

AN OVERVIEW OF THE WORK
OF THE
IOSCO TECHNICAL COMMITTEE



OICU-IOSCO

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

JULY 2008

**AN OVERVIEW OF THE WORK OF THE IOSCO TECHNICAL COMMITTEE
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INTRODUCTION

The release in March 2007 of the Consultation Report entitled, *An Overview of the Work of the IOSCO Technical Committee*¹ (Work Program Consultation Report) was followed shortly thereafter by a meeting in Madrid with financial market stakeholders (Stakeholders) to consider the issues outlined in the Work Program Consultation Report and also to discuss the general approaches that IOSCO has sought to adopt in consultations with Stakeholders, including the financial services community.

IOSCO intends to supplement its existing dialogues with Stakeholders with an additional, more structured dialogue in the interest of enhancing consultation on the various projects and activities that IOSCO has on its agenda.

The Work Program Consultation Report provides a valuable overview of the work of the IOSCO Technical Committee (TC) and was released for public consultation for a period ending in June 2007. IOSCO received 17 written submissions² on the Work Program Consultation Report, coming principally from securities market dealers, financial institutions and exchanges and organizations representing them, and from audit firms and auditor professional bodies. One submission was received from an organization of corporate treasurers.

The submissions on the Work Program Consultation Report were broadly positive and supportive of the work being carried out by IOSCO and the broad objective of seeking increased dialogue with Stakeholders. On the whole, their input demonstrates the importance that Stakeholders attach to contributing to IOSCO work, as well as their commitment to doing so. In a number of instances, the submissions received proposed that IOSCO consider giving more consideration or priority to certain aspects of the issues raised in the Work Program Consultation Report or add new projects to the work program. A few submissions sought to highlight differing perspectives from those already outlined in the Work Program Consultation Report. One commenter stated that IOSCO should consider a regulatory pause.

Many submissions urged the continuation of both formal and informal consultation with Stakeholders, suggesting measures such as semi-annual meetings and also the establishment of consultative groups to meet with the TC Standing Committees. IOSCO held the first formal meeting with Stakeholders in November 2007 in Tokyo. IOSCO has decided to organize once a year a high-level meeting with Stakeholders on an informal basis to exchange views on topics of mutual interest.

¹ *An Overview of the Work of the IOSCO Technical Committee*, Consultation Report of the Technical Committee of IOSCO, March 2007, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD239.pdf>.

² The written submissions to the Work Program Consultation Report are available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD251.pdf>.

In the submissions to the Work Program Consultation Report and in connection with the November 2007 meeting, Stakeholders identified many items for consideration that were not included in the Work Program Consultation Report. The TC Standing Committees and the relevant TC Task Forces carefully examined the Stakeholders' comments and proposals in the course of updating the work program.

In March 2008, IOSCO met with Stakeholders to further the dialogue and provide feedback on the suggestions of the Stakeholders on the IOSCO work program. The March 2008 meeting included representatives of the TC, as well as the chairpersons of the TC Standing Committees. IOSCO has encouraged more frequent and less formal engagement between Stakeholders and the TC Standing Committees, and an invitation was extended to Stakeholders to contact the Secretary General and TC Standing Committee and Task Force chairpersons on individual projects. IOSCO noted that it intended to produce for publication after the Annual Conference in May 2008, its forward work program, taking into account the comments and discussions of Stakeholders.

In view of the recent turmoil in the financial markets, in November 2007, IOSCO convened a task force (Subprime Task Force) to systematically study the subprime market turmoil in order to identify any implications for securities regulators that could be addressed through current and future IOSCO work. The review complements the work undertaken by other regulatory and governmental bodies in assessing how markets have reacted to the recent event in the credit markets. Additionally, the Subprime Task Force has coordinated with the Task Force on Credit Rating Agencies (CRA Task Force) to analyze the questions raised by the recent events concerning the role of credit rating agencies (CRAs) and how they relate to the subprime crisis and whether the IOSCO Code of Conduct Fundamentals for CRAs³ adequately addresses any conflicts of interest that may be relevant. The Technical Committee published a report on the subprime market turmoil,⁴ a report on the role of CRAs in structured finance markets,⁵ and revised the 2004 CRA Code of Conduct⁶ in May 2008.

This report sets forth the current work program (Work Program) and includes topics and projects identified by Stakeholders for consideration that were not part of the Work Program Consultation Report. Additionally, it includes the recommendations set forth in the Subprime Report.

³ *Code of Conduct Fundamentals for Credit Rating Agencies*, Technical Committee of IOSCO, December 2004, available at <http://www.iosco.org/pubdocs/pdf/IOSCOPD180.pdf> (2004 CRA Code of Conduct).

⁴ *Report on the Subprime Crisis, Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf> (Subprime Report).

⁵ *The Role of Credit Rating Agencies in Structured Finance Markets, Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf> (CRA Report)

⁶ *Code of Conduct Fundamentals for Credit Rating Agencies*, Technical Committee of IOSCO, revised May 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf> (CRA Code of Conduct).

The presentation of the Work Program herein is structured in terms of market participants in order to facilitate access by market participants to subjects relevant to their domain.

The following matrix serves as a general overview. A more elaborate explanation of current, planned, and suggested work is given for each of the themes.

OVERVIEW OF WORK PROGRAM						
		ISSUERS	ACCOUNTANTS AUDITORS	TRADING VENUES	INTERMEDIARIES	ASSET MANAGEMENT
NEW EXPLORATORY WORK				<ul style="list-style-type: none"> Price formation on fragmented markets Direct access to exchanges and other markets Outsourcing Mutual recognition 	<ul style="list-style-type: none"> Impact of new technology Financial firm internal control systems Skilled practitioners to model fair value Liquidity risk management Monitor/review work Senior Supervisor Group Definitions of "Investor" Mutual recognition 	<ul style="list-style-type: none"> Private equity conflicts of interest Standardized benchmarks in presentation of fund performance Due diligence for investing in structured products Sovereign wealth funds Exchange Traded Funds Real estate funds Mutual recognition
REGULATORY TRENDS IN FINANCIAL ACTIVITIES	<p>DISCLOSURE AND TRANSPARENCY</p> <p>GOVERNANCE & CONFLICTS OF INTEREST RULES OF CONDUCT</p>	<ul style="list-style-type: none"> Monitoring of accounting standards Principles of periodic disclosure Consult on disclosure standards for: <ul style="list-style-type: none"> Offerings of asset-backed securities Special purpose entities Valuation of investments held at fair value Internal controls and due diligence re ownership rights in securitized products Credit rating agencies - monitoring Protection of minority shareholders 	<ul style="list-style-type: none"> Review of audit standards Review of auditor ethics standards Audit quality 	<ul style="list-style-type: none"> Structured finance products market transparency 	<ul style="list-style-type: none"> Point of sale disclosure to retail investors and customers suitability Level playing field between financial products Adherence to rules of conduct 	<ul style="list-style-type: none"> CIS valuation Elements of regulation for funds of hedge funds Soft commissions and incentives Point of sale disclosure to retail investors
ENFORCEMENT				<ul style="list-style-type: none"> Exchange of information in cross-border activities Boiler rooms Asset freezing 		

THE WORK OF THE TECHNICAL COMMITTEE

A. Issuers

A.1. Monitoring Developments and the Enforcement of Accounting Standards

Recent financial scandals have shown the importance of adequate transparency on financial markets. In February 2005, the TC published the report, *Strengthening Capital Markets Against Financial Fraud* (Fraud Report),⁷ which identified several critical issues needing to be addressed in order to better prevent large-scale financial fraud. The development of standards with regard to issuer transparency and the transparency of market operations has always been a priority for IOSCO. In May 2000, IOSCO adopted a resolution on IASC standards endorsing the international accounting standards for cross-border use, subject to national treatments where needed to address outstanding issues.

IOSCO closely monitors the developments in International Financial Reporting Standards (IFRS), comments on proposed changes, and routinely discusses standard-setting work with representatives of the International Accounting Standards Board (IASB). IOSCO encourages a reduction in the complexity of accounting standards and in the number of exceptions to principles. IOSCO also calls for an appropriate balance between the costs and benefits of accounting standards.

Stakeholders suggested that IOSCO encourage reduction in variation from IFRS. IOSCO has always stressed the importance of implementing IFRS consistently throughout the world. In order to support this objective, the TC developed the IOSCO IFRS Regulatory Interpretation and Enforcement Database (IOSCO IFRS Database). Access to this database is available to securities regulators that have signed a participation agreement and is designed for sharing regulatory interpretation and enforcement decisions related to IFRS. The IOSCO IFRS Database is compatible with a similar database maintained by CESR and has been operational since January 2007. It was suggested that IOSCO should make publicly available the contents of the IOSCO IFRS Database. The IOSCO IFRS Database is still in the early stages of development and use. At this time, it would be premature to make it publicly available. IOSCO could assess making the IOSCO IFRS Database available at a later date.

Further to the objective of providing investors with appropriate and complete information on accounting frameworks used by issuers to prepare financial statements, in February 2008, the TC issued a statement⁸ recommending that all annual and interim financial statements that are prepared on the basis of national standards that are modified

⁷ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD192.pdf>.

⁸ *Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements*, Technical Committee of IOSCO, 6 February 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD262.pdf>.

or adapted from IFRS and published by publicly traded companies should include at a minimum the following statements (which should be tailored to the company's circumstances and the markets in which securities may be traded):

1. A clear and unambiguous statement of the reporting framework on which the accounting policies are based;
2. A clear statement of the company's accounting policies on all material accounting areas;
3. An explanation of where the accounting standards that underpin the policies can be found;
4. A statement that explains that the financial statements are in compliance with IFRS as issued by the IASB, if this is the case; and
5. A statement that explains in what regard the standards and the reporting framework used differ from IFRS as issued by the IASB, if this is the case.

A.2. Financial and Non-Financial Disclosure Standards

A.2.1. Periodic Disclosure

IOSCO is developing principles for the disclosure that listed issuers provide in their periodic reports. These principles should facilitate agreement among regulators on minimum standards for disclosure in periodic reports, particularly annual reports.

As a result of the Subprime Task Force recommendations, IOSCO will consider whether additional guidance and disclosure relating to off-balance sheet entities would be valuable in meeting the needs of investors. The TC Standing Committee on Multinational Disclosure and Accounting (Standing Committee 1) will provide related input to the IASB in connection with the IASB's work in this area.

A Stakeholder suggested that IOSCO should consider promoting broader disclosure standards that incorporate non-financial governance matters such as social, environmental and sustainability disclosure. Disclosure of significant non-financial governance issues are fundamentally related to the materiality standard embodied in many disclosure regimes. Although the TC does not propose that any new work is initiated in this area at this time, it is open to a continuing dialogue in this area.

Another Stakeholder suggested that IOSCO study the issue of sovereign debt issuers, as there is some concern that given the value of trade in sovereign debt, the standards and regulations applying to sovereign debt issuers are not of sufficient quality to protect investors and ensure the stability of markets. The Stakeholder acknowledged that the regulation of sovereign debt is not within the sole competence of securities regulators in many jurisdictions, but believes that IOSCO could look at potential measures to improve the quality and reliability of information provided by sovereign issuers. Standing

Committee 1 will consider what IOSCO could contribute related to the disclosure of information by sovereign debt issuers to capital market investors. As part of this analysis, Standing Committee 1 will consider the March 2007 IOSCO report, *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*.⁹ During the March 2008 meeting with Stakeholders, it was discussed that several organizations such as the World Bank and International Monetary Fund (IMF) are actively involved in promoting greater transparency of information by sovereign issuers.

Scheduled output:

- Report on *Principles for Periodic Disclosure by Listed Entities*: 2009.

A.2.2. Special Purpose Entities

See *supra*, A.2.1 regarding off-balance sheet entities.

A.2.3. Issuer Transparency in Structured Products

As discussed in the Subprime Report,¹⁰ given that among other things, the Subprime Task Force found that the recent market turmoil had relatively less effect on publicly traded structured finance products in some markets, Standing Committee 1 will consult with market participants regarding the typical structures and disclosure practices for private placements of asset-backed securities (ABSs) using disclosure requirements pertaining to public offerings and trading of ABSs as a point of comparison. Standing Committee 1 also will review the degree to which existing IOSCO issuer disclosure standards and principles are applicable to public issuance of ABSs and will develop international principles regarding disclosure requirements for public offerings of ABSs if it finds that existing standards and principles are inapplicable to such offerings.

A.2.4. Costs and Benefits of New Accounting Standards

A Stakeholder suggested that IOSCO should take into account the costs and benefits of financial reporting requirements in assessing and commenting on IASB Exposure Drafts. The TC notes that costs and benefits will continue to be a prime consideration as IOSCO evaluates proposed standards.

⁹ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf>.

¹⁰ See *supra* note 4.

A.2.5. Internal Controls Over Financial Reporting

A Stakeholder noted that internal controls over financial reporting is a prerequisite for the preparation of financial statements and should be addressed in an IOSCO work program. IOSCO published work in this area in December 2006, *Issuer Internal Control Requirements – A Survey*.¹¹ A number of IOSCO member jurisdictions were or are in the process of considering or making changes to their regimes. IOSCO will investigate later whether additional work in this area should be undertaken.

A.2.6. Internal Controls and Structured Finance Products

As a result of the findings presented in the Subprime Report, Standing Committee 1 also will review the degree to which existing internal controls and due diligence documentation procedures regarding the ownership rights attached to the assets underlying publicly traded securitized products protect the interests of investors in such products.

A.2.7. Interactive Data

One Stakeholder suggested that the issue of interactive data or XBRL is worthy of further investigation. Interactive data provides an opportunity for promoting more just, efficient and sounder markets. IOSCO is pursuing joining the XBRL Advisory Council of the International Accounting Standards Committee Foundation as an Observer.

A.3. Corporate Governance

A.3.1. Board Independence and Minority Shareholders

In the Fraud Report, IOSCO identified board independence, related party transactions and the protection of minority shareholders as crucial elements of corporate governance. Moreover, good corporate governance plays a role in investor protection. These issues are already addressed by some international standards, in particular those published by the Organisation of Economic Cooperation and Development (OECD). However, as these are high-level standards designed to accommodate different legal and regulatory frameworks, IOSCO has decided to do additional work on how the OECD principles can be implemented in practical terms. More specifically, IOSCO has set out to undertake, in collaboration with the OECD, an additional descriptive and thematic analysis of the definition and role of independent directors on the boards of public issuers and on the additional protection required in situations where these issuers are controlled by a dominant shareholder.

In 2006, the Task Force on Corporate Governance carried out an extensive survey related to independence of the board. A consultation report was published in November 2006¹²

¹¹ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD229.pdf>.

¹² *Board Independence of Listed Companies—Consultation Report*, November 2006, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD228.pdf>.

and the final report was published in March 2007 (Board Independence Report).¹³ The Board Independence Report contains an overview of the regulatory frameworks existing with respect to board independence and a related comprehensive analysis.

The Task Force on Corporate Governance currently is working on a mandate to survey and describe current mechanisms in place to protect minority shareholders from dominant shareholders or changes in control in various jurisdictions. In connection with such mandate, the Task Force on Corporate Governance circulated a questionnaire to Task Force members that is intended to broadly capture all protections afforded to minority shareholders in listed issuers. The purpose of the questionnaire is to gather information on the relevant standards in each jurisdiction. The Task Force is not expected to conduct any empirical work to assess how standards are implemented or applied in practice. This mandate does not include making recommendations or establishing best practices. The Task Force on Corporate Governance expects to complete its report in 2008/2009.

Stakeholders suggested that IOSCO could add value by focusing on the possibility of standardizing global timetables for investors' disclosure of significant shareholdings, as well as thresholds and details required by regulators. In connection with its mandate regarding the protection of minority shareholders, the Task Force on Corporate Governance is currently surveying the regulatory framework governing the protection of minority shareholders in listed issuers. Part of the questionnaire examines the disclosure of shareholdings by significant shareholders. The task force is in the process of compiling the responses to the survey questionnaires and intends to publish a report describing its findings in 2008/2009. The current mandate of the Task Force on Corporate Governance does not include the harmonization of requirements relating to the disclosure of significant shareholdings.

Scheduled output:

- Report on protection of minority shareholders from dominant shareholders or changes in control: 2008/2009.

A.3.2. Principles of Corporate Governance

A Stakeholder indicated an expectation that IOSCO will deliver principles on corporate governance. The OECD has established broad-based principles on corporate governance that have been accepted by the IMF and World Bank as a reasonable international benchmark. The Task Force on Corporate Governance therefore has not undertaken to broadly develop principles on corporate governance but instead has focused on important details of corporate governance, such as board independence and the protection of minority shareholders in listed issuers, as discussed above in section A.3.1.

¹³ *Board Independence of Listed Companies—Final Report*, Technical Committee of IOSCO, in consultation with the OECD, March 2007, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf>.

A.4. Credit Rating Agencies

In December 2004, IOSCO published the 2004 CRA Code of Conduct. The 2004 CRA Code of Conduct offers a set of robust, practical measures that serve as a guide to and a framework for implementing the objectives of the principles that were published by IOSCO in 2003.¹⁴ These measures are the fundamentals that should be included in individual CRA's codes of conduct, and the elements contained in the 2004 CRA Code of Conduct should receive the full support of CRA management and be backed by thorough compliance and enforcement mechanisms.

The CRA Task Force assessed the level of implementation of the 2004 CRA Code of Conduct by reviewing the codes of conduct published by CRAs. In February 2007, the TC published a consultation report, *Review of Implementation of the IOSCO Fundamentals of a Code of Conduct for Credit Rating Agencies* (Implementation Report).¹⁵ The responses to the Implementation Report were published in May 2007.¹⁶

IOSCO has continued to monitor new developments of CRAs' activities and their impact on the market. In view of market turmoil, in April 2007, the TC asked the CRA Task Force to analyze the role CRAs play in the structured finance market and make recommendations if the CRA Task Force concludes that the 2004 CRA Code of Conduct should be modified to better address issues relating to CRA activities in this area. In conducting this analysis, the CRA Task Force has worked closely with the Subprime Task Force, and the CRA Task Force's conclusions support and are incorporated into the Subprime Report.

A Stakeholder suggested IOSCO consider the broader regulatory issues related to CRAs, including uniform cross-border recognition of CRAs. In view of recent market events, IOSCO is focusing on a substantial amount of work related to CRAs at this time, including continuing to discuss the manner in which regulators should check for compliance with the CRA Code of Conduct and will not allocate resources to this Stakeholder suggestion.

Scheduled output:

- Published the CRA Report in May 2008, which included modifications to the 2004 CRA Code of Conduct.¹⁷

¹⁴ *IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies*, Report of the IOSCO Technical Committee, September 2003, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf>.

¹⁵ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD233.pdf>.

¹⁶ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD249.pdf>.

¹⁷ See *supra* note 5. The TC published a related consultation report in March 2008. Comments were due 25 April 2008. The consultation report is available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD263.pdf>. The comments received on such consultation report are available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD272.pdf>.

- Published the CRA Code of Conduct in May 2008.¹⁸
- Continue to discuss the manner in which regulators should check for compliance with the CRA Code of Conduct.
- Continue to monitor new developments in the market that may require revisiting the CRA Code of Conduct in the future.

B. Accountants and Auditors

B.1. Monitoring Developments with Respect to Auditing Standards

The International Federation of Accountants (IFAC) and the International Auditing and Assurance Standards Board (IAASB) are engaged in a major project to clarify and improve International Standards on Auditing (ISAs). In November 2007, IOSCO issued a statement on international auditing standards. This statement referenced determining the basis for ISA endorsement.¹⁹ IOSCO continues to provide comments to the IAASB and IESBA to encourage their development of high quality standards.

B.2. Non-audit Services

IOSCO has begun exploring issues related to auditor independence. It focused first on the issue of non-audit services offered to publicly listed audit clients and the potential impact of these services on auditor independence. IOSCO's objective was to gather information to assist its member regulators in determining how best to deal with audit independence issues in their respective jurisdictions and to encourage related cross-border convergence, in particular by exploring convergence opportunities. A survey was published on the regulation of non-audit services provided by auditors in March 2007 (Survey on Regulation of Non-Audit Services).²⁰

IOSCO continues to be actively engaged in this area. IOSCO has encouraged the IFAC's International Ethics Standards Board for Accountants (IESBA) to utilize the Survey on Regulation of Non-Audit Services and other sources in IESBA's standard setting work. In 2008, IOSCO will review its *Principles for Auditor Independence and Role of Corporate Governance in Monitoring an Auditor's Independence*. IOSCO is closely monitoring the development of auditor independence standards issued by the IESBA and regularly comments on proposed changes and additional changes needed.

¹⁸ See *supra* note 6.

¹⁹ IOSCO Statement on International Auditing Standards, dated 9 November 2007, available at <http://www.iosco.org/news/pdf/IOSCONEWS109.pdf>.

²⁰ *Survey on the Regulation of Non-Audit Services Provided by Auditors to Audited Companies*, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD241.pdf>.

B.3. Audit Quality

In relation to auditing, IOSCO is also exploring the possible drivers of audit quality. IOSCO continues to interact with a number of organizations with an interest in audit quality. It will continue to do so as it considers issues discussed at its Audit Quality Roundtable held in June 2007. Within its Standing Committee 1, IOSCO has a sub-committee devoted to auditing issues.

B.4. Audit Contingency Planning

IOSCO has identified a range of possible considerations by a securities regulator in the event of an audit crisis or the demise or suspension of a major audit firm. In May 2008, the TC published a report, *Contingency Planning for Events and Conditions Affecting Availability of Audit Services*.²¹ The TC developed this report to assist IOSCO members in considering and preparing for potential contingencies that may arise involving audit firms and that may affect the delivery of audit services in the global capital markets. It presents a collection of information about issues and experiences encountered in past events and conditions that affected the auditing of financial statements of public companies. IOSCO and a number of its member jurisdictions continue to monitor this area.

B.5. Asset Valuation and Accounting

In connection with the issues identified in the Subprime Report in the areas of asset valuation and accounting, IOSCO will consider whether additional guidance and disclosure related to measurement at fair value would be valuable in meeting the needs of investors. Standing Committee 1 would provide related input to the IASB in conjunction with its work in this area. In addition, the TC will explore whether, as a matter of internal control, registered intermediaries and investment advisors avail themselves of practitioners that are skilled or trained enough to model fair valuation adequately in illiquid market conditions.

C. Trading Venues

C.1. Regulatory Trends in Financial Activities

C.1.1. Bond Market Transparency

A key issue that was identified in the Fraud Report is the transparency and regulation of corporate bond markets. It was found that in many (though certainly not all) jurisdictions, corporate bond markets differ from equity markets in significant ways. For example, corporate bonds frequently are traded on Over-the-Counter (OTC) markets,

²¹ *Contingency Planning for Events and Conditions Affecting Availability of Audit Services—Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD269.pdf>.

where institutional investors may be more comfortable than retail investors. Similarly, many corporate bonds, although listed on exchanges, are frequently traded “off market,” between institutional dealers and buyers.

These factors combine to make bond markets’ price-setting mechanisms less transparent than those of equity, especially to retail investors. Following this, in the Fraud Report IOSCO raised the question regarding how to improve the transparency of bond market trading, and whether, in light of recent financial scandals, additional recommendations to those contained in the May 2004 IOSCO Report, *Transparency of Corporate Bond Markets*,²² could be deemed necessary.

One Stakeholder suggested that IOSCO might give more attention to projects on the fixed income markets. IOSCO notes that in March 2007, IOSCO published the report, *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*.²³

C.1.2. Multi-jurisdictional Information Sharing for Market Oversight

In recent years, issuers have increasingly sought to raise capital internationally. Moreover, many investors, especially institutional investors, have been diversifying their portfolios geographically. As a result, investors from different countries now hold an increasing proportion of many issues of securities and other financial instruments. At the same time, the marketplaces for trading these instruments have also become more international.

There are different ways in which this internationalisation of the marketplace can take place. For example, markets may offer direct (electronic) access to participants in other countries. Another example is that the same and/or closely related financial instruments are listed and/or traded in parallel in different countries.

These scenarios raise a wide range of issues concerning multi-jurisdictional oversight. In order to address these issues, IOSCO has tried to identify the regulatory approach with regard to markets that operate or seek to operate in more than one jurisdiction and has identified the categories of information that could usefully be shared on an ongoing or ad hoc basis between regulators with regard to the cross border trading of securities.

IOSCO published a final report, *Multi-Jurisdictional Information Sharing*, in April 2007.

C.1.3. Boiler Rooms

The internationalisation of investment services has also brought the development of new international scams. Sophisticated “boiler room” operations have been on IOSCO’s radar

²² Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf>.

²³ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf>.

screen for some time. This type of operation is a common problem experienced by numerous regulators. IOSCO provides a forum where regulators can readily assist each other in combating this type of crime.

C.1.4. Asset Freezing and Other Enforcement Related Issues

In addressing cross-border fraud, IOSCO has recognised (in its June 2006 Resolution on Cross-border Cooperation to Freeze Assets Derived from Securities and Derivatives Violations²⁴) that the effective enforcement of securities laws and regulations would increase if national regulators can provide cross-border assistance to a regulator in another jurisdiction in freezing assets relating to securities violations. At this time, not all IOSCO jurisdictions have sufficient powers to freeze assets which have derived from fraudulent activities. Therefore, IOSCO has encouraged its members to examine the legal framework under which they operate and strive to develop mechanisms by which within their jurisdiction these assets could be frozen.

At the base of IOSCO's enforcement-related work lies the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information Memorandum of Understanding (MMOU) which, if signed by the respective members, allows members to exchange cross-border information. The signing of this MMOU by all IOSCO ordinary and associate members is an ongoing effort.

IOSCO has also engaged a confidential dialogue with certain jurisdictions with which specific cooperation issues have been experienced. The objective of this work is to assist each of the identified jurisdictions to make genuine improvements in the level of cooperation they are able to offer their international counterparts in relation to information sharing. Positive and constructive progress has been made with a number of the securities regulators with which dialogue has been ongoing. Cross-border enforcement related cooperation and exchange of information has genuinely improved in these instances.

C.2. New Exploratory Work

C.2.1. Price Formation on Fragmented Markets

The landscape of securities exchanges has changed dramatically in recent years. Developments have included exchange demutualisation, internalisation and the creation of significant, global players through cross-border alliances of exchanges. Monitoring these developments and assessing their consequences for market integrity and investor protection continues to be one of IOSCO's priorities. One of the issues IOSCO is currently monitoring is the consequences of market fragmentation. The existence of multiple market centers through which the same securities are traded may create issues

²⁴ *Resolution on Cross-border Cooperation to Freeze Assets Derived from Securities and Derivatives Violations*, IOSCO Presidents Committee, June 2006, available at <http://www.iosco.org/library/resolutions/pdf/IOSCORES25.pdf>.

affecting the efficiency of price formation. Inefficient price formation may have an impact on market transparency and run counter to the interests of a large number of financial market stakeholders.

Stakeholders suggested that in view of the rapid changes in market and technological developments, it may be too soon to undertake a project assessing price formation on fragmented markets, or if such a project is undertaken, IOSCO assess the effects of fragmentation over time. IOSCO agrees with the Stakeholders that it may be too soon to undertake such a project. IOSCO will revisit this topic in fall 2008.

C.2.2. “Direct” Access to Exchanges and Other Markets

With the advent of electronic trading, intermediaries began transmitting orders electronically and markets were able to offer “direct” electronic access to clients of the intermediaries. In this way, the intermediaries’ clients could be given access to markets through either a registered intermediary’s system (or system provided by a third party, but effectively branded as the system of the intermediary) or via an arrangement set up by the intermediary whereby the intermediary provides or requires few controls, but allows its client to access the market utilizing the intermediary’s exchange identification.

Derivatives exchanges also permit intermediated access through registered intermediaries and, in addition, direct access by “non-intermediaries” may be granted. These non-intermediary entities are permitted to become members or participants on an exchange, if they meet certain eligibility criteria.

The question that arises for regulators with respect to direct access is: What are the regulatory regimes in place to deal with the different permutations of “direct” access? For example, regulators are concerned with whether there are tools in place to enable them to obtain any necessary information from the clients when needed. IOSCO is conducting fact-finding surveys of direct access market models located in TC-member jurisdictions and of practices of intermediaries in member jurisdictions. IOSCO will also determine whether it is appropriate and necessary to give guidance regarding access issues.

C.2.3. Outsourcing Arrangements for Markets

IOSCO is currently surveying markets and regulators in the member jurisdictions of the TC Standing Committee on the Regulation of Secondary Markets (Standing Committee 2) to identify the different regulatory regimes in place regarding outsourcing by exchange and operators of exchanges. Standing Committee 2 expects to have its survey completed in late 2008.

C.2.4. Principles for the Governance of Exchanges and Other Market Infrastructure Providers

One Stakeholder suggested that a framework be developed for the implementation of governance arrangements for market infrastructure (in the current context of consolidation among market infrastructures) to ensure a certain level of standardization, accountability, and transparency for owners, users and regulators. IOSCO has analyzed issues and concerns raised by changes in exchange ownership and business objectives in its 2001 report, *Issues Paper on Exchange Demutualization*²⁵ and in the 2006 report, *Regulatory Issues Arising from Exchange Evolution*.²⁶ IOSCO is not planning to undertake further projects in this area.

C.2.5. Structured Finance Products Market Transparency

As discussed in the Subprime Report,²⁷ given that among other things, the Subprime Task Force found that secondary trading of structured finance products, for a variety of reasons, is opaque, the TC asked Standing Committee 2 to work with the financial service industry to examine the viability of a secondary market reporting system for different types of structured finance products. In particular, they will focus on whether the nature of structured finance products lends itself to such reporting and the cost and benefits such a system might entail.

D. Intermediaries

D.1. Regulatory Trends in Financial Activities

D.1.1. Conflicts of Interest

An important element of the Fraud Report was the role of intermediaries in initial public offerings. Recent financial scandals have involved accusations of wrongdoing on the part of underwriters and investment banks. As part of a securities underwriting, market intermediaries frequently become aware of material non-public information about the issuer. Market intermediaries may be in a position to misuse this information, particularly when the intermediary is involved in the market in a number of ways (for example as an underwriter, lender, broker-dealer, market maker or proprietary trader).

In February 2007, IOSCO published the Consultation Report, *Market Intermediary Management of Conflicts that Arise in Securities Offerings*.²⁸ The comments received on

²⁵ *Issues Paper on Exchange Demutualization*, Report of the IOSCO Technical Committee of IOSCO, June 2001, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD119.pdf>.

²⁶ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD225.pdf>.

²⁷ See *supra* note 4.

²⁸ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD235.pdf>.

this consultation report were published in August 2007, and the final report was published in November 2007.²⁹

D.1.2. Point of Sale Disclosure and Customer Suitability

As retail investors may not access the same information as market professionals, their growing role in financial markets raises issues concerning their capacity to assess the suitability of financial products and investment risks related to these products.

Many retail investors who buy investment products, particularly interests in a collective investment scheme and possibly similar products, may not clearly understand the products or the layers of costs associated with those products. Also, many retail investors may not clearly understand their intermediary's financial stake in selling those products, including so-called "revenue sharing" arrangements. Therefore, they might end up purchasing a product that they would not have otherwise, had they understood the true costs of the product and/or their intermediary's conflicts of interest.

IOSCO is currently considering the key information that customers should receive at the point of sale in order to support sound investment decision-making. If appropriate, it will develop recommendations or principles relating to this issue. The TC Standing Committee on the Regulation of Market Intermediaries (Standing Committee 3) and the TC Standing Committee on Investment Management (Standing Committee 5) prepared an issues paper regarding point of sale disclosure to retail investors and are organizing a consultation in writing of various representative industry and investors associations in 2008, to provide information on the progress to date on this topic and solicit preliminary inputs for its future work.

Although IOSCO is now focussing on point of sale disclosure, it will also continue to monitor related issues such as mis-selling, suitability and best execution.

A Stakeholder suggested that IOSCO examine the issue of level playing field between financial products, in particular, the case of unfair competition between investment funds and capital market products. IOSCO recognizes that this point raises the issue of regulatory competition between substitute products. IOSCO will analyze whether some aspects of this issue are not undertaken in its work on point of sale disclosure and merit further work. Another Stakeholder noted that IOSCO should differentiate between retail investors and institutional investors with respect to point of sale disclosures. IOSCO's current project is limited to retail investors; however any final guidelines or recommendations may well be relevant to institutional investors. IOSCO could consider this issue further on completion of the current project.

A couple of Stakeholders viewed point of sale disclosures as related to customer suitability obligations. One expressed concern that "customer suitability rules appear to

²⁹ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD257.pdf>.

be non-existent in some IOSCO member jurisdictions.” A Stakeholder advocated greater standardization between point of sale disclosure and suitability requirements across jurisdictions. The Joint Forum, of which IOSCO is a member, has been engaged in a project related to customer suitability in the retail sale of financial products and services, and released a report on customer suitability in April 2008.³⁰ On the basis of this report, IOSCO will consider further work on suitability.

Scheduled output:

- Issues paper on point of sale: 2008. Standing Committees 3 and 5 will organize a consultation in writing of various representative industry and investor associations.

D.1.3. Oversight of Intermediaries Adherence to Rules of Conduct

IOSCO is reviewing the different approaches and methods used by some of its member jurisdictions to oversee intermediaries’ compliance with the rules of conduct with a view to assisting regulators in improving their oversight. It may consider the possibility of developing high level recommendations intended to assist regulators in addressing the challenges they face in seeking to ensure market intermediaries adhere to rules of conduct.

Scheduled output:

- Preparation of IOSCO members-only paper for purpose of sharing information.

D.2. New Exploratory Work

D. 2.1. Impact of New Technology

Developments in the use of the internet in financial markets continue to be monitored closely by IOSCO. In 2003, IOSCO organised several large-scale roundtable meetings in order to discuss related developments with Stakeholders and to assess if related regulatory initiatives were necessary. IOSCO will continue to monitor new technical developments and intends to periodically discuss them with Stakeholders.

In addition, IOSCO is reviewing the technological issues raised by the retention of electronic records, and the ability of firms to organise and retrieve specific types of electronic records, particularly in response to a request from regulators. In recent years the use of electronic trading, e-mail and instant messaging for securities related transactions has increased dramatically. The increased use of new communication technologies raises challenges with regard to recordkeeping, particularly the retention,

³⁰ *Customer suitability in the retail sale of financial products and services*, The Joint Forum, April 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD268.pdf>.

retrieval and form of electronic records, privacy concerns and how easily and cost-efficiently market intermediaries can make electronic records available to regulators.

It is important for regulators to have a clear understanding of the technological resources available to market intermediaries, and the cost of those resources, when seeking to gain access to electronic records that a regulator requires to be maintained. For this reason, in 2007, IOSCO met with representatives from both intermediaries and technology service providers who sell software and other technology to those intermediaries to gain better information on the manner in which technology is developing. There is a concern that a broad mandate regarding harmonizing record keeping principles and guidance would not be feasible.

Scheduled output:

- Prepare a report based on these findings for consideration by the TC.

D.2.2. Firm Risk Management and Prudential Supervision

As a result of the findings presented in the Subprime Report on the role of firm risk management and prudential supervision,³¹ Standing Committee 3 and Standing Committee 5 will undertake a study of the internal control systems of financial firms (including asset managers) in different IOSCO jurisdictions and develop principles to address any concerns identified. Standing Committee 3 also will survey members' experience on liquidity risk management and liquidity standards to assist and supplement the work being undertaken jointly with the Basel Committee on Banking Supervision. The TC will ask originators and sponsors of securitization programs to develop best practices to reinforce their due diligence and risk management practices such that the quality of assets originated for transfer off their balance sheets is of the same quality and subject to the same evaluations as for assets kept on their balance sheets. This work will be reviewed by Standing Committee 3, which will report to the TC on Standing Committee 3's opinion of the adequacy of these best practices. Additionally, Standing Committee 3 will monitor the work and review any report of the Senior Supervisors Group³² and determine whether further work is warranted by IOSCO.

D.2.3. Convergence or Standardization of Definitions of Investors

Stakeholders suggested that convergence or standardization in the definition of investors, especially wholesale sophisticated investors, would facilitate business for firms transacting cross-border business.

³¹ See Subprime Report, *supra* note 4.

³² In late 2007, regulators from seven financial supervisory agencies formed SSG to investigate risk practices among 11 major international investment banks.

IOSCO will review work that has been done in this area by member jurisdictions to assess the feasibility of additional work in this area in the future. Before IOSCO starts the work in this area, IOSCO will invite representatives from Stakeholders to the meeting of Standing Committee 3 in 2008 in order to exchange the views on this issue.

E Asset Management

E.1. Regulatory Trends in Financial Activities

E.1.1. Asset Pricing, Fund Valuation and Risk Management Aspects Linked to the Use of Derivatives and Complex Strategies Within Collective Investment Scheme (CIS) products

Due to the sheer size of hedge funds, regulatory or market failures in this field could potentially have an effect on the stability of the global financial markets. With hedge funds having an unprecedented influence on global financial markets and an ever-increasing participation by retail investors in certain jurisdictions, IOSCO has prioritised its work on hedge funds and alternative investments. In 2006, IOSCO published, *Regulatory Environment for Hedge Funds: a Survey and Comparison*, which was an exploration of issues related to hedge funds. IOSCO published the report, *Principles for the Valuation of Hedge Fund Portfolios* (Hedge Fund Portfolio Valuation Principles), in November 2007.³³

One Stakeholder suggested that IOSCO consider issuing practical methodologies and detailed guidelines for the valuation of derivatives and portfolios with complex strategies within collective investment schemes in relation to the 1999 IOSCO report, *Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes*³⁴ (1999 CIS Valuation Report). IOSCO will consider whether further work might be helpful for the purposes of updating the 1999 CIS Valuation Report and the Hedge Fund Portfolio Valuation Principles. In order to ensure a common approach on valuation, Standing Committee 5 would liaise with the Standing Committee 1.

E.1.2. Elements of Regulation for Fund of Hedge Funds

A further area under consideration by IOSCO is the examination of existing regulations on funds of hedge funds (or proposed regulations) and to identify the issues of potential concern in this area. The purpose of IOSCO work in this regard is to present regulatory approaches of IOSCO member jurisdictions and identify, with the help of representatives of the industry, the related key regulatory issues, and to develop guidelines based on best market practices in the areas where additional investor protection regulatory issues are identified, namely the methods by which funds of hedge funds' managers deal with

³³ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD253.pdf>.

³⁴ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD91.pdf>.

liquidity risk, and the nature and conditions of the due diligence process conducted by funds of hedge funds' both pre-and post-investment.

Scheduled output:

- Published *Report on Funds of Hedge Funds-Final Report*, June 2008.³⁵
- Prepare high-level principles on funds of hedge funds: end of 2008.

E.1.3. Soft Commissions and Incentives

As soft commissions could lead to conflicts of interest as regards the provision of services to investors and the allocation across funds, IOSCO published a final report on this issue, *Soft Commissions Arrangements for Collective Investment Schemes*, in November 2007.³⁶

It was suggested that IOSCO consider soft commission arrangements and incentives for non-collective investment schemes or other financial sectors. In view of preliminary research it has conducted, IOSCO has determined that it would not be appropriate at this time to develop general principles regarding soft commission arrangements, as relevant law is changing in many jurisdictions. IOSCO has undertaken to monitor these legal changes to determine whether and how general principles may be elaborated with respect to soft commissions and bundling.

E.1.4. Point of Sale Disclosure

See *supra* Section D.1.2.

E.2. New Exploratory Work

E.2.1. Private Equity Conflicts of Interest

Increasing levels of debt taken on by private firms can prompt such widespread disruption in case of large scale defaults that they could have a significant impact on global financial market stability. While part of private equity falls outside the limits of regulated markets, linkages are developing between private equity and the public markets. In November 2007, IOSCO published the *Report on Private Equity* (Private Equity Report),³⁷ which, among other things, identified a set of issues that private equity markets may pose to capital markets. The Private Equity Report noted that private equity transactions can present material conflicts of interest for a number of parties, including private equity firms, investors, target portfolio companies and market intermediaries, many of which such conflicts may be present in other types of mergers and acquisition

³⁵ *Report on Funds of Hedge Funds—Final Report*, Report of the Technical Committee of IOSCO, June 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD276.pdf>.

³⁶ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf>.

³⁷ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD254.pfd>.

activities. As a result of the Private Equity Report, which was finalized in May 2008,³⁸ IOSCO will undertake work in the area of management of conflicts of interest. Standing Committee 5 will focus on the management of conflicts of interest faced by private equity firms in their interaction with public markets, and the way in which market intermediaries and private equity firms mitigate the conflicts of interest faced by market intermediaries in their dealings with private equity firms.

E.2.2. Standardized Benchmarks in the Presentation of Fund Performance

One Stakeholder suggested that IOSCO should consider the effective use of standardized benchmarks in the presentation of fund performance, in relation to the 2003 IOSCO report, *Performance Presentation Standards for Collective Investments Schemes* (Performance Presentation Report).³⁹ In the context of the evolution of relevant law in a number of IOSCO jurisdictions, IOSCO will consider how such recent laws are in practice affecting the presentation of fund performance. IOSCO will then consider whether additional work would be necessary to complete the Performance Presentation Report.

E.2.3. Due Diligence for Investing in Structured Products

As discussed in the CRA Report, CRAs and their ratings played a critical role in the recent market turmoil. Unlike securities trading on deeper, more transparent markets, credit ratings have had an inordinate impact on the valuation and liquidity of subprime residential mortgage-backed securities (RMBSs) and RMBS-backed collateralized debt obligations (CDOs). In part, this resulted because many investors and market participants effectively outsourced their own valuations and risk analyses of RMBSs and RMBS-backed CDOs to CRAs – a tendency the CRAs, some believe, had little incentive to discourage given the growth and profitability CRAs have experienced in this market segment over the past several years. Responsibility for the market turmoil – and, indeed, responsibility for the failures that directly relate to credit ratings – extends far beyond CRAs. In particular, there are serious questions whether institutional investors relied excessively on credit ratings, with little regard for the underlying risks of the financial instruments they bought, sold, and in some cases even designed. In view of this, in the Subprime Report, the TC stated that Standing Committee 5 will review the degree that investment managers who offer CIS to retail investors have invested in structured finance products; the type of due diligence typically conducted when making these investments; the degree to which these investment managers have been affected by the current market turmoil; and if and how investment managers may have shielded retail investors from the

³⁸ *Private Equity—Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD274.pdf>. Based on the responses the TC received to the Private Equity Report, the TC did not make amendments to the Private Equity Report with respect to the issues it considers are posed by private equity to capital markets in general, or which it considers are relevant to IOSCO's objectives and principles.

³⁹ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf>.

effects of their exposure to losses from structured finance products and any broader market implications such activity may have.

E.2.4. Firm Risk Management

See *supra*, D.2.2.

E.2.5. Sovereign Wealth Funds

In consideration of the activities of various sovereign wealth funds in the current context, Standing Committee 5 is considering reviewing the regulatory issues related such funds.

E.2.6. Exchanged Traded Funds (ETFs)

Given the growing interest in ETFs worldwide as evidenced by the amount of money invested in ETFs, IOSCO initiated preliminary work on the regulatory approaches in the area in order to identify the issues associated with such products. It will then contemplate to the extent possible establishing common investor protection principles in order to deal with the issues so identified.

E.2.7. Real Estate Funds

IOSCO has undertaken initial work on the regulatory issues related to real estate funds by checking the legal regime applicable in the member jurisdictions of Standing Committee 5. As a result of this preliminary work, IOSCO has identified that the main issues relate to conflicts of interest, liquidity management and valuation.

F. Mutual Recognition

Stakeholders suggested that IOSCO should facilitate direct access to global financial markets by international financial firms; integration of financial markets must be accompanied by the elimination of barriers that prevent firms from offering services across borders; IOSCO could start working on the issue of mutual recognition.

The IOSCO General Secretariat will survey the work done within IOSCO that could provide an infrastructure for potential multilateral regulatory recognition. For example, for jurisdictions undertaking a recognition assessment process, the IOSCO Principles⁴⁰ would be relevant, and may provide a framework for such assessment process. Further, whether the jurisdictions involved in such a process are signatories to the MMOU, would likely be considered in such a recognition assessment. Additionally, the IOSCO General Secretariat will survey the work of IOSCO members regarding principles for recognition. IOSCO will continue to assess developments in a bilateral context.

⁴⁰ *IOSCO Objectives and Principles of Securities Regulation*, March 2008, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCPD265.pdf>.

G. Investor Education

One Stakeholder suggested that IOSCO should increase its investor education efforts. IOSCO published a report in January 2003 on investor education program guidelines.⁴¹ IOSCO also held a joint conference with the International Forum for Investor Education (IFIE) in October 2007 on investor education. The main topic of the conference was investor education developments in the European Union and around the globe. Panelists covered topics including: protecting investors through investor education; investor education in Europe; investor education around the globe; the role of regulators and industry in investor education; and the impact of investor education on economic growth. As a result of this successful event, another investor education conference is currently being organized jointly with IFIE for the first quarter of 2009.

⁴¹ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD140.pdf>.