cannot provide other services. In some jurisdictions an investment adviser that deals on behalf of clients and/or is permitted to hold client assets would be classified as a market intermediary. In other jurisdictions, investment advisers are treated separately from market intermediaries. When this distinction exists the scope of Principles 29 to 32 may apply differently depending on the type of investment adviser.[301] Regulation should depend on, and be appropriate to, the adviser's activities. This is clarified in more detail under the heading of "investment advisers" in Principle 29.

To the extent that this section calls for an assessment of the ongoing operations of intermediaries consistent with the Principles, the assessor should be certain that any conclusions reached are consistent with those contained in Principles 10, 11 and 12 related to enforcement and inspection powers and implementation of such powers.

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300 A market intermediary may also be authorized, in addition to the activities mentioned in the paragraph above, to hold custody of client assets (e.g., safekeeping and administration of securities) as an ancillary activity. Custody in this context means "physically" holding the client assets *(i.e., in electronic or in paper form) where they could be at risk of custodial error or misappropriation. However, merely being able to deduct an advisory fee from customer assets held not at the advisor but rather at a bank or broker-dealer would not be considered having "custody."*

301 In this respect, three types of investment adviser could be identified:

(a) Investment advisers that deal on behalf of clients.

(b) Investment advisers that do not deal on behalf of clients, but are permitted to have custody of client assets.

(c) Investment advisers who neither deal on behalf of clients nor hold or have custody of client assets nor manage portfolios, but who offer only advisory services without offering other investment services.

3. Principles 29 through 32

Principle 29	**Regulation should provide for minimum entry standards for market intermediaries.**

The licensing[302] and supervision of market intermediaries, including its staff, should set minimum standards for them and provide consistency of treatment for all similarly situated market intermediaries. It should also reduce the risk to investors of loss caused by negligent or illegal behaviour and/or inadequate capital.

Key Issues

Authorization

1. The authorization, licensing, or registration should specify the services or activities which the market intermediary is authorized to provide.

2. The authorization, licensing or registration of market intermediaries should set minimum standards of entry that make clear the basis for authorization and the standards that should be met on an ongoing basis. Such standards should include:

   (a) An initial minimum capital requirement as set forth in Principle 30.

   (b) A comprehensive assessment of the applicant and all those who are in a position directly, or indirectly, to control, or materially influence, the applicant. In this regard, regulation should determine the conditions or criteria to be met by the market intermediary and its staff in order to be allowed to participate in the market. This should include, but not be restricted to, a demonstration of appropriate knowledge, business conduct, resources, skills, ethical attitude (including a consideration of past conduct), and internal organization.[303]

   (c) A requirement that the entry standards be consistently applied.

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302 The terms "licensing", "authorization" and "registration" are used interchangeably in this section. In some jurisdictions authorization or registration is used instead of licensing. The term "licence" in this section should be understood to refer also to authorization and registration. See *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf.

303 Examples from jurisdictions include: statutory disqualification programs and detailed criteria relating to education, training, experience or the so-called "fitness and propriety" of an applicant to be met before a person may be licensed. These criteria are intended to protect the investor. See *Fit and Proper Assessment - Best Practice*, Final Report, Report of the Emerging Markets Committee of IOSCO, December 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD312.pdf.

Authority of Regulator

3. The licensing authority should have the power to:

   (a) Refuse licensing of a market intermediary, subject only to administrative or judicial review, if authorization requirements have not been met.

   (b) Withdraw, suspend, or apply a condition to, a licence or authorization where a change in control or other change results in a failure to meet relevant requirements, according to Principle 3.

4. The regulator, or the SRO subject to the regulator's oversight, should demonstrate an ability to carry out an effective review of applications for licensing or authorization to ensure compliance with regulatory requirements.

Ongoing Requirements

5. Periodic updating of relevant information and reporting of material changes in circumstances affecting the conditions of licensing should be required, in order to ensure that continued licensing remains appropriate. For example, changes in control, or material influence, should be required to be made known to the regulator, such that it may seek to ensure that its assessment of the market intermediary remains valid.

6. To enable investors to better protect their own interests, the regulator should seek to ensure that the public has access to relevant information concerning the licensee or authorized market intermediary such as,: the identity of senior management, and those authorized to act in the name of the market intermediary; the category of licence held; its current status; and the scope of authorized activities.[304]

Investment Advisers

7. In jurisdictions where investment advisers are treated separately from market intermediaries, as explained in the scope section above, investment advisers that deal on behalf of clients or that are permitted to have custody of client assets should be licensed. There are investment advisers who neither:

   (a) deal on behalf of clients nor hold, or have custody of, client assets; nor

   (b) manage portfolios, but who only offer advisory services without other investment services. In this case, separate licensing of the investment adviser may not be strictly required.[305]

8. In regulating the activities of investment advisers, the regulator may elect to place emphasis on the substantive licensing criteria and the capital and other requirements recommended for regulation of other market intermediaries, as explained under Principles 29 to 32. Alternatively, the regulator may use a disclosure-based regime designed to permit potential advisory clients to make an informed choice of advisers subject to the activities performed by the investment adviser.

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[304] The information must be freely available and readily accessible. It may be maintained in a central repository by the regulator or by an SRO.

[305] Where an investment adviser is offering advice through market intermediaries that are adequately licensed according to the Principles, separate licensing of the investment adviser may not be required.

9. Regardless of these two options, the regulatory scheme should include the following requirements based on the type of adviser:

   (a) If an investment adviser deals on behalf of clients,[306] the capital and other operational controls (explained in Principles 29 to 32) applicable to other market intermediaries also should apply to the adviser.

   (b) If the investment adviser does not deal, but is permitted to have custody of client assets,[307] regulation should provide for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party), and capital and organizational requirements as explained under Principles 29 to 32.

10. At a minimum, however, the regulatory scheme selected for investment advisers should contain the following elements of the markets intermediaries regime, as applicable:

   (a) A licensing regime that is sufficient to establish authorization to act as an investment adviser and to ensure access by the public to an up-to-date list of authorized investment advisers.

   (b) Bars against the licensing of persons who have violated securities or similar financial laws or criminal statutes during a specific time period preceding their application.

   (c) Record keeping requirements.

   (d) Clear and detailed disclosure requirements to be made by the investment adviser to potential clients.[308]

   (e) Rules and procedures designed to prevent guarantees of future investment performance and misuse of client assets, and to address potential conflicts of interest.[309]

Key Questions

Authorization

1. Does the jurisdiction require that, as a condition of operating a securities business, the market intermediaries (as defined above) are licensed?

306 Investment adviser type a) in footnote 302 above.

307 Investment adviser type b) in footnote 302 above.

308 For example, descriptions of the adviser's educational qualifications, relevant industry experience, disciplinary history (if any), investment strategies, fee structure and other client charges, potential conflicts of interest, and past investment performance (if relevant) that is updated periodically and as material changes occur.

309 It may not be possible to resolve all potential conflicts but conflicts should be addressed and if not resolved, at least disclosed.

2. Are there minimum standards or criteria that all applicants for licensing must meet before a licence is granted (or denied)[310] that are clear and publicly available, which:

   (a) Are fair and equitable for similarly situated market intermediaries?

   (b) Are consistently applied?

   (c) Include an initial capital requirement, as applicable?

   (d) Include a comprehensive assessment of the applicant and all those in a position to control, or materially influence, the applicant, which require a demonstration of appropriate knowledge, business conduct, resources, skills, ethical attitude (including a consideration of past conduct)?

   (e) Include an assessment of the sufficiency of internal organization and risk management and supervisory systems in place, including relevant written policies and procedures, which enable ongoing monitoring as to whether the minimum standards are still met?

3. Does the regulator, or the SRO subject to the regulator's oversight, have in place processes and resources to effectively carry out a review of applications for licence?

Authority of Regulator

4. Does the relevant authority have the power to:

   (a) Refuse licensing, subject only to administrative or judicial review, if authorization requirements have not been met?

   (b) Withdraw, suspend or apply a condition to a licence where a change in control or other change results in a failure to meet relevant requirements on an ongoing basis?

   (c) Take effective steps to prevent the employment of persons (or seek the removal of persons) who have committed securities violations or who are otherwise unsuitable, so that they cannot continue to engage in intermediary activities, even if these persons are not separately licensed market intermediaries, if they can have a material influence on the firm?

Ongoing Requirements

5. Are market intermediaries required: to update periodically relevant information with respect to their licence; and to report immediately to the regulator (or licensing authority) material changes in the circumstances affecting the conditions of the licence?[311]

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[310] In some jurisdictions the criteria are stated for denying or disqualifying potential applicants.

[311] Id. There should be regular information provided to the regulator that indicates the market intermediary's ongoing activities. In addition, where there is a change in the market intermediary's staff, activities or environment that would have a material effect on its ability to perform its role, this should be reported to the regulator in a timely fashion.

6. Is the following relevant information about licensed market intermediaries available to the public:

   (a) The existence of a licence, its category, and status?

   (b) The scope of permitted activities and the identity of senior management and names of other authorized individuals who act in the name of the market intermediary?

Investment Advisers

7. Does the regulatory scheme for investment advisers require that, as applicable:

   (a) If an investment adviser deals on behalf of clients, the capital and other operational controls (explained in Principles 29 to 32) applicable to other market intermediaries also should apply to the investment adviser?

   (b) If the investment adviser does not deal, but is permitted to have custody of client assets, regulation provides for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party) and capital and organizational requirements as explained under Principles 29 to 32?

   (c) In the case of both (a) and (b), as well as investment advisers who manage client portfolios without dealing on behalf of clients or holding client assets, does regulation impose relevant requirements that cover record keeping, disclosure and conflicts of interest as explained in Principle 31?

Explanatory Notes

Some jurisdictions may licence persons who operate a CIS as CIS operators; other jurisdictions may licence CIS operators as investment advisers. This characterization should be without prejudice to their assessment under Principles 24 through 28, on CIS, according to the assessment criteria for those Principles and, in any case, these Principles should still apply to the market intermediaries' activities of that investment adviser.

Recognition of another licensing regime, in connection with access to domestic clients by a foreign intermediary subject to relevant conditions, is contemplated as being a licensing or authorization program under the assessment benchmarks, provided that the criteria used are transparent, clear, consistently applied, and address the objectives of the Principles.

Where individuals or entities are licensed, registered, or authorized in more than one capacity, assessors must assure what criteria are applied to each category.

Where a jurisdiction has a self-regulatory organization that licences market intermediaries, assessment of the appropriate oversight of the process by the regulator is addressed under Principle 9.

When considering Key Question 3, assessors should give consideration to Principle 3 on resources.

When considering Key Question 2(e), assessors should give consideration to the extent to which assessment of these systems by the regulator, or its designee (such as a self-regulatory organization), is possible prior to the granting of a licence.

Benchmarks[312]

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 6(b).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 2(e), 4(c), 6(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 2(c), 2(d), 3, 4(a) and (b), 5, 6(a), 7(a), 7(b) and 7(c) to the extent applicable.

[312] In the case of investment advisers, affirmative answers are only required to those Questions applicable to the category of adviser(s) permitted in the jurisdiction. This does not refer to principal protected or guaranteed specified minimum rate of return plans for which appropriate disclosures are made.

Principle 30	**There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.**

Capital adequacy standards foster confidence in the financial markets and investor protection. Establishment of adequate initial and ongoing capital standards also contributes to ensuring the protection of investors, and the integrity and stability of financial systems. A market intermediary should be required to ensure that it maintains adequate financial resources to meet its business commitments and to withstand the risks to which its business is subject.

Assessors should assess each country's capital adequacy standards by reference to the capital adequacy principles published by IOSCO.[313]

Key Issues

1. There should be an initial capital requirement for market intermediaries as a condition of authorization. This requirement should be based on a capital adequacy test that addresses the risks to such firms judged by reference to the nature and amount of the business *expected to be* undertaken.

2. There should be an ongoing capital requirement directly related to the nature of the risks and the amount of business *actually* undertaken by a market intermediary. The capital required should be maintained by the market intermediary and subject to timely periodic reporting to the regulator, or authorized SRO that is subject to regulatory oversight. This should involve a combination of regular reporting, and one-off trigger-based early warning reporting when the threshold levels for minimum capital are approached.

3. Market intermediaries should be subject to capital adequacy and liquidity standards which should cover solvency. Lack of liquidity can cause difficulties for a firm because it might not be able to meet its liabilities as they fall due.[314]

313 See *Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf. For additional guidance see *Guidance to Emerging Market Regulators regarding Capital Adequacy Requirements for Financial Intermediaries*, Report of the Emerging Markets Committee of IOSCO, December 2006, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD230.pdf.

314 See *Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989, page 17, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf.

4. Capital adequacy standards[315] should be designed to allow a market intermediary to absorb some losses and continue to operate, particularly in the event of large, adverse market moves, and to achieve an environment in which it could wind down its business over a relatively short period without loss to: its clients; its counterparties; or the clients of other firms, and without disrupting the orderly functioning of the financial markets. Capital standards should be designed to provide supervisory authorities with time to intervene to accomplish the objective of orderly wind down.

5. In addition to the organizational requirements under Principle 31, a market intermediary should be subject to:

   (a) Independent audits of its financial condition.

   (b) Inspections, including periodic and for cause examinations, by a regulator, or an authorized SRO that is subject to regulatory oversight.

6. The regulator should have specific authority to impose: restrictions on a market intermediary's regulated business activities; and more stringent capital monitoring and/or reporting requirements, if a market intermediary's capital deteriorates or when it falls below minimum requirements.[316]

7. Any exposure of a market intermediary to significant risks arising from the activities of other entities in its group(s) should be addressed. Consideration should be given as to the need for information about the activities of unlicensed and off balance sheet affiliates.[317]

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315 See *Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf; *Capital Requirements for Multinational Securities Firms*, Report of the Technical Committee of IOSCO, November 1990, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD14.pdf; *Multidisciplinary Working Group on Enhanced Disclosure*, Joint Report of the Basel Committee on Banking Supervision, the Committee on the Global Financial System of the G-10 Central Banks, the International Association of Insurance Supervisors and IOSCO, April 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD116.pdf; and *Risk Management Practices and Regulatory Capital - Cross-Sectoral Comparison*, Report of the Joint Forum, November 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD122.pdf.

316 For example, when it is determined that an intermediary is in danger of not being able to fulfil its obligations towards its clients, the market or its creditors, or it is determined that the intermediary's financial condition is deteriorating although still above minimum requirements. Assessors should note that although this is a regulatory requirement, in the first instance, the responsibility for managing risks rests with the firm.

317 *Sound Practices for the Management of Liquidity Risk at Securities Firms*, Report of the Technical Committee of IOSCO, June 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD128.pdf; and *Capital Requirements for Multinational Securities Firms*, Report of the Technical Committee of IOSCO, November 1990, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD14.pdf. See also *Multidisciplinary Working Group on Enhanced Disclosure*, Joint Report of the Basel Committee on Banking Supervision, the Committee on the Global Financial System of the G-10 Central Banks, the International Association of Insurance Supervisors and IOSCO, April 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD116.pdf. See also *Risk Management Practices and Regulatory Capital - Cross-Sectoral Comparison*, Report of the Joint Forum, November 2001, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD122.pdf; and *Regulatory and Market Differences: Issues and Observations*, Report of the Joint Forum, May 2006, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD215.pdf.

Key Questions

1. Are there initial and ongoing minimum capital requirements for market intermediaries? Are there also liquidity standards? Do the capital and liquidity standards address solvency?

2. Are the capital adequacy requirements structured to result in capital addressed to the full range of risks to which market intermediaries are subject, e.g., market, credit, liquidity, and operational risks?

3. Are capital adequacy requirements sensitive to the quantum of risks undertaken; that is, does required capital increase as risk increases, e.g., in the event of large market moves?

4. Are capital standards designed to allow a market intermediary to absorb some losses, and to wind down its business over a relatively short period without loss to its clients or disrupting the orderly functioning of the markets?

5. Are relevant market intermediaries required to maintain records such that capital levels can be readily determined at any time?

6. Are the detail, format, frequency, and timeliness of reporting to the regulator, and/or the SRO, sufficient to reveal a significant deterioration in the capital adequacy position of market intermediaries?

7. Is the financial position of the market intermediary subject to audit by independent auditors to provide additional assurance that the financial position reflects the risks that the market intermediary undertakes?

8. Does the regulator:

   (a) Regularly review market intermediaries' capital levels?

   (b) Take appropriate action when these reviews indicate material deficiencies?

9. Does the regulator:

   (a) Have specific authority to impose: restrictions on a market intermediary's regulated business activities; and more stringent capital monitoring and/or reporting requirements, if a market intermediary's capital deteriorates so as to endanger its capacity to fulfil its obligations or when it falls below minimum requirements?

   (b) Is there evidence that the regulator exercises this authority?

10. Does the prudential framework address risks from outside the regulated entity, for example from unlicensed affiliates and off-balance sheet affiliates?

Explanatory Notes

In assessing the Principles, generally, it should be understood that there are two main approaches to the setting of capital adequacy standards for market intermediaries. A "net capital" approach is used in the United States, Canada, Japan, and some other non-EU jurisdictions. The purpose of the net capital approach is, among other things, to protect clients and creditors by requiring broker-dealers to maintain sufficient liquid assets to allow

the orderly self-liquidation of financially distressed broker-dealers. The other main approach is incorporated in the EU's Capital Adequacy Directive, which is based on the amendment to the Basel Capital Accord to incorporate market risks.[318] The emphasis in this approach is on ensuring the capital solvency of firms. The two approaches differ somewhat in their objectives, but their practical effects overlap to a significant extent. There may be other equivalent approaches that address the performance standards of the Principles, for example in relation to investment advisers,[319] and there may also be other equivalent approaches in various countries. In the latter case, assessors need to consider if the rules of that particular country comply with the capital adequacy principles published by IOSCO.[320]

There are also different approaches to assessing the risks posed to market intermediaries by affiliated entities. One approach (used in the United States) is to require the regulated entity, the registered broker-dealer, to provide extensive "risk assessment" information to the regulator concerning its material affiliates. A number of other jurisdictions have regulatory authority over such affiliates and may require the affiliates to provide information to them directly.

The EU generally requires securities firms to provide capital adequacy information on a consolidated basis, and to meet capital requirements at the consolidated group level as well as at the level of individual regulated entities. The assessment criteria recognize that other approaches may be employed.[321]

Some market intermediaries act in such a way that their activity is of lower risk. Where the market intermediary does not handle client money directly, is an inter-dealer broker with no principal at risk, or operates on a matched book basis,[322] it may be appropriate to set capital requirements at a level lower than the level applicable to market intermediaries that carry client assets or take principal positions for their own account.

Capital adequacy requirements may explicitly refer to a particular risk, but be set at a level that in practice covers other risks as well. The assessor should inquire about the method of minimum capital determination being used, and the types of market intermediaries in the jurisdiction to which it applies; taking into account that more than one method or technique of computing capital or capital requirements is permitted under the Principles.[323]

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318 See Directive 2006/49 on the capital adequacy of investment firms and credit institutions (recast) and Directive 2006/48 relating to the taking up and pursuit of the business of credit institutions (recast).

319 Principle 29, Key Issue 8, infra, regarding investment advisers.

320 See *Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf. For additional guidance see *Guidance to Emerging Market Regulators regarding Capital Adequacy Requirements for Financial Intermediaries*, Report of the Emerging Markets Committee of IOSCO, December 2006, pages 24 & 25, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD230.pdf.

321 See *Trends in Risk Integration and Aggregation*, Report of the Joint Forum, August 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD149.pdf; and *Operational Risk Transfer Across Financial Sectors*, Report of the Joint Forum, August 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD148.pdf.

322 Please note that this does not include market intermediaries that take positions on their own account.

323 For greater detail on the specified risks, *Methodologies for Determining Minimum Capital Standards for Internationally Active Securities Firms Which Permit the Use of Models Under Prescribed Conditions*, Report of the Technical Committee of IOSCO, May 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD77.pdf.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 10.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 6, 9(b) and 10.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3, 4, 5, 7, 8(a), 8(b), and 9(a).

Principle 31	**Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.**

Market intermediaries should conduct their businesses in a way that protects the interests of their clients and their assets and helps preserve the integrity of the market.[324]

Regulation should require that market intermediaries have in place appropriate internal policies and procedures for observance of securities laws and appropriate internal organization and risk management systems. Regulation should not be expected to remove risk from the market place but should aim to ensure that there is proper management of that risk.

Instances of operational breach can occur despite the existence of internal procedures designed to prevent misconduct or negligence. It is not practicable for the regulator to oversee adherence to those internal procedures on a day-to-day basis. That is the primary responsibility of the management of the market intermediary. Management must ensure that they are able to discharge that responsibility.

Key Issues

Management and Supervision

1. The management of a market intermediary should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm. This includes ensuring that the firm is structured appropriately and has an adequate internal structure and controls, given the types of

[324] See *Resolution on Rules of Ethics of Intermediaries*, Resolution of the Presidents´ Committee of IOSCO, September 1989, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES43.pdf. See also *International Conduct of Business Principles*, Report of the Technical Committee of IOSCO, July 1990, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD8.pdf; and *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, (and in particular, Key Recommendations 8 - 11 and text), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf; *Report on Securities Activity on the Internet III*, Report of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf; *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf; and *Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism*, Report of the Joint Forum, June 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD146.pdf.

business in which it engages, including any activities which have been outsourced,[325] to ensure investor protection and the management of risks.

(a) Management must ensure adherence to internal procedures on a day-to-day basis. They must understand the nature of the firm's business, its internal control procedures and environment and its policies on the assumption of risk, and clearly understand the extent of their own authority and responsibilities.

(b) All relevant information about the business must be:

(i) timely;

(ii) readily accessible;

(iii) and regularly reported to management,

and such information should be subject to procedures intended to maintain its security, availability, reliability, and integrity.

2. Periodic evaluation of risk management processes within a regulated entity is necessary. This should be conducted by someone of sufficient autonomy so as not to compromise the evaluation. SROs and third parties, such as external auditors, may be used to assist in this process.

Organizational requirements[326]

3. Markets intermediaries should have systems or processes in place that seek to ensure that they are complying with all applicable laws and regulations and to reduce their risk of legal or regulatory sanctions, financial loss or reputational damage.

4. The details of the appropriate internal organization of a firm, including risk management, internal audit, and compliance functions, will vary according to the size of the firm, the nature of its business and the risks it undertakes. Information regarding the firm's internal organization should also be available to the regulator upon request. With regards to a market intermediary's internal organization, the regulatory framework should require the following to be considered:

[325] See *Principles on Outsourcing of Financial Services for Market Intermediaries*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD187.pdf; *Operational and Financial Risk Management Control Mechanisms for Over-the-Counter Derivatives Activities of Regulated Securities Firms*, Report of IOSCO, July 1994, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD35.pdf.

[326] See *Compliance Function at Market Intermediaries*, Final Report, Report of the Technical Committee of IOSCO, March 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf.

(a) Compliance with all applicable legal and regulatory requirements, as well as with the firm's own internal policies and procedures should be monitored, where appropriate, by a separate compliance function[327] that reports directly to senior management in a structure that makes it independent from operational divisions. [328]

(b) Maintenance of effective policies and operational procedures and controls in relation to the firm's day-to-day business, including:

(i) clear policies covering the risk management and internal controls applicable to proprietary trading; and

(ii) procedures that seek to ensure the integrity, security, availability, reliability and thoroughness of all information, business continuity, as well as outsourcing procedures.[329]

(c) Evaluation of the "effectiveness" of those operational procedures and controls in the light of whether they serve reasonably to ensure:

(i) The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest, and professional manner.

(ii) Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors, or may be susceptible to abuses which expose the firm or its clients to inappropriate risks.

(d) Addressing any conflict of interest arising between its interests and those of its clients. Where the potential for conflicts arise, a market intermediary should ensure fair treatment of all its clients by taking reasonable steps to manage the conflict through organizational measures to prevent damage to its clients' interest, such as: internal rules, including rules of confidentiality; proper disclosure; or declining to act where conflict cannot be resolved.

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327 The term "compliance function" is used as a generic reference to refer to the range of roles and responsibilities for carrying out specific compliance activities and responsibilities. The expression does not intend to denote any particular organizational structure, recognizing the diversity of size and type of securities firms. See *Compliance Function at Market Intermediaries*, Final Report, Report of the Technical Committee of IOSCO, March 2006, p. 7, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf.

328 In the smaller firms, there may be an overlap between senior management who trade or provide advice and the compliance function. In such a case, procedures are required to prevent conflicts of interest or other problems regarding the performance of their compliance responsibilities". See IOSCO report on *Compliance Function at Market Intermediaries*, March 2006, p. 12. Assessors need to recognise the difficulty of achieving complete independence for the compliance function in the smallest firms. (See IOSCO report on *Compliance Function at Market Intermediaries*, March 2006.)

329 Those operational procedures could include consideration of the use of risk transfer mechanisms (and the implications of their use in transforming or transferring risks). See *Outsourcing in Financial Services*, Report of the Joint Forum, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf.

5. If DEA ("Direct Electronic Access") is allowed, market intermediaries should use controls, including automated pre-trade controls, which can limit or prevent a DEA client from placing an order that exceeds the market intermediary's existing position or credit limits.[330]

Protection of Clients

6. Where a market intermediary has control of, or is otherwise responsible for, assets belonging to a client which it is required to safeguard, it should make adequate arrangements to safeguard clients' ownership rights (for example, segregation and identification of those assets). These measures are intended to: provide protection from defalcation; facilitate the transfer of positions in cases of severe market disruption; prevent the use of client assets for proprietary trading or the financing of a market intermediary's operations; and assist in orderly winding up on the insolvency of an individual market intermediary and the return of client assets.

7. Market intermediaries should have an efficient and effective mechanism to address investor complaints.

8. With regards to a market intermediary's conduct with clients, the following are to be considered as important components:

   (a) When establishing a business relationship with a client a market intermediary should identify, and verify, the client's identity using reliable, independent data. A market intermediary should also obtain sufficient information to identify persons[331] who beneficially own or control securities and, where relevant, other accounts.[332] Procedures to implement this requirement will facilitate a market intermediary's ability to mitigate the risk of being implicated in fraud, money laundering, or terrorist financing.

   (b) A market intermediary should obtain and retain from its clients any information about their circumstances and investment objectives relevant to the services to be provided. Where the activities of a market intermediary extend to giving specific advice, the advice should be given based on an understanding of the needs and circumstances of the customer.[333]

   (c) The client should be able to obtain a written contract of engagement or account agreement, or a written form of the general and specific conditions of doing business through the market intermediary.

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330 See *Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf.

331 For example, by obtaining the beneficial owner's name and address.

332 For further clarification of this requirement, please see the discussion under Principle 2 (pages 7-8) of *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf.

333 In this context, the "know your customer" principle relates to suitability of investment recommendations and disclosure obligations. It should be distinguished from obligations relating to client identification imposed to prevent money laundering.

(d) Records containing the above information should be kept for a reasonable number of years in accordance with best practices in order to facilitate investor protection and exchange of information between jurisdictions.[334] If market intermediaries are permitted to use reliable third parties to meet their client obligations under these principles, they nonetheless remain responsible for the performance of such obligations. Policies and procedures should be established which ensure the integrity, security, availability, reliability and thoroughness of all information, including documentation and electronically stored data, relevant to the market intermediary's business operations.

(e) A market intermediary should disclose or make available adequate information to its client in a comprehensible and timely way so that the client can make an informed investment decision. It may be necessary for regulation to require a particular form of disclosure where products carry risk that may not be readily apparent to the retail client. Recruitment and training should seek to ensure that staff who provide investment advice understand the characteristics of the products they advise upon.

(f) A market intermediary should promptly, and at suitable intervals, provide each client with a report of the value and composition of the clients' account or portfolio including, as appropriate, an account of transactions and balances.

(g) A market intermediary should provide each client with information about fees and commissions.

(h) A market intermediary should act: with due care and diligence in the best interests of its clients and protect their assets; and in a way that helps preserve the integrity of the market.

(i) The regulator should be able to demonstrate that it has in place a supervision program, which includes internal processes, skilled and knowledgeable staff and other resources, that monitors compliance by market intermediaries with these requirements.

Key Questions

Management and Supervision

1. With regards to a market intermediary's internal organization, does the regulatory framework require the following to be considered:

   (a) An appropriate management and organization structure, including in relation to activities that have been outsourced?[335]

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334 In *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf.

335 See *Principles on Outsourcing of Financial Services for Market Intermediaries*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD187.pdf.

(b) Adequate[336] internal controls?

(c) Management that is required to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm?

2. Does the regulatory framework require market intermediaries: to provide all relevant information about the business in a timely, readily accessible way; and to regularly report to management? Is such information subject to procedures intended to maintain its security, availability, reliability, and integrity?

3. Does the regulatory framework require a market intermediary to be subject to an objective,[337] periodic evaluation of its internal controls and risk management processes?

Organizational requirements

4. Does the regulatory framework include the assessment of a market intermediary's compliance function, taking into account the market intermediary's size and business? When the regulator becomes aware of deficiencies are steps taken to require market intermediaries to improve their compliance function?

5. Does the regulatory framework require a market intermediary to establish and maintain appropriate systems of client protection, risk management and internal and operational controls, including policies, procedures, and controls relating to all aspects of its day-to-day business intended reasonably to ensure:

(a) The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest, and professional manner?

(b) Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors, or may be susceptible to abuses, which expose the firm, or its clients, to inappropriate risks?

6. Taking into account Principle 8, does the regulatory framework require a market intermediary:[338]

(a) To endeavour to address a conflict of interests arising between its interests and those of its clients, or between its clients?

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336 The notion of adequacy should take into account the size of the firm, the nature of its business and the types and amount of risks it undertakes.

337 This evaluation should be performed by someone of sufficient autonomy so as not to compromise the evaluation.

338 *Market Intermediary Management of Conflicts that Arise in Securities Offerings*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD257.pdf.

(b) Where the potential for conflicts arises:

(i) to have mechanisms in place to manage conflicts of interests that seek to ensure an unbiased decision making process and fair treatment of all its clients; and

(ii) consider further steps if the mechanisms identified in (a) prove inadequate, which may include disclosure of the conflict, internal rules of confidentiality, declining to act where a conflict cannot be resolved?

7. If DEA is allowed, does the regulatory framework require market intermediaries to use controls, including automated pre-trade controls, which can limit or prevent a DEA client from placing an order that exceeds the market intermediary's existing position or credit limits?[339]

Protection of clients

8. If a market intermediary has control of, or is otherwise responsible for, assets belonging to a client which it is required to safeguard, are there regulations that require proper protection for them (for example, segregation and identification of those assets) by the market intermediary? Do these measures facilitate the transfer of positions and assist in the orderly winding up in the event of financial insolvency and the return of client assets?

9. Does the regulatory framework require market intermediaries to provide for an efficient and effective mechanism to address investor complaints?

10. Does the regulatory framework require market intermediaries to identify, and verify, the client's identity using reliable, independent data, including persons who beneficially own or control securities?

11. Does the regulatory framework require market intermediaries to obtain and retain information from a client about their circumstances and investment objectives relevant to the services to be provided?

12. Does the regulatory framework require a market intermediary to "know its customer" before providing specific advice to a client?

13. Does the regulatory framework require market intermediaries to keep records containing the above information for a reasonable number of years?[340] Is the market intermediary required to maintain those books and records in such a way that allows the supervisor to be able to find all the relevant facts relating to a particular transaction?

14. Does the regulatory framework require market intermediaries to provide to the client a written contract of engagement or account agreement, or a written form of the general and specific conditions of doing business through the market intermediary?

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339 See *Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, p. 20, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf.

340 *Compliance Function at Market Intermediaries*, Final Report, Report of the Technical Committee of IOSCO, March 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf.

15. Does the regulatory framework require a market intermediary to disclose, or make available, information to its client so that the client can make an informed investment decision?

16. Does the regulatory framework require market intermediaries to provide a client with statements of account, at least annually?

17. Does the regulatory framework require market intermediaries to provide a client with information about any fees and commissions associated with the client's transactions?

18. Does the regulatory framework require market intermediaries to act: with due care and diligence in the best interests of its clients and their assets; and in a way that helps preserve the integrity of the market?

19. Can the regulator demonstrate that it has in place a supervision program, including internal processes that seek to monitor compliance by market intermediaries with these requirements?

Explanatory Notes:

Treatment of client assets also may be relevant to adequacy of capital as addressed in Principle 30.

What constitutes adequate disclosure by a market intermediary may depend on the type of services being offered. For example, the disclosures required of a pure order taker would be different from those of a full service broker also providing investment advice.

Key Question 19 should not be interpreted as imposing or requiring a fiduciary duty on all market participants in dealing with their clients.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 9.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3, 5(a), 5(b), 6(a) or (b), 7 (if applicable), 9, 10, 12, 14 and 15.

Not-Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 2, 4, 8, 11, 13, 16, 17, 18, 19.

Principle 32	**There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.**

The failure of a market intermediary can have a negative impact on clients and counterparties and may have systemic consequences. The regulator must have a clear and flexible plan in place to deal with the eventuality of failure by market intermediaries.

Key Issues

1. The regulator should have a clear plan for dealing with the eventuality of failure by market intermediaries. The circumstances of financial failure are unpredictable so the plan should be flexible.

2. The regulator should attempt to minimize damage and loss to investors and to the functioning of the financial system caused by the failure of a market intermediary. A combination of actions, may be necessary:

   (a) to restrain conduct;

   (b) to aim to ensure that assets are properly managed; and

   (c) to provide information to the market.

3. Depending upon the prevailing domestic bank regulatory model, it may also be necessary to cooperate with banking regulators, and if the domestic arrangements require it, insolvency authorities. As a minimum position, the regulator should have identified contact persons at other relevant domestic and foreign market authorities.[341]

4. The regulator should have a mechanism/monitoring system in place to determine the potential systemic impact of the failure of a market intermediary in a very short time frame.

Key Questions

1. Does the regulator have clear plans for dealing with the eventuality of a firm's failure, including a combination of activities: to restrain conduct; to ensure assets are properly managed; and to provide information to the market, as necessary?

2. Are there early warning systems or other mechanisms in place to give the regulator notice of a potential default by a market intermediary, and time to address the problem and take corrective actions?

3. Does the regulator have the power to take appropriate actions: In particular, can it:

[341] See *Report on Cooperation Between Market Authorities and Default Procedures*, Report of the Technical Committee of IOSCO, March 1996, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD49.pdf.

(a) Restrict activities of the market intermediary with a view to minimizing damage and loss to investors?

(b) Require the market intermediary to take specific actions, for example, moving client accounts to another market intermediary?

(c) Request appointment of a monitor, receiver, curator or other administrator, or, in the absence of such power, can the regulator apply to the relevant authorities to take possession or control of the assets held by the market intermediary, or by a third party on behalf of the market intermediary?

(d) Apply other available measures intended to minimize client, counterparty, and systemic risk in the event of intermediary failure such as, client and settlement insurance schemes, or guarantee funds?

4. Can the regulator demonstrate that it has the power and practical ability to take these actions against a market intermediary?

5. Do the regulator's processes and procedures for addressing financial disruption include communication and cooperation with other regulators, both domestic and foreign, where appropriate, and is there evidence that contact arrangements are in place, and that such cooperation occurs?

Explanatory Notes

In assessing the adequacy of the regulatory regime to protect client assets in the possession of failed or failing market intermediaries, in addition to consideration of the adequacy of capital and other prudential regulations, it is appropriate to consider the adequacy of arrangements for segregation, if applicable. Also, it is appropriate to consider the availability and adequacy of insurance and/or compensation schemes designed to protect clients' funds and securities in the event of a market intermediary's insolvency, as well as settlement assurance schemes or other arrangements that may minimize counterparty and systemic risk.

The assessor should indicate what combination of arrangements is available and how they are intended to mitigate risk.

Assessments of Principle 32 should be consistent with any findings under the assessment of Principle 6 on systemic risk, and with any findings related to risk management practices under Principles 29 and 30.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 3(d).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 3(b), 3(c), 3(d).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2, 3(a), 4 and 5.

I. PRINCIPLES RELATING TO THE SECONDARY MARKETS

1. Preamble

Regulators in all jurisdictions acknowledge that investors want fair, efficient, and transparent secondary markets. The Principles under this section are intended to promote these objectives.[342] The fairness of the markets is closely linked to investor protection and to the prevention of improper trading practices.

In Principles 33 through 37, the word "markets" should be understood in its widest sense, including any facility used to trade equity and debt securities, options and derivative products. In addition to traditional organized exchanges, secondary markets should be understood to include various forms of non-exchange trading market systems. These systems include alternative trading systems (ATSs), multilateral trading facilities (MTFs), and "proprietary" systems developed by intermediaries, typically offering their services to other brokers, banks, and institutional/retail investors who meet the operator's credit standards. Increasingly, products that traditionally have been traded through private over-the-counter (OTC) transactions are migrating onto electronic trading facilities. At the time of the current revision to the Methodology, IOSCO had initiated work on OTC derivatives.[343] It is likely that this work may require further modifications to the Methodology.

Notwithstanding the broad meaning of "markets", for assessment purposes this Methodology is directed to topics that have been addressed by IOSCO reports. Authorized exchanges and regulated trading systems, that is, market systems that bring together multiple buyers and sellers in a manner that results in completed transactions or trades, are the main focus of this assessment.

Regulation appropriate to a particular secondary market will depend upon the nature of the market, its products, and its participants. Regulation will increasingly need to take account of the growing internationalization of trading, and the impact of technological developments on markets and their infrastructure.

The operation of some exchanges and trading systems is performed by the markets and systems themselves. In others, it is undertaken by a separate entity that acts as the operator. In this section, the terms "authorized exchange" and "regulated trading system" should be understood to include both of these types of exchanges and trading systems.[344]

The level of regulation will depend upon the characteristics of the market in question, including: the structure of the market and the sophistication of its participants; rights of access; types of products traded; the degree of integration with other markets; the extent of cross-border business; the impact of technological developments; and the ability of the operators to fulfil any self-regulatory and risk management role under the powers and authority granted by law.

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342 *Supervisory Framework for Markets*, Report of the Technical Committee of IOSCO, May 1999, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf.

343 See *Report on Trading of OTC Derivatives*, Report of the Technical Committee of IOSCO, February 2011, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf.

344 References to "operator" herein should be understood to include the authorized exchange or regulated trading system and vice versa.

Because regulation may differ according to market structure, market participant or product, information about such differences, and the rationale for such differences, is an important component of any assessment. For example, the Principles do not specify particular regulatory methodologies. In most cases the Principles may be implemented by legislation, administrative rules, advisories, guidelines or procedures, market rules, equitable principles of trade or best practices, or professional market codes of conduct, agreed market conventions or, for electronic markets, integrated into the algorithm; provided, however, that whatever method of implementation is chosen is enforceable to the extent necessary to achieve its objectives and takes into account the Benchmarks.

Accordingly, in order to accurately assess regulatory structure, assessors must understand the market structure, including clearing and settlement arrangements, types of participants and international linkages (both foreign and domestic). The Introduction to this Assessment Methodology provides further guidance regarding the effect of market structure on the approach to undertaking an assessment.

The Principles also recognize that "in some cases it will be appropriate that a trading system should be largely exempt from direct regulation…" but will require approval from the relevant regulator after proper consideration by the regulator of the type of approval (or exemption) necessary.[345] If this is the case, the criteria should be transparent, accessible, and consistently applied.[346] The effect of exemptions on the market and public may be relevant to inquiries into the "perimeter of regulation" inquiry under Principle 7.

In addition, in many jurisdictions, the authorization or recognition process and relevant requirements for electronic trading systems sponsored by foreign operators may differ from the process for fully domestic systems.[347] Similarly, some jurisdictions may provide tiered levels of regulation for markets depending upon the type of product traded and sophistication of the participants. Still other jurisdictions regulate alternative trading systems as brokers and apply regulation consistent with that for market intermediaries under these Principles coupled with certain rules on transparency, insider trading and market abuse prohibitions. Such flexibility in regulation is consistent with the Principles. Differences related to the type of service provided, product traded and participants in the market are generally accepted bases for drawing appropriate regulatory distinctions.[348]

Confidence in the rule of law, the enforceability of contracts and the adequacy of commercial and insolvency law are critical to the effective regulation of secondary markets, so to the extent gaps exist these should be identified in the assessment.[349]

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345 See *Supervisory Framework for Markets*, Report of the Technical Committee of IOSCO, May 1999, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf.

346 For example, exemption from some requirements for trading systems with limited trading volumes may be appropriate. Also, in many jurisdictions, the trading markets for sovereign (and in some cases, sub-sovereign) debt securities are not subject to regulation, or subject to more limited regulation, than the trading markets for corporate securities.

347 There should, however, be no unnecessary barriers to entry and exit from markets and products. In some cases, these may be caused by laws not subject to the control of regulators, such as fiscal or other general laws. See Annexure 1. For example, however, access criteria can be based on mutual recognition, additional disclosure or other requirements.

348 *Supervisory Framework for Markets*, supra, Section IV. A., Alternative Trading Systems.

349 Annexure 1.

2. Scope

Principles 33 through 38 examine how a jurisdiction's overall regulatory structure ensures the integrity of regulated markets.

Principles 33 and 34 examine the general requirements for authorization of exchanges and trading systems and their on-going supervision. Specifically, Principle 33 examines the criteria that are required when an exchange or trading system is *initially* authorized in a jurisdiction. Principle 34, on the other hand, examines the procedures by which the regulator is assured of the *on-going compliance* by an authorized exchange or regulated trading system with the relevant conditions thought necessary as pre-requisites to authorization.

Principles 35, 36 and 37 focus on specific regulatory objectives that are intended to promote market integrity. Principle 35 focuses on the extent to which the regulatory structure promotes transparency (defined in terms of the availability of pre-trade and post-trade information). Principle 36 focuses on the regulations and mechanisms that prohibit, detect and deter manipulative, fraudulent, and deceptive conduct or other market abuses. Finally, Principle 37 focuses on the mechanisms in place to ensure the proper management of large exposures, defaults, and market disruptions. Principle 37 also addresses the need for short selling regulatory requirements in equity security markets.

Principle 38 makes clear that because of the potential for disruptions to securities and derivatives markets and to payment and settlement systems, both domestic and non-domestic, securities settlement systems and central counterparties should be subject to effective regulation and oversight to ensure that they are fair, effective, and efficient and that they reduce systemic risk.

3. Principles 33 through 37

Principle 33	**The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.**

The regulator's authorization of exchanges and trading systems, including the review and approval of trading rules, helps to ensure fair and orderly markets.[350] The fairness of markets is closely linked to investor protection and, in particular, by the prevention of improper trading practices.

Regulation should seek to ensure that investors are provided fair access to market facilities on a non-discriminatory basis. Regulation should promote market practices and structures that ensure fair treatment of orders and a reliable price formation process. This includes the requirement of an appropriate post-trade reporting system that provides the public promptly with information concerning the prices at which trades were executed.

Key Issues

Criteria for authorization

Exchanges or Trading Systems Subject to Regulation

1. Regulation should provide for the assessment of the initial and ongoing propriety and competence of the operator of an exchange or trading system as a secondary market. The operator should be accountable to the regulator and, when assuming principal, settlement, guarantee, or performance risk, must comply with prudential and other requirements designed to reduce the risk of non-completion of transactions.

Supervision

2. The regulator should assess the reliability of all the arrangements made by the operator for the monitoring, surveillance and supervision of the exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation. There must be mechanisms in place to identify and address disorderly trading conditions and to ensure that contravening conduct, when detected, will be dealt with. Details of procedures for trading halts, other trading limitations and assistance available to the

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350 Assessors should refer to the following IOSCO reports for background: *Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems*, Report of IOSCO, October 1994, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD42.pdf. See also *Screen-Based Trading Systems for Derivative Products*, Report of the Technical Committee of IOSCO, June 1990, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD6.pdf. See also *Principles for the Oversight of Screen-Based Trading Systems for Derivatives Products - Reviews and Additions*, Report of the Technical Committee of IOSCO, October 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD111.pdf. See also *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf; and *Securities Activity on the Internet II*, Report of the Technical Committee of IOSCO, June 2001, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf.

regulator in circumstances of potential trading disruption on the market should be provided to the regulator.

3. When functions are outsourced, such outsourcing does not negate the liability of the outsourcing market for any and all functions that the market may outsource to a service provider. The outsourcing market must retain the competence and ability to be able to ensure that it complies with all regulatory requirements. Accordingly, with respect to the outsourcing of key regulatory functions, markets should consider how and whether such functions may be outsourced. Outsourcing should not be permitted if it impairs the market authority's[351] ability to exercise its statutory responsibilities, such as proper supervision and audit of the market.[352]

Products and Participants

4. The regulator should, as a minimum requirement, be informed of the types of securities and products to be traded on the exchange or trading system, and should review/approve the rules governing the trading of the product, where applicable. In doing so, the market and/or the regulator should:

   (a) Consider product design principles, where applicable, listing requirements and trading conditions.

   (b) Ensure that access to the system or exchange is fair and objective, and consider the related admission criteria and procedures.

Execution Procedures

5. The order execution rules, as well as any cancellation procedures, should be disclosed to the regulator and to market participants, and should be applied fairly to all participants. The exchange or trading system's order routing procedures should also be clearly disclosed to the regulator and to market participants, applied fairly, and should not be inconsistent with relevant securities regulation (*e.g.*, client precedence or prohibition of front running or trading ahead of customers).[353]

6. The fairness of latency differences resulting from different technical connection options and in particular from co-locating high speed algorithmic trading systems adjacent to exchange servers raises significant technical and market integrity issues.[354] Pending the development of further work on this issue, Market Authorities should take into account the approach set out in IOSCO's *Principles for the Oversight of Screen-Based Trading Systems* (2000), which focused on equality of treatment within a given connectivity option and disclosure of differences in response time.

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351 The term "market authority" is used in this context to refer to the authority in a jurisdiction that has statutory or regulatory powers with respect to the exercise of certain regulatory functions over a market. The relevant market authority may be a regulatory body, a self-regulatory organization and/or the market itself. *Principles on Outsourcing by Markets*, Final Report, Report of the Technical Committee of IOSCO, July 2009, fn. 2, p.3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD299.pdf.

352 See *Principles on Outsourcing by Markets*, Final Report, Report of the Technical Committee of IOSCO, July 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD299.pdf.

353 Not all jurisdictions grant SRO obligations to markets. The specific responsibilities of a market will always be defined by the applicable laws and regulations.

354 *Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf.

7. Direct electronic access (DEA) refers to the process by which a person transmits orders on their own (i.e., without any handling or re-entry by another person) directly into the market's trade matching system for execution.[355]

8. A market should not permit DEA unless there are in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate trading limits.[356]

9. Markets should provide member intermediaries with access to pre-trade and post-trade information (on a real time basis) to enable these intermediaries to implement appropriate monitoring and risk management controls.[357]

Trading Information

10. Information on completed transactions, trading information and rules and operating procedures should be available, and the regulator should verify that it is provided on an equitable basis to all similarly situated market participants.[358]

    (a) Any categorization of participants, for the purpose of access to pre-trade information, should be made on a reasonable basis.

    (b) Any differential access to such information should not unfairly disadvantage specific categories of participants.

11. Full trade documentation and an audit trail should be available to the regulator.

Key Questions

Exchanges or Trading Systems, Subject to Regulation

1. Does the establishment of an exchange or trading system[359] require authorization?

2. Are there criteria for the authorization[360] of exchange and trading system operators that:

    (a) Require analysis and authorization of the market by a competent authority?

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355 Id. Appendix 1 definition of DEA.

356 Id. P. 20, DEA Principle 6.

357 Id. P.17 DEA Principle 5. This Principle reflects the Technical Committee's recognition that in the dispersed world of electronic trading, intermediaries must have timely access to relevant pre-trade and post-trade information in order to facilitate the performance of their traditional risk management functions in the context of DEA.

358 Market participants include not only market members, but also investors in a larger sense.

359 To the extent a trading system is treated as a broker the applicable requirements under these Principles would be those related to market intermediaries, coupled with any transparency, insider trading or market abuse requirements.

360 The term "authorization" should be interpreted to include "licensed," "granted authority to do investment business" or "recognition."

(b) Seek evidence of operational or other competence of the operator of an exchange or trading system as a secondary market?

(c) Require the operator of an exchange or trading system that assumes principal, settlement, guarantee, or performance risk, to comply with prudential and other requirements designed to reduce the risk of non-completion of transactions (*e.g.*, mandatory margin assessment and collection, capital or financial resources, member contributions, guaranty fund, credit or position limits)?

(d) Permit the regulator to impose ongoing conditions (as appropriate) on the operator of an authorized exchange or regulated trading system, such as the obligation to establish: rules; policies; and procedures, to prevent fraudulent behaviour, treat all members or participants fairly, and have the capacity to carry out the market's and the competent authority's obligations?[361]

Supervision [362]

3. Does regulation require an assessment of:

(a) The reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation? The market's dispute resolution and appeal procedures or arrangements as appropriate, its technical systems standards and procedures related to operational failure, information on its record keeping system, reports of suspected breaches of law, arrangements for holding client funds and securities, if applicable, and information on how trades are cleared and settled?

(b) The mechanisms that must be in place to identify and address disorderly trading conditions, and to deal with any contravening conduct that is detected, including details of: procedures for trading halts;[363] other trading limitations; and assistance available to the regulator, in circumstances of potential trading disruption on the system?

(c) Does the relevant market authority (i.e., the regulator or relevant SRO), the outsourcing market, and its auditors, have: access to the books and records of service providers relating to an exchange's outsourced activities; and the ability to obtain promptly, upon request, other information concerning activities that are relevant to regulatory oversight?

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361 *Supervisory Framework for Markets*, Report of the Technical Committee of IOSCO, May 1999, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf, states at page 7: "Through the authorization process, the regulator retains an important enforcement tool: the ability to prohibit or place restrictions upon operations." This is implicit in the concept of being "accountable".

362 Id. Pages 8 and 9.

363 See *Indexation: Securities Indices and Index Derivatives*, Report of the Technical Committee of IOSCO, February 2003, pp. 28-29, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD143.pdf. "More aggressive surveillance can be applied to supplement the design characteristics inherent in non-diversified indices…"

Securities and Market Participants

4. With respect to securities and market participants:

   (a) Is the regulator informed of the types of securities to be traded, and does it approve the rules governing the admission of the securities to trading or listing?

   (b) Where applicable, does the regulator, or the market, take product design[364] and trading conditions into account in order to admit a product for trading?

   (c) Does the regulatory framework provide for fair access[365] to the exchange, or trading system, through oversight of the related rules for participation?

Fairness of Order Execution Procedures

5. With respect to order execution procedures:

   (a) Are order routing procedures clearly disclosed to regulators and to market participants, applied fairly, and not inconsistent with relevant securities regulation (e.g., requirements with respect to precedence of client orders and prohibition of front-running or trading ahead of customers)?[366]

   (b) Are execution rules disclosed to the regulator and to market participants, and consistently applied to all participants?

   (c) Where applicable, does the regulator review the trade matching or execution algorithm of automated trading systems for fairness?[367]

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364 Securities may be subject to rules or requirements for admission to public trading. See *The Application of the Tokyo Communiqué to Exchange-Traded Financial Derivatives Contracts*, Report of the Technical Committee of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD85.pdf. In the case of derivatives, "Contract design rules for derivatives markets should be viewed as a complement to an appropriate surveillance system. In general, contract design standards are intended to assure that contracts are not readily susceptible to manipulation, that the delivery and/or settlement mechanism is reliable, and (for derivative products) that the prices of the underlying and the derivative converge at expiration and, as a consequence, can serve a valid risk management function."

365 For example, with respect to access to electronic systems for derivative products, do rules ensure that: response time is equivalent for all system participants; all similarly situated system users have an equal ability to connect and to maintain the connection to the system; all equivalent "inputs" (e.g., volume and order type) by system users are treated fairly and equally; and access by links or interfaces with other systems (e.g., clearing systems, order routing systems, quotation vendors) are equitable? See also the discussion of Principle 3 in *Screen-Based Trading Systems for Derivative Products*, Report of the Technical Committee of IOSCO, June 1990, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD6.pdf. These are illustrative "best practices" developed in the context of regulated trading systems for derivative products and are not intended to limit or define practices for regulated trading systems for other securities products.

366 Regulatory issues may depend on whether orders are transmitted to an organized regulated market or to other regulated trade execution and matching systems. See also the discussion in paragraphs 67-73 of *Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems*, Report of the Technical Committee of IOSCO, October 1994, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD42.pdf.

367 *Screen-Based Trading Systems for Derivative Products*, supra.

(d) Do all system users have equal opportunity to connect, and maintain the connection to, the electronic trading system, and are differences in order execution response times disclosed by the system operator?

(e) Are there in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate risk limits?

Operational Information

6. With respect to trading information:

(a) Do similarly situated market participants have equitable access to market rules and operating procedures?

(b) Are adequate records (i.e., audit trails) available to reconstruct trading activity within a reasonable time?

(c) Is the system capable of disclosing the types of information that it is designed to make available, and, conversely, of providing safeguards to preserve the confidentiality of other information, the disclosure of which is not intended?[368]

(d) Does the market provide member intermediaries with access to relevant pre- and post-trade information (on a real time basis) to enable these intermediaries to implement appropriate monitoring and risk management controls?

Explanatory Notes

Not all of the regulatory objectives set out above would apply to ATS, MTFs or proprietary trading systems in the same way.[369] For example, some jurisdictions use a combination of intermediary and market regulation for trading systems. In addition, in some jurisdictions only exchanges may have rules relating to disciplining members or participants. However, trading systems should have mechanisms for ensuring compliance with, at a minimum, securities legislation.

The assessor should understand the regulatory structure used by the jurisdiction and apply the appropriate benchmarks. For example, when combinations of regulatory programs are used, some trading systems may be regulated under intermediary principles, subject to adequate transparency arrangements and market abuse prohibitions and surveillance. This observation also applies to Principles 34 and 35.

The availability of trading information, particularly when combined with the speed of electronic trading technology and the increased linkages among markets, both within the market's jurisdiction and in other jurisdictions where traders or information providers have access to the market, can exacerbate the market consequences of transactions that are executed in error. A regulator's assessment into the reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange, or trading

368 See the discussion of Principle 2 in *Screen-Based Trading Systems for Derivative Products*, supra.

369 The extent to which a jurisdiction regulates these types of trading systems will vary. Not all jurisdictions authorize or otherwise regulate ATSs or proprietary trading systems.

system, should include, among other things, a consideration of the need of an exchange, or a trading system, for adopting error trade policies.[370]

More broadly, a regulator's review of an exchange, or a trading system, should inquire into any linkages or inter-connections with other trading venues, both domestic and outside the jurisdiction.[371]

A regulator may recognize an exchange, or trading system, established in another jurisdiction based on the equivalence, or comparability, of the regulation applicable to the market in its domestic jurisdiction consistent with these Principles. In cases of multiple markets, the assessor will be required to form a judgment about the criteria applied by the regulator having due regard to the volume of trading and turnover, and the related importance of the market.

Assessors should consider a Principle to be *Not Applicable* whenever it does not apply given the nature of the securities market in the given jurisdiction (where there is no operating exchange or trading system, established, or operating, within the jurisdiction), and relevant structural, legal, and institutional considerations. In such a case, the reason for the determination should be documented.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

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370 *Policies on Error Trades*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD208.pdf. Recommendation 7 states that "market supervisors should support the implementation of error trade policies that are consistent with …[the Report]".

371 A variety of IOSCO Reports have discussed the implications of "linkages" or "inter-connections" among trading systems and products as well as the need for regulators to cooperate and share information to address these cross-market and cross-jurisdictional effects. See, e.g., *Principles Regarding Cross-Border Supervisory Cooperation*, Final Report, Report of the Technical Committee of IOSCO, May 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf; *Multi-jurisdictional Information Sharing for Market Oversight*, Final Report, Report of the Technical Committee of IOSCO, April 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf; *Regulatory Issues Arising From Exchange Evolution*, Final Report, Report of the Technical Committee of IOSCO, November 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD225.pdf; *Report on Trading Halts and Market Closures*, Report of the Technical Committee of IOSCO, November 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD138.pdf; *Mechanisms to Enhance Open and Timely Communication Between Market Authorities of Related Cash and Derivative Markets During Periods of Market Disruption*, Report of the Technical Committee of IOSCO, October 1993, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD29.pdf; *Coordination Between Cash and Derivative Markets*, Report of the Technical Committee of IOSCO, October 1992, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD22.pdf. See generally recommendation 11 – risks in links between CCPs in *Recommendations for Central Counterparties*, Final Report, Report of the Technical Committee of IOSCO and the Committee on Payment and Settlement Systems, November 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD176.pdf. See also *Principles for Financial Market Infrastructures*, Consultative Report, Report of IOSCO-CPSS, March 2011, Par.4.4.2 - 4.4.3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD350.pdf.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 3(b) in so far as it pertains to dispute resolution or applicable appellate procedures, and to Questions 4(b) and 5(c).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 4(b), 5(c), 5(d) and 6(b) and Question 3(b) as otherwise permitted under "*Broadly Implemented*."

Not Implemented

Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 2(c), 2(d), 3(a), 3(b) subject to the departures set forth in "*Broadly Implemented"* above, 3(c) 4(a), 4(c), 5(a), 5(b), 5(e), 6(a), 6(c) or 6(d).

Principle 34	**There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.**

Orderly smooth functioning markets promote investor confidence. Accordingly, there should be ongoing supervision of the markets.[372]

Key Issues

1. The regulator must remain satisfied that the conditions thought to be necessary pre-requisites of authorization remain in place during operation.

2. Amendments to the rules or requirements of the authorized exchange or regulated trading system should be provided to, or approved by, the regulator.

3. Authorization of the authorized exchange or regulated trading system should be re-examined, or withdrawn, when it is determined that the system is unable to comply with the conditions of its authorization, or with securities law or regulation.

Key Questions

1. Does the regulatory system:

   (a) Include a program whereby the regulator or an SRO, which is subject to oversight by the regulator:

      (i) monitors day-to-day trading activity on the exchange or trading system (through a market surveillance program);

      (ii) monitors conduct of market intermediaries (through examinations of business operations); and

      (iii) collects and analyzes the information gathered through these activities?[373]

[372] *Supervisory Framework for Markets*, supra, at page 3.

[373] *Supervisory Framework for Markets*, supra, at page 9.

(b) Include regulatory oversight mechanisms to verify compliance by the exchange, or trading system, with its statutory or administrative responsibilities, particularly as they relate to the integrity of the markets, market surveillance, the monitoring of risks, and the ability to respond to such risks?[374]

(c) Provide the regulator with adequate access to all pre-trade and post-trade information available to market participants?

2. Does the regulatory framework require that amendments to the rules or requirements of the exchange, or trading system, must be provided to, or approved by, the regulator?

3. When the regulator determines that the exchange, or trading system, is unable to comply with the conditions of its approval, or with securities law or regulation, is there a mechanism that permits the regulator[375] to:

(a) Re-examine the exchange, or trading system, and impose a range of actions, such as restrictions or conditions on the market operator?

(b) Withdraw the exchange, or trading system, authorization?

Explanatory Notes

These issues and questions apply to both exchanges and trading systems; however, they may apply in different ways. For example, an exchange may also act as a self-regulatory organization and therefore have regulatory responsibilities; a trading system may not act as an SRO. Consequently, the rules or requirements for an exchange will have broader scope - such as issuer and participant regulation. Trading systems requirements may outline the market structure of the trading system, how orders are entered, interact, and are executed. They will not have the same regulatory impact as exchange rules.

Question 3(a) gives more content to the phrase "re-examine the market's authorization." "Since licence revocation is such a serious disciplinary action, in many cases market operators will not believe it would ever be used and therefore it may not be an effective deterrent. The regulator also should have the clear power to impose an escalating range of disciplinary actions, such as conditions or restrictions on the market operator. While imposition of these restrictions should be subject to some procedural fairness conditions, the process must not be so slow, or cumbersome, so as to prevent regulators acting swiftly and effectively when required."[376] If not, the regulator should be invited to discuss how revocation power can be used to buttress its ability to use moral suasion to achieve corrective action.

374 Such information can be provided through formal mechanisms, such as written reports and inspections, or through informal mechanisms such as regular meetings. *Supervisory Framework for Markets*, supra, at page 9.

375 Id.

376 *Supervisory Framework for Markets*, supra, at page 7.

If the regulator does not have authority to withdraw the exchange, or trading system, authorization because the authorization was not subject to approval by the regulator (e.g., the exchange was "grandfathered in"), it may be possible to adjust the rating to take account of this fact. In such circumstances, where a negative answer to Question 3(b) is the only reason for a *Not Implemented* rating, it would be permissible for an assessor to conclude that Question 3(b) is answered affirmatively and a *Partly Implemented* rating is warranted, if the regulator demonstrates it has authority to suspend all trading on the exchange or trading system for a period of at least six months.

Alternatively, a *Partly Implemented* rating may be justified if the regulator can answer affirmatively to Question 3(a), and the regulator demonstrates that the range of available sanctions and restrictions include the ability to revoke the authority of the market operator, or change the management of the exchange, or trading system.[377]

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 3(a).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 2 and 3(a).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c) or 3(b).

[377] FAQS https://www.iosco.org/webmeth_pub/faqs.cfm?prin=25

Principle 35 Regulation should promote transparency of trading.

Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available. The *degree* of transparency of a market can be measured as a deviation from a real-time standard. Pre-trade information concerns the posting of firm bids and offers, in both quote and order-driven markets, as a means to enable intermediaries and investors ("market participants") to know, with some degree of certainty, whether, and at what, prices they can deal. Post-trade information is related to the prices and volume of all individual transactions actually concluded.

Market transparency is generally regarded as central to both the fairness and efficiency of a market, and in particular to its liquidity and quality of price-formation.

Pre-trade and post-trade transparency enhances investor protection by making it easier for investors to monitor the quality of executions that they receive from their intermediaries. Transparency can also help to promote market efficiency. Inefficiencies can arise in the pricing of securities when market participants are unaware of others' trading activity. This is particularly the case in dealer-dominated markets where pre-trade quotation information, if it can be obtained at all, can be obtained only from a small number of dealers, thus leaving buy-side clients at an informational disadvantage. Post-trade transparency can reduce information asymmetries between dealers and buy-side clients. If trade prices are publicly known, buy-side market participants will be more likely to question if they are not obtaining prices similar to those at which executions have occurred in the past.

The wide availability of information on bids and offers is a central factor in ensuring price discovery and in strengthening users' confidence that they will be able to trade at fair prices. This confidence should in turn, increase the incentive of buyers and sellers to participate; facilitate liquidity; and stimulate competitive pricing.

Information in respect of the volumes and prices of completed trades enables market participants not only to take into account the most recent information on volumes and prices but also to monitor the quality of executions they have obtained compared with other market users.

In general, the more complete and more widely available trading information is, the more efficient the price discovery process should be, and the greater the public's confidence in its fairness. However, establishing market transparency standards is not straightforward, as the interest of individual market participants in transparency levels varies. Regulators need to assess the appropriate level of transparency of any particular market structure with considerable care.[378]

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[378] *Transparency and Market Fragmentation*, Report of the Technical Committee of IOSCO, November 2001, at pages 4-5, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD124.pdf; *Stock Repurchase Programs*, Report of the Technical Committee of IOSCO, February 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD161.pdf. See also *Transparency of Structured Finance Products*, Final Report, Report of the Technical Committee of IOSCO, July 2010, page 21, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD326.pdf. *Principles for Dark Liquidity*, Final Report, Report of the Technical Committee of IOSCO, May 2011, page 26, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD353.pdf.

Key Issues

1. Ensuring timely access to information is a key to the regulation of secondary market trading. Timely access to relevant information about secondary market trading allows market participants to assess the terms on which they can trade, and the quality of the execution that they receive, and thereby to look after their own interests, and also reduces the potential for manipulative, or other unfair trading practices.[379]

2. Where a market authority permits some derogation from the objective of real time transparency, either pre-trade or post-trade, the conditions should be clearly defined and the market authority (being either, or both, the exchange operator and the regulator) should have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives. [380]

3. Transparent orders should have priority over dark orders at the same price within the same trading venue.[381]

4. Information on completed transactions should be provided on an equitable basis to all market participants including those transactions executed in dark pools, or as a result of dark orders entered into a transparent market.[382] Dark pools, and transparent markets that offer dark orders, should provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed.[383]

5. Regulators should periodically monitor the development of dark pools and dark orders in their jurisdictions to seek to ensure that such developments do not adversely affect the efficiency of the price formation process, and take appropriate action as needed.[384]

Key Questions

1. Does the regulatory framework include:

   (a) requirements or arrangements for providing pre-trade (e.g., posting of orders[385]) information to market participants?

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379 Discussed in *Transparency on Secondary Markets: A synthesis of the IOSCO Debate*, Report of the Technical Committee of IOSCO, December 1992 available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD27.pdf, in Sections 3 and 4 on the content of information and for a discussion of practice in member jurisdictions see *Transparency of Corporate Bond Markets*, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf.

380 See, e.g., *Transparency of Structured Finance Products*, supra, at p. 25 for a list of non-prescriptive factors that regulators may wish to consider in developing a post-trade transparency regime for SFPs. Considerations.

381 Id.

382 *Principles for Dark Liquidity*, supra.

383 *Principles for Dark Liquidity*, supra, p. 31.

384 *Principles for Dark Liquidity*, supra.

385 Orders do not include non-binding offers.

(b) requirements or arrangements for providing post-trade information (e.g., last sale price and volume of transaction) to market participants on a timely basis?

(c) requirements or arrangements that information on completed transactions be provided on an equitable basis to all market participants?

2. Where derogation from the objective of real-time transparency is permitted:

(a) Are the conditions clearly defined?

(b) Does the market authority (being either, or both, the exchange operator and the regulator) have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives?

(c) Does the regulator have access to adequate information to monitor the development of dark trading and dark orders?

(d) Do transparent orders have priority over dark orders?

(e) Do dark pools, and transparent markets that offer dark orders, provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed?

Explanatory Notes

As noted above, the degree of transparency of a market can be measured as a deviation from a real-time standard. However, there is no single standard of "timeliness." Most exchanges and regulatory systems provide for a certain degree of deviation from a real--time standard, such as: permitting some degree of opaqueness of quote information for block transactions; adopting different definitions of "real-time"; adopting a "promptness" standard that varies from several minutes to a longer time; allowing exceptions to real-time based on the size of the trade, type of trade (dealer mediated rather than auction market), or type of dealer and market model. Indeed, each type of market microstructure delivers market fairness, efficiency and transparency in slightly different ways.

Any derogation to the general requirements relating to post-trade transparency should be explained. Reasonable derogations should not prompt the assignment of the jurisdiction to a lower rating but should be documented. For markets whose participants are largely institutional investors, different transparency standards may be appropriate for the execution of large orders that expose intermediaries to risk and could affect the integrity of the price formation process, liquidity, or the orderly conduct of the market.

In all cases, the market authority (being either, or both, the exchange operator and the regulator) should, in any such event, have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives. Under any circumstance, the market's regulator should, in carrying out its supervisory role, be aware of the market's transparency decisions. In addition, it is important that regulators monitor the development of dark pools to ensure that they do not adversely impact on the price discovery process of transparent markets. Where regulators are concerned that the development of dark

trading may adversely impact the price discovery process they should take appropriate action to address such a distortion.[386]

In practice, except for wholesale and certain over-the-counter transaction venues, most markets seek to have post-trade price reporting and publication as close as possible to real-time. Assessments are focused on regulated/organized markets, but any assessment must consider the prevailing structure of markets within the jurisdiction when addressing transparency.

In the end, the final approach to transparency – and the degree of timeliness – is a policy decision, taken at the level of each individual jurisdiction, on how to weigh the conflicting interests of the different market players (small investors, institutions, intermediaries and exchanges).[387] The regulator should provide information, as to the basis for these decisions, and as to how they meet the objectives stated in the Key Issues.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Question 2(c) and/or to Question 1(a), in a primarily institutional trading market.

Partly Implemented

Requires affirmative responses to all applicable Questions except to Question 1(a), 2(c), Question 2(d) and 2(e) as specified above and Question 1(b) and (c) post-trade information is not available on an equitable basis to all participants in an institutional market.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1 (b), 1(c), 2(a), 2(b) if applicable, subject to the departures permitted above, or post-trade information on concluded transactions is not available either on a timely or on an equitable basis in a market accessible to retail investors.

386 *Principles for Dark Liquidity*, supra.

387 *Transparency on Secondary Markets: A synthesis of the IOSCO Debate*, supra, at pages 23-24 and 30.

Principle 36 Regulation should be designed to detect and deter manipulation and other unfair trading practices

Market manipulation, misleading conduct, insider trading and other fraudulent or deceptive conduct may distort the price discovery system, distort prices and unfairly disadvantage investors.[388]

Such conduct could be addressed through a number of mechanisms, which, might include: direct surveillance; inspection; reporting; product design requirements; position limits settlement price rules; or market halts, complemented by vigorous enforcement of the law and trading rules.[389]

An effective market oversight program should have a mechanism for monitoring compliance with the securities laws, regulations and market rules, operational competence requirements, and market standards.

The regulator must ensure that there are in place arrangements for the continuous monitoring of trading. These arrangements should trigger inquiry whenever unusual and potentially improper trading occurs.

Particular care must be taken to ensure that regulation is sufficient to cover cross market conduct, for example, conduct in which the price of an equity product is manipulated in order to benefit through the trading of options, warrants or other derivative products, or where there are multiple markets trading the same product.

Key Issues

1. The regulation of trading in secondary markets should prohibit: market manipulation; misleading conduct; insider trading; and other fraudulent or deceptive conduct, and apply adequate, proportionate, and dissuasive sanctions.[390]

2. The regulator should ensure that there are in place arrangements for the continuous monitoring of trading. These arrangements should trigger inquiry whenever unusual and potentially improper trading occurs.[391]

3. Regulation should cover cross-market conduct where, for example, the price of an equity product could be manipulated through the trading of options, warrants or other derivative products.

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388 See *Investigating and Prosecuting Market Manipulation*, Report of the Technical Committee of IOSCO, May 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf.

389 See *The Application of the Tokyo Communiqué to Exchange-Traded Financial Derivatives Contracts*, Report of the Technical Committee of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD85.pdf.

390 See *Investigating and Prosecuting Market Manipulation*, supra. See also Principle 11 and Principle 12.

391 See *Transparency of Corporate Bond Markets*, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf.

4. There must be adequate information sharing between relevant regulatory authorities, sufficient to ensure effective enforcement.[392]

5. Authorities responsible for the supervision of commodity futures markets (*e.g.*, either the market, a governmental regulator or an SRO) ("futures market regulators") should have access to information that permits them to identify concentrations of positions, and the overall composition of the market, including the power to access a trader's related financial and underlying market positions.[393]

Key Questions

1. Does the regulatory system prohibit the following with respect to securities admitted to trading on authorized exchanges and regulated trading systems:
   (a) Market or price manipulation?
   (b) Misleading information?
   (c) Insider trading?
   (d) Front running?
   (e) Other fraudulent or deceptive conduct and market abuses?
2. Does the regulatory approach to detect and deter such conduct include an effective and appropriate combination of mechanisms drawn from the following:
   (a) Direct surveillance, inspection, reporting, such as, for example:
      (i) securities listing, or product design requirements (where applicable);
      (ii) position limits;
      (iii) audit trail requirements;
      (iv) quotation display rules;
      (v) order handling rules;
      (vi) settlement price rules; or
      (vii) market halts, complemented by enforcement of the law and trading rules?
   (b) Effective, proportionate and dissuasive sanctions for violations?[394]

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392 See *Indexation: Securities Indices and Index Derivatives*, Report of the Technical Committee of IOSCO, February 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD143.pdf, pp. 35-40 regarding enhanced inter-market and cross-border cooperation.

393 *Task Force on Commodity Futures Markets*, Final Report, Report of the Technical Committee of IOSCO, March 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD285.pdf, p. 17.

394 Compare to requirements under Principles 10, 11 and 12.

3. Are there arrangements in place for:

   (a) The continuous collection and analysis of information concerning trading activities?

   (b) Providing the results of such analysis to market and regulatory officials in a position to take remedial action if necessary?

   (c) Monitoring the conduct of market intermediaries participating in the market(s)?

   (d) Triggering further inquiry as to suspicious transactions or patterns of trading?

4. If there is potential for domestic cross-market trading, are there:

   (a) inspection;

   (b) assistance; and

   (c) information-sharing, requirements or arrangements in place to monitor and/or address domestic cross-market trading abuses?

5. If there are foreign linkages, substantial foreign participation, or cross listings, are there cooperation arrangements with relevant foreign regulators, and/or markets, that address manipulation, or other abusive trading practices?

6. Regarding authorities responsible for the supervision of commodity futures markets (e.g., either the market, a governmental regulator or an SRO) ("futures market regulators") only: Does the authority have access to information that permits it to identify concentrations of positions, and the overall composition of the market, including the power to access a trader's related financial and underlying market positions?

Explanatory Notes

Essential elements of monitoring compliance include:

1. monitoring the day-to-day trading activity in the markets (through a market surveillance program);

2. monitoring the conduct of market intermediaries (through examinations of business operations); and

3. collecting and analyzing information gathered from these activities.[395] Techniques may differ for securities and derivatives markets. The regulator should be invited to explain how its approach operates to detect, deter, and sanction misconduct.

[395] *Supervisory Framework for Markets*, supra, at page 9.

The following are examples of some cases when cross-market surveillance information is relevant: when the underlying instrument is traded in a jurisdiction other than the one where a derivative instrument is traded, or where identical financial products are traded in two jurisdictions, there may be increased potential for fraud or manipulation because of the difficulty of a regulator in one jurisdiction to monitor market activity directly or to conduct complete investigations of market activities in another jurisdiction. [396] It is also relevant if the product is traded on multiple markets.[397]

The regulator can make use of an exchange or trading system surveillance system provided that the regulator has reviewed it under Principle 34 above.

Concerns with respect to the behaviour of commodity markets (both financial (i.e., the regulated commodity futures markets) and the underlying (i.e., cash market)), in periods of considerable price rises and increased market volatility have highlighted the special surveillance needs of commodity futures markets. In this regard, the Technical Committee has endorsed the *Tokyo Communiqué*, which sets out guidance on standards of best practice in: contract design; surveillance; and information sharing, with respect to physical delivery futures markets, as comprehensive guidance that can assist futures market regulators in building an effective market integrity program.[398] A key point of that guidance is that authorities who are responsible for futures market surveillance should be able to access sufficient information about futures but also related cash positions in order to identify dangerous concentrations of positions, to evaluate overall composition of the market and to assess its functioning.[399] Equity derivatives raise additional issues that were not addressed by the Tokyo Communiqué and assessment must take into account the unique attributes of the market and product in question.[400]

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions.

Broadly Implemented

Requires affirmative responses to all applicable Questions except to Questions 4 and 5, provided that there is not substantial cross-border or cross-market activity and cooperation in fact occurs.

Partly Implemented

Requires affirmative responses to all applicable Questions except that if Questions 4 and 5 are applicable, there is evidence of cross-market and cross-border cooperation and information sharing, although no formal arrangements for cooperation may be in place.

396 *Supervisory Framework for Markets*, supra, at page 6.

397 See *Multi-Jurisdictional Information Sharing for Market Oversight* (April 2007), p.13.

398 See *Task Force on Commodity Futures Markets* (2009), supra.

399 *Task Force on Commodity Futures Markets* (2009), supra, p. 15.

400 *Application of the Tokyo Communiqué to Exchange-Traded Financial Derivatives Contracts* (1998), supra.

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d), 1(e), 2(a), 2(b), 3(a), 3(b), 3(c), 3(d) or 6 (if applicable) or if Questions 4 or 5 are applicable, there is no evidence of cross-border cooperation whether or not there are formal arrangements for cooperation in place.

Principle 37 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption

Risk taking is essential to an active market and regulation should not unnecessarily stifle legitimate risk taking. Rather, regulators should promote and allow for the effective management of risk and ensure that capital and other prudential requirements: are sufficient to address appropriate risk taking; allow the absorption of some losses; and check excessive risk taking. An efficient and properly structured clearing and settlement process that is supervised and uses effective risk management tools is essential.[401] The legal system also must support effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction. Insolvency law must support isolating risk, and retaining and applying margin previously paid into the system, notwithstanding a default, or commencement of an administration or bankruptcy proceeding.

Instability may result from events that occur in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

This section also addresses concerns with regard to the possible market effects of short selling in equity markets.

Key Issues

Monitoring of Large Exposures

1. Market authorities[402] should have mechanisms to monitor open positions, or credit exposures, on unsettled trades that are sufficiently large to pose a risk to the market or to a clearing firm (i.e., large exposures)[403] and for this purpose:

   (a) Establish trigger levels appropriate to their markets and continuously monitor the size of positions on their markets.[404]

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401 See Principle 38.

402 The term "market authority" is used, for purposes of large exposures, to refer to the authority in a jurisdiction that has statutory or regulatory powers with respect to the exercise of certain regulatory functions over a market. The relevant market authority, depending on the jurisdiction, may be a regulatory body, a self-regulatory organization, and/or the market itself. *Report on Cooperation Between Market Authorities and Default Procedures*, Report of the Technical Committee of IOSCO, March 1996, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD49.pdf, at page 2.

403 The expression "large exposure" refers to an open position that is sufficiently large to pose a risk to the market or a clearing firm. For these purposes "large exposures may be construed to be open unsettled positions; open short positions, margined positions, options and other derivatives.

404 The assessor should request empirical evidence of an evaluative procedure before concluding that there is effective ongoing monitoring. See also *Report on Cooperation between Market Authorities and Default Procedures*, supra, at page 3 par.6.

(b) Have access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries' members.[405]

(c) Have authority to take appropriate action where a direct market participant does not make requested market information available to the market authority.

(d) Have the power to take appropriate action, such as requiring the market participant to reduce exposures, increase margin, or deposit additional collateral.

(e) Promote mechanisms that facilitate the sharing of information on large exposures through appropriate channels.

Default Procedures – Transparency and Effectiveness

2. Market authorities should make relevant information concerning market default procedures available to market participants.

3. Regulators should ensure that the procedures relating to defaults, and permitted corrective actions, are effective and transparent.

4. Market authorities for related products (cash or derivative) should consult with each other, as soon as practicable, with a view to minimizing the adverse effects of market disruptions.[406]

Short Selling

5. Short selling should be subject to appropriate controls to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of financial markets.

6. Short selling should be subject to a reporting regime that provides timely information to the market, or to market authorities.

7. Short selling should be subject to an effective compliance and enforcement system that is intended to instil settlement discipline and minimize the potential for settlement disruption risk and provides for surveillance of short selling activities.

8. Regulation of short selling should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

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405 A broker's direct (i.e., immediate) client who signed the account documentation in reality may be operating on behalf of an unknown person who controls the account (the beneficial owner). A market authority must be able to identify such a beneficial owner in order to aggregate positions, for example.

406 See *High Level Principles for Business Continuity*, Report of the Joint Forum, August 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD224.pdf.

Key Questions

Monitoring of Large Exposures

1. Does the market authority have a mechanism in place that is intended to monitor and evaluate continuously the risk of open positions, or credit exposures, that are sufficiently large to expose a risk to the market, or to a clearing firm, that includes:

   (a) Qualitative, or quantitative, trigger levels appropriate to the market for the purpose of identifying large exposures (as defined by the market authority), continuous monitoring, and an evaluative process?[407]

   (b) Access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries?

   (c) The power to take appropriate action against a market participant that does not provide relevant information needed to evaluate an exposure (e.g., require liquidation of positions, increase margin requirements and/or revoke trading privileges)?[408]

   (d) The general power to take appropriate action, such as to compel market participants carrying, or controlling, large positions to reduce their exposures or to post increased margin?

2. Do arrangements, whether formal or informal, exist to enable markets and regulators to share information on large exposures of common market participants, or on related products:

   (a) In the domestic jurisdiction?

   (b) In other relevant jurisdictions?[409]

Default Procedures – Transparency and Effectiveness

3. Does a market authority make its default procedures available to market participants, including, specifically, information concerning:

   (a) The general circumstances in which action may be taken?

   (b) Who may take it?

   (c) The scope of actions which may be taken.[410]

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407 See I, supra, at page 3 par.4.

408 See *Report on Cooperation Between Market Authorities and Default Procedures*, supra, at page 4 par.8.

409 *Report on Cooperation Between Market Authorities and Default Procedures*, supra, at page 4 par.8 regarding the promotion of formal/informal mechanisms. See also *Report on Trading Halts and Market Closures*, Report of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD138.pdf, pp. 23-24.

410 Id. For a template or list of information that should be available to market participants as to market default procedures regarding futures and options transactions.

4. Do default procedures, and/or national law, permit markets, and/or the clearing and settlement system(s), to promptly isolate the problem of a failing firm by addressing its open proprietary positions, and positions it holds on behalf of customers; or otherwise protect customer funds and assets, from an intermediary's default under national law?

5. Is there a mechanism by which market authorities for related products can consult with each other in order to minimize the adverse effects of market disruptions?

Short Selling on Equity Markets[411]

6. Does the relevant market authority[412] provide for:

   (a) Controls which are appropriate to the equity market in question and that have as their goal: to reduce or minimize the potential risks that could affect the orderly and efficient functioning and stability of equity markets including, at a minimum, a strict settlement of failed trades?

   (b) A reporting regime that provides timely short selling information to the market or, as a minimum requirement, to market authorities?

   (c) As part of an effective compliance and enforcement system (assessed under Principle 11), (i) measures that promote settlement discipline, including regular monitoring by the market authority of settlement failures and (ii) surveillance of short selling activities. Any deficiency here should also be taken into account in the assessment of principle 11.

   (d) Appropriate exceptions for certain types of transactions for efficient market functioning and development (such as, but not limited to, bona fide hedging, market making and arbitrage activities)?

Explanatory Notes

"Large Exposure" Monitoring

Market authorities should closely monitor large exposures and share information with one another in order to permit the appropriate assessment of risk. The approach to large exposure monitoring contained in this Methodology reflects, as noted in the Secondary Markets Methodology Preamble that "regulation may differ according to market structure, market participant or product…". Accordingly, assessment of the related Key Questions should recognize the different regulatory structures in place and the characteristics of markets.

411 The *Regulation of Short Selling*, Final Report, Report of the Technical Committee of IOSCO, June 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf, addresses short selling in equity markets only. For example, the Report's reference to naked short selling, capital markets, and the need for a short settlement cycle illustrate the equity focus of the Report.

412 *Regulation of Short Selling*, supra, at p. 4, fn. 2 describes the term "market authority" to include securities regulators, self-regulatory organizations, exchanges and alternative trading facilities. That Report further states that "in some jurisdictions, short selling regulation comprises statute-based requirements overseen by securities regulators and rules set by self-regulatory organizations, exchanges or alternative trading systems.

For example, the Methodology recognizes that the large exposure monitoring function itself may be performed by a regulatory body, a self-regulatory organization, and/or the market itself (i.e., a "market authority").

Similarly, in stating that trigger levels" (which are qualitative, or quantitative, criteria that are used to identify a large exposure) should be established, the Principles and Key Question 1 made clear that they should be "appropriate" to the markets in question. In this regard, the determination of what constitutes a "large exposure" will be made by the relevant "market authority" acting within its discretion. It therefore follows that not every market will have the same large exposure monitoring needs, trigger levels, or approach to monitoring.

To perform this monitoring function market authorities should have access to information on the size and beneficial ownership of positions held by "direct" customers of market members (i.e., the customers with whom the market member deals). Market authorities can then take the appropriate action, such as requiring the member to reduce the exposure, or increasing margin requirements.

Market authorities should promote mechanisms that facilitate the sharing of the above information through appropriate channels. Where a market member does not make the relevant information available to the market authority, the authority should be able to take appropriate action – while taking into account the mechanisms already provided by the CCP - such as: imposing limitations on future trading by the member; requiring liquidation of positions; increasing margin requirements; or revoking trading privileges.

The Market and Financial Integrity Objectives of Large Exposure Monitoring

The monitoring program itself should be appropriate not only for the type of market, but also for the monitoring objective – i.e., market integrity or financial integrity. Differences between equity and futures markets must be taken into account.[413]

For example, large exposure monitoring in commodity *futures markets* for the purpose of *market integrity* purposes (i.e., market surveillance for the purpose of detecting possible manipulation or other abusive trading) has been directly addressed by IOSCO.[414] These reports make clear that a "large exposure" monitoring program is necessary with respect to commodity futures markets.[415]

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413 See *The Application of the Tokyo Communiqué to Exchange-Traded Financial Derivatives Contracts*, Report of the Technical Committee of IOSCO, September 1998, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD85.pdf.

414 *Task Force on Commodity Futures Markets*, Final Report, Report of the Technical Committee of IOSCO, March 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD285.pdf. See also *Task Force on Commodity Futures Markets, Report to the G-20*, Report of the Technical Committee of IOSCO, June 2010 and November 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD324.pdf and https://www.iosco.org/library/pubdocs/pdf/IOSCOPD340.pdf.

415 *Task Force on Commodity Futures Markets, Final Report*, supra, p.17.

In contrast, IOSCO reports on the market integrity concerns of equity markets have focused on the relationship between cash (equity) and derivatives markets during periods of market disruption, and stressed the need for market authorities to be able to access information on related positions.[416]

For both equity and derivatives markets, the *financial integrity* concerns that are related to large *credit* exposures are dealt with in greater detail in the standards to be applied to securities settlement systems and to central counterparties; their related assessment methodologies that have been jointly adopted by IOSCO and the Committee on Payment and Settlement Systems (CPSS), and may be jointly revised and adopted, from time to time, by IOSCO and the CPSS. Accordingly, in assessing a market authority's monitoring program that addresses *credit exposures*, assessment under Principle 38 should be undertaken and viewed as complementary to any separate assessment that may be conducted under the IOSCO-CPSS standards.

Defaults

Effective and Transparent - Regulators should ensure that the procedures relating to defaults are effective and transparent. Market authorities should make relevant information concerning market default procedures available to market participants.

Consultation and Information Sharing - Market authorities for related products (cash or derivative) should consult with each other, as soon as practicable, with a view to minimizing the adverse effects of market disruption. The information that may be needed includes contingency plans, contact persons, and structural measures to address market disruption,; and information about market conditions (such as actions taken by market authorities, prices, trading activities, and aggregate market data).

Instability may result from events that occur in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

Insolvency Law - The legal system must support effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction. Insolvency law must support isolating risk, and retaining and applying margin previously paid into the system, notwithstanding a default or commencement of an administration or bankruptcy proceeding.

For example, the following mechanisms can be relevant to addressing a financial failure or market disruption; however, other mechanisms also may be adequate if the objectives of: isolating risk; and protecting funds from being taken to cover the intermediary's default, are achieved.

- National insolvency laws that specifically accommodate market default procedures.
- Central bank guarantees.

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416 See *Mechanisms to Enhance Open and Timely Communication Between Market Authorities of Related Cash and Derivative Markets During Periods of Market Disruption*, Report of the Technical Committee of IOSCO, October 1993, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD29.pdf, and *Coordination Between Cash and Derivative Markets*, Report of the Technical Committee of IOSCO, October 1992, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD22.pdf.

- The use of the defaulting firm's proprietary funds and assets to meet its obligations to market counterparties.
- The transfer or liquidation of customer positions at the defaulting firm under market rules without interference from bankruptcy law.[417]
- The transfer of customer funds and assets, or use of a guarantee system.
- Where customer positions or funds are to be transferred, arrangements for distinguishing firm and customer positions, deposits and accruals.

The regulator should identify any concerns with respect to applicable bankruptcy law.

Assessments of Principle 37 should take account of any vulnerability in risk management identified with respect to Principle 38, and there should be close communication as to any findings under this Principle and those relating to clearing and settlement.

Short Selling

Short selling is regarded as a useful mechanism in some jurisdictions to aid liquidity. It plays an important role in the market for a variety of reasons, such as providing more efficient price discovery, as well as potentially mitigating market bubbles and facilitating hedging and other risk management activities. However, there is also a general concern that, especially in extreme market conditions, certain types of short selling, or the use of short selling in combination with certain abusive strategies, may contribute to disorderly markets. When short selling is introduced, an effective regulatory framework should be put in place. The primary objective of such regulation would be to reduce the potential destabilizing effect that short selling, used in an abusive manner, can cause without exerting undue impact on securities lending, hedging and other types of transactions that are critical to capital formation and to reducing volatility (such as those used for risk management purposes). Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

In respect of Key Question 6(c), monitoring and surveillance are components of an effective compliance and enforcement system which can be carried out through the reporting of short positions, and/or flagging of short sales. Market authorities of jurisdictions that have a short sale flagging, and/or short position reporting, regime are encouraged to establish a mechanism to analyse the information obtained through short selling reporting to identify potential market abuses and systemic risk.

[417] Liquidation is acceptable in cases where the nature of the position makes transfer impracticable, or in cases where a customer may not have completed the documentation necessary for the transfer or the applicable regulation does not allow for transfers. See also *Report on Cooperation Between Market Authorities and Default Procedures*, supra, paragraph 6(3). The market, however, should not be required to maintain open unsettled transactions once a direct participant has defaulted.

Benchmarks

Fully Implemented

Requires affirmative responses to all applicable Questions taking into account that the combination of mechanisms enumerated in Question 4 available in the jurisdiction are sufficient to reduce the impact of any failure and in particular to isolate risk to the failing institution.[418]

Broadly Implemented

Requires affirmative responses to all applicable Questions subject to an evaluation of the mechanisms in Question 4, except to Questions 1(a), 1(b), 1(c), 2(b), 3(a) and 5, provided that other measures are in place to address cross-market risks,[419] and only minor deficiencies in Question 6(c) or 6(d).

Partly Implemented

Requires affirmative responses to all applicable Questions except to Questions 1(a), 3(a), 5 and 6(a) or 6(b).

Not Implemented

Inability to respond affirmatively to one or more of Questions 1(d), 2(a) if applicable, 3(b), 3(c), 4, or 6(a) and (b), or bankruptcy or other relevant national law is uncertain or does not support isolation of risk to the failing firm and effective management of a disruption.

[418] See responses to market disruption should seek to facilitate stability domestically and globally through cooperation and information sharing.

[419] Exception reporting based on a surveillance program is consistent with the monitoring contemplated by Key Question 1(a).

J. PRINCIPLE RELATING TO CLEARING AND SETTLEMENT

Principle 38	**Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.**

Because of the potential for disruptions to securities and derivatives markets and to payment and settlement systems, both domestic and non-domestic, securities settlement systems (SSS) and central counterparties (CCPs) should be subject to effective regulation and oversight to ensure that they are fair, effective, and efficient; and that they reduce systemic risk. Regulators should be prepared to cooperate with other relevant regulators, including central banks, both domestically and internationally, to address potential domestic and cross-border risks.

The standards to be applied to securities settlement systems, and to central counterparties, as well as the methodologies for assessing compliance with those standards, are those that are set forth in the recommendations and assessment methodologies that have been jointly adopted by IOSCO and the Committee on Payment and Settlement Systems (CPSS) and as may be jointly revised and adopted, from time to time, by IOSCO and the CPSS.[420]

Assessment should take note that the SSS recommendations define SSS broadly to include the full set of institutional arrangements for: confirmation; clearance; and settlement, of securities trades; and safekeeping of securities. As a result, the specific scope of the SSS recommendations will vary.[421]

Note: In March 2011 IOSCO and the Committee on Payment and Settlement Systems published a consultative report "Principles for financial market infrastructures", which reviews and updates the standards for financial market infrastructures (FMIs) that facilitate the recording, clearing, and settlement of monetary and other financial transactions. The standards would cover systemically important payment systems, central securities depositories (CSDs), SSS and CCPs. The standards would also provide additional guidance for over-the-counter (OTC) derivatives CCPs and trade repositories. These standards, if adopted by IOSCO and the CPSS, should be referred to in an assessment. Particular attention should be focussed on the mapping of the new standards to existing IOSCO-CPSS standards

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420 See *Recommendations for Securities Settlement Systems*, Report of the Technical Committee of IOSCO and the Committee on Payment and Settlement Systems (CPSS), November 2001, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD123.pdf; *Assessment Methodology for "Recommendations for Securities Settlement Systems"*, Report of IOSCO-CPSS November 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD139.pdf; and *Recommendations for Central Counterparties* (standards and assessment methodology combined), Final Report of IOSCO-CPSS, November 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD176.pdf.

421 Securities regulators, central banks and, in some cases, banking supervisors will need to work together to determine the appropriate scope of application of the SSS recommendations. IOSCO-CPSS SSS Recommendations at par.1.10.

in order to determine their applicability as well as the continuing applicability of any prior standards.[422]

[422] For example, a full reconsideration of the marketwise recommendations from the SSS was not undertaken as part of the review and those recommendations were proposed to remain in effect. See proposal at par.1.7.

Appendix 1 - The Legal Framework

Effective securities regulation depends upon an appropriate legal framework. The matters to be addressed in the domestic laws of a jurisdiction include:

1 Company Law

1.1 company formation

1.2 duties of directors and officers

1.3 regulation of takeover bids and other transactions intended to effect a change in control

1.4 laws governing the issue and offer for sale of securities

1.5 disclosure of information to security holders to enable informed voting decisions

1.6 disclosure of material shareholdings

2 Commercial Code / Contract Law

2.1 private right of contract

2.2 facilitation of securities lending and hypothecation

2.3 property rights, including rights attaching to securities, and the rules governing the transfer of those rights

3 Taxation Laws

3.1 clarity and consistency, including, but not limited to, the treatment of investments and investment products

4 Bankruptcy and Insolvency Laws

4.1 rights of security holders on winding up

4.2 rights of clients on insolvency of intermediary

4.3 netting

5 Competition Law

5.1 prevention of anti-competitive practices

5.2 prevention of unfair barriers to entry

5.3 prevention of abuse of a market dominant position

6 Banking Law

7 Dispute resolution system

7.1 a fair and efficient judicial system (including the alternative of arbitration or other alternative dispute resolution mechanisms)

7.2 enforceability of court orders and arbitration awards, including foreign orders and awards

Table of Documents Referenced in the Methodology Footnotes

The following table has been produced from the footnotes of the Methodology. The objective of the table is to show which documents are considered relevant to an assessment of compliance with a particular IOSCO Principle.

The order of the table follows that of the Methodology. The table is organized as follows:

- Column 1: The name of the document and a hyperlink to the pdf copy of the document on the internet.
- Column 2: The year the document was published - this is key to identifying an IOSCO document on the IOSCO website should the hyperlink fail, as the IOSCO library is ordered by date.
- Column 3: Document number - this is the number allocated by IOSCO and is the second key to finding the document on the IOSCO website as documents are numbered sequentially within each year. Therefore, the lower the number the closer to the start of the particular year the document was issued.
- Column 4: Other Principles - this highlights where a document is referenced in more than one Principle.

Notes:

- Where the 3rd column (document no.) has been shaded this is to indicate that the document is an IOSCO Resolution or Recommendation and is not located in the IOSCO Website library: Policy Documents/Public Documents/filed by year (December to January). IOSCO Resolutions and Recommendations are located in Corporate Documents/Resolutions (most recent first).
- There are two instances where the shading in the 3rd column relates to the document being an IOSCO Statement rather than a Resolution – Principle 18 and Principle 19.

Document	Year	Doc No.	Other Principles
Introduction			
Objectives and Principles of Securities Regulation, IOSCO, June 2010, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf	*2010*	*323*	
Measures to Disseminate Stock Property, Report of the Emerging Markets Committee of IOSCO, May 1999, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD95.pdf	*1999*	*95*	

Document	Year	Doc No.	Other Principles
Objectives of Securities Regulation			
Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets - Interim Report, Report of the Emerging Markets Committee of IOSCO, September 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD80.pdf	*1998*	*80*	
Causes, Effects and Regulatory Implications of Financial and Economic Turbulence in Emerging Markets, Report of the Emerging Markets Committee of IOSCO, November 1999, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD99.pdf	*1999*	*99*	
Hedge Funds and Other Highly Leveraged Institutions, Report of the Technical Committee of IOSCO, November 1999, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD98.pdf	*1999*	*98*	
Introduction: The Regulatory Environment			
Organization for Economic Cooperation and Development's *OECD Principles of Corporate Governance* at http://www.oecd.org/pdf/M00008000/M00008299.pdf		*N/A*	*17*
Resolution of the Presidents' Committee on IOSCO Adoption of the Objectives and Principles of Securities Regulation, September 1998, http://www.iosco.org/library/resolutions/pdf/IOSCORES16.pdf	*1998*	*16*	
Principle 8: Regulator and Managing Conflicts of Interest			
Unregulated Financial Markets and Products, Final Report, Report of the Technical Committee of IOSCO, September 2009, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf	*2009*	*301*	*16*

Document	Year	Doc No.	Other Principles
Principle 9: SRO			
Model for Effective Self-Regulation, Report of the SRO Consultative Committee of IOSCO, May 2000, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD110.pdf	*2000*	*110*	
Principles of Effective Market Oversight, Council of Securities Regulators of the Americas, May 1995,http://www.cvm.gov.br/ingl/inter/cosra/inter.asp	*1995*	*N/A*	
Issues Paper on Exchange Demutualization, Report of the Technical Committee of IOSCO, June 2000, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD119.pdf	*2000*	*119*	
Principle 10: Inspection, Investigation and Surveillance Powers			
Outsourcing in Financial Services, Report of the Joint Forum, February 2005, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf	*2005*	*184*	*18* *31*
Resolution on Principles for Recordkeeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws, Resolution of the President´s Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES15.pdf **"Resolution on Recordkeeping"**	*1997*	*15*	*11* *13* *14* *15*
Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, IOSCO, May 2002, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf **"IOSCO MMoU"**	*2002*	*126*	*11* *12* *13* *14* *15*

Document	Year	Doc No.	Other Principles
Principles on Client Identification and Beneficial Ownership for the Securities Industry, Report of IOSCO, May 2004, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf	*2004*	*167*	*31*
Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism, Report of the Joint Forum, June 2003, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD146.pdf	*2003*	*146*	*31*
Principle 11: Regulator's Enforcement Powers			
Resolution on Enforcement Powers, Resolution of the Presidents´ Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf	*1997*	*14*	*13*
Resolution on Principles for Record Keeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws, Resolution of the President´s Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES15.pdf	*1997*	*15*	*10* *13* *14* *15*
Securities Activity on the Internet, Report of the Technical Committee of IOSCO, September 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf	*1998*	*83*	*13* *16* *31* *33*
Securities Activity on the Internet II, Report of the Technical Committee of IOSCO, June 2001, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf	*2001*	*120*	*16* *33*
Report on Securities Activity on the Internet III, Report of the Technical Committee of IOSCO, October 2003, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf	*2003*	*159*	*13* *16* *31*

Document	Year	Doc No.	Other Principles
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Principle 12: Use of Powers			
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