IOSCO Task Force Report on Wholesale Market Conduct

The Board

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Chapter 1 – Preface

Market regulators[1] set, administer, supervise and enforce standards of conduct in financial markets. As part of the broader international efforts to reduce the risk of misconduct in wholesale financial markets, in September 2015, IOSCO established a Market Conduct Task Force (the Task Force) to conduct a review of IOSCO members' existing conduct approaches and the work IOSCO has completed in this area.[2]

The Task Force's review is focused on examining regulatory approaches and tools that are relevant to address market conduct by traders and other professionals engaging in trading with, advising or providing other investment services to, professional counterparties in wholesale markets and the managers who are responsible for supervising such professionals. The objectives of this work are to:

- Raise a broader awareness about the tools and approaches IOSCO members use to regulate conduct in wholesale markets; and

- Highlight examples of market conduct tools and approaches, including innovative and impactful approaches that are particularly relevant in the context of wholesale markets, to assist IOSCO members.

To further this mandate, the Task Force undertook both a mapping exercise of existing IOSCO work relevant to conduct in wholesale markets, as well as a survey of its members seeking information about their approach to regulating against misconduct.

The Task Force is undertaking its work in parallel with a number of other IOSCO work streams relevant to minimizing misconduct risk in financial markets following the global financial crisis.[3] This ongoing IOSCO work is set out further in Chapter 3 and Annex A of this report.

Other initiatives include the work of the Financial Stability Board (FSB) on measures to reduce misconduct risk with the aim of strengthening the resilience of the global financial system through the raising of expectations for, as well as awareness of, good practice standards of behavior and conduct across markets and market participants. The FSB established a Working Group on Governance Frameworks (WGGF) in May 2016 to exchange good practices on the use of governance frameworks to address misconduct risk at firms.

In addition, the Foreign Exchange Working Group established by the Bank for International Settlements (BIS), through a partnership between central banks and market participants,

[1] In this Report, the term, "market regulator", refers to both market regulators and supervisors.

[2] The members of the Task Force are listed in Annex B to this Report.

[3] As part of the FSB workplan on *Measures to Reduce Misconduct Risk*, IOSCO is working with the FSB's Compensation Monitoring Contact Group (CMCG) in its stocktake of compensation practices in the securities sector and its consideration of the role that compensation and other incentives, both monetary and non-monetary, play in addressing conduct issues. In 2016, the IOSCO Board created a group comprised of representatives from several IOSCO Committees to participate in this work. In light of the specialized work being undertaken by the CMCG with IOSCO input, this report does not address compensation related tools.

undertook work on a set of global principles of good practices for wholesale foreign exchange markets. .The complete code and adherence mechanisms were published in May 2017.

At national levels, market regulators continue to build on and refine their existing regulatory regimes to address conduct issues in financial markets and it is anticipated that the toolkit set out in Chapter 4 of this report will be of particular use in this respect.

Industry groups are also carrying out work at an international level to help to raise standards of conduct in wholesale markets. While industry standards do not constitute legally binding rules or codes, such initiatives may be useful for providing more detailed guidance on accepted practices and help to foster private sector buy-in for improved conduct, particularly if there is publicly available information about market participants' commitments to abide by such standards, incentivizing more firms to ensure their practices comply with prevailing standards and are aligned with others in their industry.

The report of the Task Force should therefore be considered within the context of these wide-ranging efforts to minimize misconduct risk.

Chapter 2 –Wholesale markets and misconduct

2.1 Introduction

The efficient functioning of wholesale financial markets is critical to both global and national economies. Misconduct in these markets can undermine their effective operation and participants' and the public's confidence in using them for funding, investment, risk management or trading purposes.

IOSCO's stated objectives include protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk. Trust and confidence in the fair and efficient operation of wholesale markets is critical.[4]

Without this trust and confidence, investors and others may be discouraged from using wholesale markets because, for example, their prices and activities may not be relied on to reflect genuine forces of supply and demand. Conduct failings in wholesale markets may, in turn, affect the ability of other markets to deliver products and services to meet retail customer and wider economic needs. Significant or widespread misconduct may even create systemic risks.

This Report addresses the misconduct of participants (including firms and market professionals) which may undermine the effective operation of and trust and confidence in wholesale markets. Individual behavior or the failure to supervise and control individuals has been behind many recent and past cases of misconduct in the wholesale marketplace. The focus of this Report is therefore on individual misconduct.

This Chapter describes wholesale markets and the particular characteristics common to these markets which may give rise to misconduct. Chapter 3 identifies existing and ongoing IOSCO initiatives which are relevant to misconduct risk in wholesale markets, including some broad expectations of conduct for individual market participants in light of these risks. These core conduct expectations are consistent with existing IOSCO principles, standards and its other previous work, which generally reflect IOSCO members' approaches to conduct regulation. These conduct expectations identified by the Task Force comprise honesty, integrity, conflicts management, competence, and communication and confidentiality. Chapter 4 comprises a suite of tools used by one or more market regulators to address misconduct in wholesale markets. Chapter 5 sets out an overview of how market regulators help ensure that firms and individuals meet their obligations under the legal, regulatory and supervisory frameworks described above.

The mapping exercise in Annex A illustrates how IOSCO Principles and Standards seek to address these core expectations of conduct.

Expectations of individual conduct are contained in jurisdictions' regulatory frameworks that comprise firm-level obligations, licensing and registration, regulatory supervision (including monitoring) and enforcement. In these frameworks, authorization, enforcement and supervision perform independent and mutually reinforcing functions. Integrating these

4 The Methodology elaborating on the IOSCO's *Objectives and Principles of Securities Regulation* acknowledge that sound securities and derivatives markets (which includes wholesale markets) are vital to the growth, development and strength of market economies.

different functions into a comprehensive regulatory framework is how market regulators deter, detect and respond to misconduct.

2.2 Wholesale markets

2.2.1 What are wholesale markets and why are they important?

While there is no widely accepted definition, for the purposes of this Report, wholesale markets may be understood to be those markets that predominantly consist of professional counterparties where both counterparties are persons or firms that are considered more sophisticated than typical retail customers or participants. These wholesale markets can have a decided impact upon the rest of the economy, and so misconduct can have a detrimental effect on large and small companies, investment decisions, and markets' efficient and fair operation.

Wholesale counterparties typically possess significant resources, trade in relatively large volumes and/or conduct high value trades and tend to have a higher degree of financial markets expertise. In some jurisdictions, wholesale counterparties are typically considered to be dealing with each other on a relatively equal and more sophisticated basis than retail market participants in their market facing actions. In practice there can still remain an imbalance in information, skill or bargaining power. Examples of clients or counterparties in wholesale markets might include banks, hedge funds, insurers, sovereign governments, central banks, large companies and high net worth individuals.

Wholesale markets are designed to meet a variety of needs. The size and sophistication of the participants in these markets, and their trades, mean that financial instruments are often tailored to participants and their clients' specific financing needs and profiles.

The wholesale equity markets are an important source of finance and capital-raising for economic activity and play an important role in risk, portfolio and investment management, while the wholesale fixed income markets provide financing for governments and government related agencies as well as short term and long term funding for banks and non-financial companies. Foreign exchange markets, comprising both derivatives and spot markets, facilitate the exchange of currencies and the hedging of currency risk for investment and transactional purposes. Trading in the financial commodity markets both determines and reflects the prices of a broad array of commodities, including food, precious metals, and raw materials.

2.2.2 What is misconduct in the wholesale markets?

At the most basic level, misconduct in wholesale markets involves behavior or practices that are inconsistent with jurisdictions' laws, rules, principles and objectives of financial market regulation that have been developed to address realized or potential market failures. This conduct may undermine the integrity of the markets, investors' confidence to trade in these markets, and the overall effectiveness of the markets. Widespread misconduct may therefore mean that market prices and activity may not be relied on to reflect genuine forces of supply and demand. Serious misconduct can also have the effect of undermining key objectives of financial regulation: reducing potential systemic risk and securing fair and effective markets.

2.3 Characteristics of wholesale markets that may give rise to potential misconduct risk

As noted previously, there is no hard-and-fast definition of "wholesale" financial markets. However, there are certain characteristics of wholesale markets that, to a greater or lesser degree, may heighten the risk of misconduct in these markets. These characteristics may lead market regulators to focus on particular aspects of conduct in wholesale markets and, as such, the areas of attention for market regulators in wholesale markets may differ from those in retail markets, even though the same conduct regulation tools may be used.

The section below sets out some of the key characteristics of wholesale markets which may increase misconduct risk and may affect the approach by market regulators to regulation of these markets. While some of these characteristics are not exclusive to wholesale markets and may similarly impact on conduct in retail markets, in the context of the wholesale market environment, these may increase the possibility of misconduct occurring.

2.3.1 Decentralized market structure

Wholesale markets often have decentralized market structures.[5]

In a centralized market structure, most trades take place through one or more central venues or exchanges that oversee trading and where prices and information about order flows are made available to the market or public as a whole. Trading in decentralized markets, by contrast, often takes place through exchange-like trading venues or platforms, or bilaterally in over-the-counter (OTC) markets. While OTC markets and market makers provide a useful economic function, by facilitating trading in less liquid markets where exchange-trading may not be feasible, their structures can give rise to potential misconduct risk.

As a consequence of these decentralized structures, there are not necessarily central organizing bodies overseeing trading across wholesale markets, nor acting as a hub for dispersing information on prices and order flows to the markets as a whole. There may also be no single body that monitors or sets standards to address risks such as front-running, manipulation or the misuse of information. The risk of anti-competitive or collusive behavior is also heightened in wholesale markets with a small number of large providers and no centralized oversight. This presents a number of challenges for market regulators. These structures may impact on how market surveillance and investigation of misconduct are undertaken due to relevant data not being held in one place, but rather held privately at the firms or in a number of repositories. Moreover, the decentralized structure can lead to inefficient asymmetries of information between market participants. Decentralized market structures may also mean that regulators cannot necessarily rely on a central exchange to obtain market data or to undertake surveillance activities or other regulatory functions. Reconstructing transactions may require aggregation of data from multiple sources. The small number of individuals involved in some OTC trades also bears on market structure.

In addition, there may also be issues concerning the integrity of information within such markets. The lack of a central coordinating body may provide more opportunities for dishonest

5 However, it should be appreciated that not all wholesale markets share these characteristics. Securities and derivatives that are traded in wholesale markets, such as government bonds, may be both standardized and traded on organized exchanges with greater or less transparency.

individuals to manipulate information on prices and flows to other participants, as there may not be sufficient checks and controls.

2.3.2 Opacity

Wholesale markets are often opaque to other market participants, particularly when products are traded OTC, so that market participants potentially face difficulties in obtaining relevant information and data on trading interests and prices. The complexity of many products traded in wholesale markets may contribute to this opacity, making the price discovery function of markets more difficult to protect. In particular, complexity can require greater sophistication and analysis to identify improper or abusive trading strategies.

A lack of transparency may increase misconduct risk by creating opportunities for dishonest market participants to engage in abusive practices, for example, a lack of market transparency in the secondary market where bonds are traded could potentially facilitate abuses such as front running and the inappropriate disclosure of client trading information by individuals.

The opacity of wholesale markets may also foster the belief amongst participants that misconduct is less likely to be detected or sanctioned, thereby potentially incentivizing inappropriate behavior.

2.3.3 Conflict of interest between market makers and clients

The significant role often played by market making in wholesale markets may give rise to conflicts of interest. First, the market maker may have an interest in market price movements that conflict with clients' interests because of its need to hold inventory, or its own proprietary position. This may come from proprietary trading by the market maker, or from a different line of business or set of trades engaged in by the market maker. Second, the market maker gains information about demand by trading with customers and counterparties. While this knowledge may enhance the service provided by market makers, this information can also be misused.

In some cases, participants may be trading as principal, whether as market makers or on a solely proprietary basis, as well as acting as an agent for clients. This may create both conflicts and confusion, opening the door to possible misconduct. The result may be that firms and individual traders are unsure of whose interest they are acting in on a particular transaction – their clients, their firms or their own – and whether they owe any duties, for example, to protect confidential information. These situations may create risk of misconduct where client information may be inappropriately shared or used by individuals for their own benefit or that of their firm.

2.3.4 Size and organizational complexity of firm participants in wholesale markets

Many wholesale markets include very large organizations, with a variety of different business units and thousands of employees located across multiple geographies.

This can present a number of challenges in terms of deterring, identifying and sanctioning misconduct.

Cost and effectiveness of oversight: Although it is essential that firms have proportionate and effective systems and controls to provide sufficient oversight, it can be costly and difficult to oversee and apply controls to large, complex and varied businesses, particularly if they are carried out on a cross-border basis. If control and supervisory systems are inadequate, then employees may believe that misconduct might go unnoticed, or not be identified sufficiently. This can also be the case for smaller firms.

Similarly, it may be difficult for extremely large firms to effectively disseminate expectations around conduct. This is especially the case if the scale and variety of the organization's activities leads to "silos", where information is quarantined within particular business or functional units.

Effectiveness of firm-level penalties: In recent years, substantial fines have been imposed for misconduct on firms operating in wholesale markets. While the financial penalties levied at the organizational level may catch the attention of a firm's senior management and shareholders, they have likely had much less bearing on the interests and incentives of traders and other front-line staff individually.

2.3.5 Individual accountability in the firm context

The combination of characteristics of the wholesale markets discussed above may have the effect of diluting individual accountability within a firm. For example, the complicated organizational structures and systems of wholesale market participants may create ambiguity about which specific staff members are responsible for a particular function or the oversight of that function. Not only can this make it difficult for the firm and/or market regulators to detect and appropriately sanction misconduct or mean that functions are not undertaken effectively, it may also reinforce a perception by perpetrators that they will not be held accountable for their misconduct.

The role of monetary incentives and bonuses, particularly an extreme focus on meeting financial performance targets may potentially instill less loyalty by individuals to the firms that employ them, which may lead them to be more prepared to breach relevant rules and regulations for their own benefit. Furthermore, given the nature and scale of transactions in wholesale markets, certain individuals or "star" traders may be in the position to enter into transactions that have a significant impact on their firm's balance sheet and financial performance. Such an outsized contribution to a firm's performance by specific individuals may impact a firm's willingness to impose appropriate governance and controls over the activities of those individuals. Conversely, those individuals may come to believe that relevant governance controls do not apply to them.

Some regulators believe that encouraging firms to improve or address failings in culture (a term difficult to precisely define) can play a role in discouraging or encouraging individuals to hold themselves accountable to regulatory standards.

2.3.6 Increasing automation

Financial markets, including wholesale markets, are continually innovating and to effectively address misconduct risk going forward, regulators must be aware of, understand and respond to changes. Such changes can be seen in the rapid adoption of new technology and increased reliance on automation in the wholesale markets.

One area where advances in technology may impact regulators' ability to address misconduct risk is how market regulators apply existing conduct expectations in light of the increased disintermediation of market participants from the trading process resulting from automation. Some expectations, such as honesty, may be more difficult to interpret and apply when individual trading decisions are made by automated pre-programmed algorithms, not people. Focus may change to those who program the algorithms and ensure that claims regarding outcomes promised by computers match real world performance. Market integrity and conflicts management are elements that must be considered and built into automated systems. Honesty and competence will take on a new emphasis to ensure that parties understand the role of technology and that clients continue to be provided with consistent and fair services. The roles, responsibility and accountability of firms and individuals will need new considerations.

Another challenge is the need to monitor and supervise markets that move at increasingly high speeds and generate huge volumes of data. The amount of data, cross-market trading and speed of activities raises issues for market operators and market regulators in obtaining a complete and accurate view of market activity, heightening the significance of surveillance and data analysis tools.

Chapter 3 – IOSCO work relevant to conduct in wholesale markets

At the international level, IOSCO has provided guidance to and supported national regulators in their work to discourage, identify and prevent misconduct in financial markets, with certain IOSCO initiatives being of particular relevance to minimizing conduct risk in wholesale markets.

3.1 IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMoU)

Given the cross-border nature of wholesale markets, it is critical that effective mechanisms for international cooperation are in place to ensure enforcement of rules and regulation.

To facilitate such collaboration, market regulators have entered into a number of bilateral and multilateral cooperation understandings, the most notable of which is the IOSCO MMoU.

Under the IOSCO MMoU, market regulators are able to obtain assistance from their counterparts in the investigation, litigation and prosecution of misconduct when information, individuals, entities or assets are located in another jurisdiction. As a result of such international cooperation, market regulators are able to obtain the critical evidence to hold accountable those individuals and institutions engaging in potential misconduct across multiple jurisdictions. Additionally, where multiple regulators have parallel investigations into the same activity, such cooperation can facilitate coordinated actions.

In May 2016, IOSCO finalized the text of an Enhanced Multilateral Memorandum of Understanding (Enhanced MMoU) on cooperation and exchange of information in which member signatories would commit to providing additional kinds of assistance that IOSCO believes are important for its member regulators to ensure their continued effectiveness in deterring cross-border misconduct and fraud in securities markets, and which takes into account technological and regulatory developments since the launch of the IOSCO MMoU in 2002.

3.2 Expectations of conduct of participants in wholesale markets

There has been a substantive amount of previous IOSCO work that is relevant to conduct in wholesale markets. The Task Force has identified certain conduct expectations of market participants that are particularly relevant to wholesale markets regulation, which are summarized in the table below. This table is not intended to be an exhaustive list, but sets out particular categories of conduct expectations derived from work that IOSCO has produced to date and the approaches to regulation identified in the IOSCO member survey referred to in Chapter 1 above.

Relevant Conduct Expectations Identified in Prior IOSCO Work	
Conduct Expectations	**Examples of relevant IOSCO Work**
Honesty: The expectation that market participants act honestly, including through the statements they make.	• International Conduct of Business Principles (July 1990) • Model Code of Ethics (June 2006) • Objectives and Principles of Securities Regulation (August 2013) (Principle 31) *See generally* Annex A, Part II.1
Uphold Market Integrity: The expectation that market participants do not behave in ways that undermine the fairness, the price formation function of markets, or the public and other participants' confidence in those markets.	• Principles for the Regulation and Supervision of Commodity Derivatives Markets (September 2011) • International Standards for Derivatives Market Intermediary Regulation (June 2012) (Recommendation 7) • Objectives and Principles of Securities Regulation (August 2013) (Principles 31, 36) • Credible Deterrence in the Enforcement of Securities Regulation (June 2015) *See generally* Annex A, Part II.2
Conflicts Management: The expectation, when dealing with potential or actual material conflicts of interest that market participants will generally avoid, disclose or otherwise manage such conflicts.	• Model Code of Ethics (June 2006) • Report Market Intermediary Management of Conflicts that Arise in Securities Offerings (November 2007) (Part 2) • Principles for Financial Benchmarks (July 2013) (Principle 3) • Objectives and Principles of Securities Regulation (August 2013) (Principles 8, 23, 31) *See generally* Annex A, Part II.3
Competence: The expectation that market participants have the appropriate skills and knowledge to provide the services that they offer and to exercise due care and diligence in doing so.	• Compliance Function at Market Intermediaries (March 2006) (Topics 4, 7) • International Standards for Derivatives Market Intermediary Regulation (June 2012) (Recommendations 12-13) • Principles for Financial Benchmarks (July 2013) (Principle 4) • Objectives and Principles of Securities Regulation (August 2013) (Principle 29) *See generally* Annex A, Part II.4
Communication and Confidentiality: The expectation that market participants	• International Conduct of Business Principles (July 1990) (Principle 5)

disclose relevant information to counterparties or clients in a clear and timely way to allow for informed counterparty decision making and, in doing so, respect the confidentiality of their clients.	• Model Code of Ethics (June 2006) • IOSCO Objectives and Principles of Securities Regulation and Methodology (August 2013) *See generally* Annex A, Part II.5

<u>Note</u>: A more detailed narrative explaining each of the conduct expectations above, and further details of the IOSCO work referred to above is set out in Annex A.

3.3 Benchmarks

In light of the investigations and enforcement actions relating to the attempts at manipulation of major interest rate benchmarks, the IOSCO Board established the Task Force on Financial Market Benchmarks (Benchmarks Task Force) in 2012 to identify and consider benchmark related issues (including benchmark governance and factors to be considered in transition to an alternative benchmark) and to develop principles to support the quality and resilience of benchmarks.

The Benchmarks Task Force published the IOSCO Principles for Financial Benchmarks in July 2013 and undertook further work to review the implementation of these principles in coordination with the FSB. The Benchmarks Task Force's work is ongoing.

Chapter 4 – Toolkit: Selected tools particularly relevant to individual misconduct in the wholesale markets

This Chapter provides examples of regulatory tools (including recently developed tools) which the Task Force wishes to highlight as being particularly relevant to minimizing the misconduct risk that may arise due to particular characteristics of the wholesale markets as set out in Chapter 2: market structure; opacity; conflicts of interest with market makers; size and organizational complexity of market participants; and influential individuals. In addition, this section also sets out some regulatory tools of particular relevance to increasing automation in the wholesale markets.

It should be noted that the tools set out below are only a selection of the forward looking measures used by one or more market regulators to address misconduct. In addition to these, market regulators more generally also use many of the tools described in the general overview set out in Chapter 5 to address misconduct risk in wholesale markets. Also, a reference in this Report to a tool used by a specific market regulator does not mean that other regulators do not use such tools.

The tools referred to in this chapter are intended to be illustrative examples of the actual measures and approaches used by certain market regulators to deter and reduce misconduct in financial markets, recognizing similar or alternative tools may also exist. This chapter is not intended to rank or assess the usefulness of a particular tool over another tool.

As set out above, some of the characteristics of the wholesale markets may also be relevant to retail markets. The Task Force therefore recognizes that some or all of these tools may also be applied in retail markets.

4.1 Tailored enforcement and remedial sanctions

4.1.1. Orders to participate in market structural reforms

A regulatory tool used in wholesale markets to address issues regarding transparency and asymmetric market knowledge lies in the flexible nature of remedies available upon imposition of an enforcement sanction. Enforcement sanctions can be designed to require firms and individuals to take specific action to resolve key market structure issues that may otherwise increase the risk of misconduct. Regulators can be creative and forward-thinking in efforts to prevent future misconduct through a broad range of remedial sanctions to improve the overall marketplace. In resolving enforcement proceedings, regulators need not limit sanctions to financial penalties and suspensions.

In the United States, the Commodity Futures Trading Commission (CFTC) may seek, in the course of a negotiated resolution of its enforcement actions, remedial measures. These measures can include affirmative obligations placed on firms and individuals that seek, in creative ways, to lessen the risk of future misconduct by individuals in the wholesale markets.

In the United Kingdom, the Financial Conduct Authority (FCA) has similar powers.

The CFTC, the FCA, and other market regulators have taken enforcement actions against a number of financial institutions since 2012 for attempted manipulation of financial benchmarks, in particular the London Inter-Bank Offered Rate (LIBOR) and the Euro Inter-Bank Offer Rate (EURIBOR).

This led to specific, creative remedies designed to thwart future misconduct. For example, in a settlement arising out of a 2012 LIBOR enforcement case, the CFTC specified that a firm charged with abusive trading practices associated with benchmarks take very specific remedial measures, including the firm's participation in efforts to detect and deter trading intended to manipulate swap rates, ensure the integrity and reliability of bank benchmark submissions, and improve related internal controls. The settlements in such enforcement cases also included the firm participation in the development of rigorous standards for benchmark interest rates. This preceded international efforts to reform benchmarks and the firm's work influenced international reports on benchmark reform.

The enforcement actions brought by the FCA, the CFTC, and others against firms in relation to LIBOR had important consequences for market structure in this way: they helped to drive the development for a new methodology for calculation of the LIBOR benchmark as well as new regulatory and supervisory regimes for monitoring LIBOR-submitter bank operations and a new authorization regime for the LIBOR administrators.

In the United Kingdom, the FCA, the Bank of England and HM Treasury supported the creation of a non-public entity, the Fair Markets Standards Board (FMSB), to create voluntary standards of practice for the industry to follow. The FMSB helps to establish peer review and pressure to conform to conduct expectations that were not followed in the benchmark scandals (honesty, market integrity, management of inherent conflicts, and the like).

4.1.2 Agreed remediation and other undertakings

In some jurisdictions, regulators can agree to undertakings with regulated firms to address compliance issues as an alternative to slower and more costly regulatory actions. Undertakings are especially useful as a tool to address identified supervisory and compliance weaknesses among firms, but is less appropriate in serious cases of actual misconduct. The attraction of these mechanisms is that the parties can agree on appropriate remediation actions and there can be systems of oversight to ensure the agreed actions are taken.

In Australia, ASIC accepted what is known as an "enforceable undertaking" from three banking group entities (entities), operating in Australia as foreign financial service providers, following concerns about significant and repeated failures to comply with the disclosure condition of the Australian financial services license (license) exemptions relied upon by the entities.

The entities failed to disclose to clients that they were exempt from holding a license and are regulated by overseas regulatory authorities under foreign laws, which differ from Australian laws.

The number and duration of these failures – impacting over 500 wholesale clients – demonstrated a systemic weakness in the compliance controls implemented by the entities. Accordingly, under the terms of the undertaking, the entities were required to appoint an ASIC approved independent expert to review the relevant compliance frameworks, report any deficiencies and make recommendations on how to rectify those deficiencies to ensure compliance.

Following the recommendations, the enforceable undertaking required the entities to implement a remediation action plan to address any deficiencies and recommendations from the independent expert's report. The independent expert’s role extends to assessing and testing the remedial actions implemented by the entities by conducting a hindsight review of compliance one year after the implementation of the remedial action plan. The enforceable undertaking also extended to a possible second remediation plan to be devised and implemented by the entities, if the first was found to be inadequate.

4.2 Tracking “bad apples”

In some jurisdictions, specific requirements are in place in respect of the information that must be shared when certain types of staff move between firms which enable individuals with histories of misconduct or “bad apples” to be identified.

In addition, regulators or SROs may keep registers accessible to the general public. The information contained in registers differs from jurisdiction to jurisdiction, but typically includes basic information about individual market professionals. The existence of public registers helps to ensure transparency, providing benefits to clients wishing to know more about individuals with whom they are doing business, helping to build trust. It also helps firms by informing hiring decisions. Some regulators may also keep registers of more detailed information that are not available to the general public.

In Germany, in addition to the European standard test for key function holders, BaFin operates an internal employee and complaints register tracking certain individual’s misbehavior. When relevant individuals seek to change employment to another investment firm, BaFin may use the information in the register to consider whether it may be appropriate to prohibit the firm’s employment of such individuals.

In Japan, the Japan Securities Dealers Association has rules under which its members must inform the association about inappropriate acts that employees have committed. When a member firm intends to hire a person, it must inquire with the association whether that person has committed an inappropriate act. In response to the inquiry, the association replies to the firm based on the record of inappropriate acts it keeps. The association may prohibit member firms from hiring persons for a certain period of time, if the act committed by them is considered to impair public confidence in the financial instruments business.

In Switzerland, the Swiss Financial Market Supervisor Authority (FINMA) maintains two tools to intensify supervisory oversight of certain individuals. The watch list is a non-public database of individuals with questionable business conduct or with a track record of not meeting relevant legal requirements. The aim of the database is to ensure that only people who meet the proper business conduct requirements are involved in the strategic or executive management of authorized institutions or hold qualified participations in them. FINMA additionally sends a business conduct letter to those entered on the watch list in certain circumstances, including where there is a possibility of the individual assuming a position subject to business conduct requirements in the future. While the business conduct letter is not a ruling, it will inform the individual that FINMA reserves the right to review compliance with business conduct requirements if the individual intends to assume a specific position. Any subsequent review will be carried out by means of enforcement proceedings.

In the United Kingdom, regulatory references need to be prepared by the firm using a mandated template with which firms must then share certain information about employees moving between firms. This is designed to support firms in assessing whether a new hire is "fit and proper". This information is expected to include any breaches of regulatory requirements, internal disciplinary actions and breaches of the FCA's individual conduct rules. The references, which include 6 years of the employee's employment history, are required for anyone performing a senior manager, non-executive director or significant harm function (that is, a function where the employee could potentially cause material loss or damage to the firm). The FCA also pre-approves senior managers at the gateway through its authorizations process.

In the United States, FINRA maintains a publicly available database of brokers called BrokerCheck. BrokerCheck contains background information for every registered firm and person. For a registered person, BrokerCheck includes information concerning the person's: (1) current employer; (2) qualifications, including examination history; (3) registration history; (4) employment history; (5) other business activities; and (6) disclosure events in the person's past, such as law enforcement actions (whether civil or criminal) and customer disputes.

4.3 Surveillance and data analysis to identify suspicious trades

Wholesale markets are often fragmented, with multiple platforms and infrastructures. In addition, the generally opaque nature of wholesale markets may result in difficulties in obtaining relevant and transparent data and information. As such, the role of regulators in undertaking market surveillance and data analysis activities to detect misconduct becomes both more important and more challenging.

In recent times, many market regulators have worked to bolster their market surveillance and data analysis capabilities, investing in both technology and human expertise to track and assess transactions across multiple markets and undertake sophisticated analysis to identify potentially suspicious trading that may be evidence of misconduct.

In France, the AMF launched, in April 2016, a five-year program in order to improve its market surveillance activities. The project is based on "big data" technologies and will permit the AMF supervision team to deal with a larger and increasing quantity of market data (due to new requirements under MiFID and EMIR regulations). This new project will also permit the AMF to deal with high volumes of activity in a scalable manner. The use of algorithms will enable the AMF staff to set up methodologies to detect market manipulation or other relevant market events. This project will also permit the AMF staff, in coordination with data scientists, to develop their own market surveillance tools in an effective and evolving manner.

In the United States, the CFTC has embedded forensic economists with substantial experience into its enforcement division and acquired data visualization tools that enable enforcement attorneys and forensic economists alike to detect wholesale market trading abuses. The use of such software has also enhanced coordination between enforcement and economic and data analysis within the CFTC. The CFTC also has a market surveillance unit that analyzes trading data to detect potential violations for referral to the enforcement division. On multiple occasions, the scope of investigated misconduct has expanded due to close communication between forensic economists' data analytics work and enforcement work.

Similarly, the SEC's enforcement division uses software tools devised to analyze large volumes of data to identify potentially fraudulent trade allocations, analyze order books to detect possible abusive trading, and track possible wrongdoers across national borders, in close collaboration with the SEC's Division of Economic and Risk Analysis (DERA). As an example, in June 2015, the SEC announced fraud charges against a Wisconsin-based investment advisory firm, and its owner, for allegedly fraudulently "cherry-picking" winning options trades. The conduct was identified with help from DERA staff, who conducted a statistical analysis to determine whether the trades at issue could have resulted from a coincidental or lucky combination of trades. In addition, the SEC's Office of Compliance, Inspection, and Examination (OCIE), which conducts the SEC's National Exam Program has expanded its ability to analyze large amounts of data with a software tool and program, National Exam Analytics Tool (NEAT), which enables examiners to access and systematically analyze years' worth of a registrant's trading data in minutes.

4.4 Ensuring individual responsibility and accountability

Regulators have identified certain tools to help ensure individual accountability in often complex and geographically diverse organizational structures, including clarifying which individual is responsible for particular conduct or for ensuring appropriate oversight.

4.4.1 Holding a controlling person liable

To help ensure that managers at firms establish effective controls, in some jurisdictions regulators can bring enforcement action against individuals in positions of authority who fail to take adequate steps to prevent misconduct from taking place. This can occur even if the manager had no knowledge of the underlying misconduct, provided it can be proven that the person knowingly induced misconduct or lacked good faith.

In the United States, the CFTC can bring an enforcement action against an individual who had actual control over a firm (regardless of whether that individual holds a supervisory or executive position) and hold them responsible for wrongdoing when they fail to act in good faith or knowingly induce the wrongdoing. This is different from liability for failure to supervise. For example, the CFTC brought an enforcement action against the former Chief Executive Officer of MF Global, not just for failing to supervise his employees regarding a substantial diversion of funds, but also for liability as a controlling person. This executive was aware of the diversion of funds, helped shape the policies of the firm and directly and indirectly controlled the employees responsible for the diversion of funds. Thus, the CFTC asserted, the executive was also liable on the facts as a controlling person for the misconduct that occurred under his watch. *CFTC v. MF Global Holdings LTD, et al.*, No. 11-cv-7866 (S.D.N.Y.) (Jan 5, 2017).

4.4.2 Holding supervisors or managers liable

Many jurisdictions hold supervisors liable for failure to supervise, including in some cases the imposition of criminal liability.

In Italy, where a manager fails to properly supervise an employee, CONSOB can sanction the legal person (the firm) in relation to failings to comply with applicable rules, but can also impose sanctions on those persons performing administrative, managerial or supervisory functions. Under Italian civil and administrative law, there are general principles that CONSOB can apply, including *culpa in eligendo* (bad choice of employees) and *culpa in vigilando* (failure to properly supervise employees). Application of these principles may result in sanctions against the firm or directors, managers and controllers.

In Poland, Director liability for the actions of employees means the Polish Financial Supervision Authority (KNF) can impose administrative penalties on a member of the Board of an investment firm (rather than the firm), where it was the specific responsibility of that Board member to supervise the offending employee.

In Singapore, the failure of a director or executive officer of a financial institution to take all reasonable steps to secure the financial institution's compliance with relevant legislation is a form of misconduct and can be punished by a fine, imprisonment, or both.

4.4.3 Clear allocation and mapping of senior management's responsibilities

Specific requirements can be placed upon managers to effectively oversee and take responsibility for compliance by business units or functions under their control. Responsibility maps are used to comprehensively assign specific responsibilities to specific senior managers in a clear and transparent manner. This can address the problem, in large, complex organizations, of responsibility for acts and omissions becoming ambiguous, which may enable misconduct to take place or go undetected or unaddressed.

In Hong Kong, the SFC has introduced measures to heighten the accountability of senior management of firms and to promote awareness of senior management obligations under the current regulatory regime under a "Manager-In-Charge" initiative. Guidance has been provided on who should be considered as senior management of a firm and identifies eight core functions (including (i) overall management oversight, (ii) key business line, (iii) operational control and review, (iv) risk management, (v) finance and accounting, (vi) information technology, (vii) compliance, and (viii) anti-money laundering and counter-terrorist financing) which are instrumental to the operations of firms. Firms are expected to designate fit and proper individuals to be Managers-In-Charge of each of these functions by July 2017.

In the United Kingdom, under the senior managers and certification regime, senior managers and certified persons working for banks and major investment banking institutions are required to comply with a set of core principles. The senior managers regime will ensure that senior managers can be held accountable for any misconduct that falls within their areas of responsibility if they fail to take reasonable steps to prevent the misconduct. Meanwhile, the certification regime and conduct rules aim to hold individuals working at all levels to appropriate standards of conduct. The senior managers regime involves firms allocating and mapping out responsibilities and preparing Statements of Responsibilities for individuals carrying out senior management functions, which are shared with the regulator. Plans have been announced to extend this regime beyond banks and major investment banking institutions to all regulated institutions.

Moreover, in the United Kingdom, as part of the Senior Managers and Certification Regime, individuals who are not senior managers but undertake specific significant-harm functions, including material risk takers, are subject to certification by the firms they work for. Individuals may only undertake these functions if they are issued with an annual certificate by the firm. The certificate may only be issued if the individual is found to be fit and proper to perform their role. Relevant considerations include the individual's qualifications, training, competence and personal characteristics (honesty, integrity and reputation) required by an individual for that role.

Relevant to this is adherence to the FCA's rules and the Individual Code of Conduct, which places obligations on all staff to (i) act with integrity, (ii) act with due skill, care and diligence, (iii) be open and cooperative with regulators, (iv) pay due regard to the interests of customers and treat them fairly, and (v) observe proper standards of market conduct. Where a staff member fails to meet any of the above requirements, a firm subject to the rules must report this to the FCA. A senior manager must be appointed to oversee the effective operation of the certification regime.

4.4.4 Making financial penalties impactful

Many firms offer senior managers benefits, which may include insurance policies or agreements for indemnification for any financial penalty. Regulators can include settlement terms in enforcement resolutions that account for this by specifying that individuals may not avail themselves of various forms of indemnification and insurance. This helps to preserve the penalizing and deterrent effect of a fine.

In the United States, a former chief executive of MF Global agreed not to seek or accept reimbursement and indemnification for the financial penalty imposed upon him. *CFTC v. MF Global Holdings LTD, et al.*, No. 11-cv-7866 (S.D.N.Y.) (Jan 5, 2017).

4.5 Protecting and rewarding whistleblowers

In more opaque markets, tipsters and whistleblowers, who inform regulators of suspected instances of misconduct, can be a vital source of information to support regulation against misconduct. Market regulators can incentivize market participants to provide such information by ensuring that necessary protections are in place so that no retaliation is taken against a whistleblower for disclosure of information and, in certain circumstances, monetary rewards are provided.

In Europe, from July 2016, all 31 EU and EEA member states were required to implement whistleblower reporting systems according to the European Market Abuse Regulation.

In the United Kingdom, legislation protects whistleblowers' rights to report wrongdoing and enables them to seek compensation and redress if they suffer detriment as a result of reporting wrongdoing. Whistleblowers can report wrongdoing within the firm and also to a number of prescribed persons, including the FCA. Under the UK Senior Managers regime, the FCA requires UK banks to inform their staff about the FCA and PRA whistleblowing services, as well as putting in place arrangements that can 'handle all types of disclosure from all types of person'. Responsibility for overseeing the whistleblowing arrangements must be assigned to a senior individual within the firm, which is expected to be a non-executive director.

In the United States, the SEC has established a whistleblower program pursuant to the Dodd-Frank Act. Under this program, the SEC is authorized to pay an award of 10% to 30% of amounts collected in connection with a case where an eligible whistleblower voluntarily provides original information that led to a successful enforcement action brought by the SEC where monetary sanctions exceeding US$1 million are ordered. The SEC is also authorized to pay an award for an action brought by certain other agencies when the other agency's action is based on the same whistleblower information that led to the SEC action, In terms of whistleblower protection, under the Dodd-Frank Act, no employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower, which includes: (i) providing information to the SEC; (ii) initiating, testifying in, or assisting in any investigation or judicial or administrative action of the SEC based upon or related to such information; or (iii) making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002. An individual may bring a private right of action in federal court against their employer for such retaliation. In addition, the SEC may bring an enforcement action against a company for violation of these anti-retaliation provisions.

4.6 Requirements to manage conflicts of interest

The large role often played by market making in wholesale markets may also create significant misconduct risks. First, the market maker may have an interest in market price movements that conflict with clients' interests. Second, the market maker gains information about demand by trading with customers and counterparties, necessitating the need to manage confidential information. As such, in many jurisdictions, market regulators impose specific expectations about how firms should manage conflicts of interest.

In the European Union, MiFID II requires investment firms to take all appropriate steps to identify and to prevent or manage conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof, including those caused by the receipt of inducements from third parties or by the investment firm's own remuneration and other incentive structures. Where organizational or administrative arrangements made by the investment firm to prevent conflicts of interest from adversely affecting the interest of its client are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose to the client the general nature and/or sources of conflicts of interest and the steps taken to mitigate those risks before undertaking business on its behalf.

In the United Kingdom, the FCA previously examined and shared insight into how these requirements apply in relation to certain wholesale market practices within inherent conflicts. This includes the practice of firms (typically brokers) charging commission to the client originating an order as well as the counterparty with whom the trade is then executed (the market maker) in exchange for sending order flow to them (known as Payment for Order Flow or "PFOF").

In 2012, the UK Financial Services Authority (the predecessor to the FCA) consulted on and then finalized guidance which set out views on how the practice of PFOF may fit with conflicts, inducements and best execution rules, for clients of varying sophistication. This was followed up by the FCA in 2014, where a report was published on the findings of thematic supervisory work looking at various types of firms' compliance with rules and the earlier guidance. It noted that some firms continued to accept and pay PFOF, despite recognizing the inherent conflict and failing to manage this in line with FCA expectations, including not managing conflicts, not providing best execution on a consistent basis and failing to adhere to rules against payment of inducements.

This resulted in follow-up direct supervisory work with those firms involved in the thematic study to oversee amendments to their business practices to bring them into line with expectations. The FCA noted a significant improvement following the thematic review report, with firms largely stopping the payment of PFOF. A final statement was also made in an FCA MarketWatch newsletter in September 2016 to reflect on observed residual non-compliance by certain firms and reiterated the FCA's expectations of how rules apply when firms are acting for the most sophisticated type of client – eligible counterparties – where firms do not need to meet the FCA's inducement and best execution requirements. It noted that PFOF was incompatible with conflicts of interest rules and highlighted the potential risks such arrangements may pose to price formation and market integrity.

4.7 Firms' self-assessment to identify own gaps and weaknesses

Some market regulators are now using cultural or other conduct risk indicators to assist regulators and regulated firms to identify and prevent or respond to potential misconduct that is enabled, facilitated or even encouraged by the conduct risk environment, or the culture of a firm.

In Australia, ASIC's Market Integrity Group has now issued three compulsory questionnaires, including a "conduct calculator", to investment banks and independent market participants. These questionnaires are intended to determine their attitude, appetite and approach to managing conduct risk. The questionnaires ask high level questions focusing on key areas, including how investment banks' business strategy aligns with their conduct risk strategy, governance and supervisory frameworks, and performance and remuneration frameworks. The calculator covers the frameworks, tools, practices, controls and programs used by the firms to manage conduct risk.

The self-assessment process is intended to draw attention to potential risk areas for firms. For example, it has assisted firms to determine the extent to which conduct risk is associated with the behavior of individuals, business units and the organization as a whole; to ascertain the structure and practices in place to ensure appropriate conduct and the escalation and remediation of poor conduct; and to identify any potential gaps. Importantly, the respondents to the survey are provided with a benchmarking of their results – encouraging them to address areas where culture or conduct risk is being not being managed at a level comparable to their peers

For example, in meetings following the use of the calculator, one institution indicated it would be making changes to its definition of conduct risk to take in to account the inadvertent behaviors that can lead to the risk eventuating. It indicated it would also review how it ensures material conduct risk takers understand their additional responsibilities and obligations and how it encourages staff to escalate an issue or questionable behavior on the part of others that they see.

ASIC also saw evidence in its 2017 review that many institutions had made improvements to their conduct framework since the 2015 review. One institution, for example, introduced a risk culture element to its risk maturity self-assessment framework, placed additional emphasis on conduct as part of the operational risk management framework and provided more conduct training to employees.

The results from the self-assessments may also be used by ASIC to identify patterns or trends and to help direct its supervisory resources towards particular misconduct risks.

4.8 Addressing increased automation

Technology may automate surveillance and compliance roles, bringing together data and allowing complex analytics through the use of "reg-tech" tools. While the capacity and ability to piece together structured and unstructured data in great volumes may pose challenges in identifying and proving possible individual misconduct, technology may also enhance market regulators' capabilities to supervise individuals and firms and monitor markets, such as through the use of analytics software and ultra-fast communication to monitor market integrity.

4.8.1 Regulation of high frequency trading (HFT) and direct electronic access (DEA)

In some jurisdictions, requirements are being put in place that impose more specific and tailored expectations for firms that are seeking to engage in HFT or offer DEA technologies.

In the European Union, MiFID II mandates that a person must notify the relevant regulator if they engage in algorithmic trading across any of the asset classes covered by the Directive. Where a person uses a HFT technique, they will generally also be subject to authorization. In addition to notifying the regulator, the firm must also notify the competent authorities of the trading venues at which it engages in algorithmic trading as a member or participant of the trading venue. The purpose of the organizational requirements is to ensure that the firm undertaking the algorithmic trading has effective systems and controls, which are suitable to the business it operates.

Investment firms must also establish an automated surveillance system, which effectively monitors transactions, generates alerts and reports for signs of potential market manipulation. The investment firm must also monitor in real time all algorithmic trading activity that takes place under its trading code, including that of its clients, for signs of disorderly trading, including trading across markets, asset classes, or products, in cases where the firm or its clients engage in such activities. This monitoring should be undertaken by the trader in charge of the trading algorithm or algorithmic trading strategy, by the risk management function or by an independent risk control function.

MiFID II also contains rules requiring firms to have systems and controls when providing DEA so as to prevent trading by clients that may create risks to the clients themselves, or create or contribute to a disorderly market.

4.8.2 Establishing legal certainty on computer-based forms of trading abuses

Some regulators have sought enhanced clarity for their legislative authority to address abusive market practices that are often associated with automated trading practices.

In the United States, the Dodd-Frank law explicitly made spoofing a violation of federal law. 7 U.S.C. Sec. 6c(a)(5)(C). This provision was an important regulatory tool, adding legal clarity to fact patterns that are relatively new for lawyers and judicial officers. Thus an individual was subject to both criminal and civil sanctions after "spoofing" by employing a computer algorithm that was designed to place orders with the intent to cancel them before execution, an unlawful disruptive trading practice. This spoofing led to a civil order disgorging US$1.4 million in trading profits as well as a penalty of the same amount.

Chapter 5 – How market regulators regulate against misconduct

Market regulators are primarily mandated to protect investors, promote fair, efficient and transparent markets and reduce systemic risks. As set out in more detail below, the regulatory tools identified in Chapter 4 are not used by market regulators in isolation, but are part of a general approach that establishes regulatory requirements for financial markets (both retail and wholesale), informed by conduct expectations. For example, regulators can establish licensing or registration requirements, whereby firms and, sometimes, individuals may undergo an assessment to determine whether they have the appropriate capacity, resources and systems to operate in financial markets. Regulators then supervise firms and individuals both to identify instances of possible misconduct and to check and test that firms have appropriate governance and oversight processes in place. Through enforcement regimes, regulators investigate and sanction market participants who engage in misconduct. Where it is credible, this deterrence and punishment supports the entire regulatory system by ensuring that there are appropriate consequences for individuals and firms that fail to meet the expectations of conduct.

These various modes of regulation are interrelated. One of the strengths of market regulators' regulatory regimes is that various tools can be used flexibly and in combination.

5.1 Regulatory requirements based on conduct expectations

The regulation of market conduct begins with the establishment of regulatory requirements based on conduct expectations (see Annex A below). These place enforceable expectations on market professionals (and firms) as to the standards of behavior expected in financial markets to ensure that investors' interests are safeguarded and that markets remain fair and efficient.

5.2 Licensing and registration

Regulatory regimes typically require firms undertaking certain specified activities to register with them before they begin operating in the market. At the point of registration, market regulators can also gather information about the firm and its controllers to establish whether it has the appropriate capacity, resources and systems to operate in financial markets in line with regulators' expectations. The need to be registered also means that registration can be revoked where expectations are not being met, posing a threat to other market participants. Registration allows market regulators to impose those requirements noted above on an ongoing basis, although some requirements can be imposed on market participants regardless of registration.

5.3 Supervision

Supervision consists of the monitoring of markets, firms and individuals directly and indirectly by market regulators for compliance with specific rules as well as policies, procedures, and broader conduct expectations. Market regulators' principal goal in deploying a broad range of supervisory practices is to detect and deter misconduct. Supervision for individual misconduct is a particular focus of market regulators, given the volume and scale of trading in relevant markets, the special regulatory responsibilities of some market professionals, and the need for regulatory insight into significant amounts of market data and complex market structures. Firm-level supervision can help address misconduct risk by ensuring that firms have the appropriate internal compliance controls in place to reduce the risk of misconduct by individuals and to properly report and remediate misconduct when it occurs. Market regulators also enhance their supervision of both firms and individuals through detailed market surveillance.

Market regulators do not undertake supervision solely to detect rule violations and refer these violations for enforcement action. Although detection of misconduct is important, supervision has a complementary and independent role beyond detection and enforcement referrals. Market regulators' broad range of supervisory practices also have a preventative or corrective effect, by seeking to deter individual misconduct or firm-level obligation failures. Both firms and individuals working within firms are deterred from contemplating or committing misconduct when there are strong firm internal controls to detect and punish misconduct by individuals.

5.3.1 Supervisory oversight through inspections and examinations of firms and individuals

Market regulators adopt a range of supervisory practices to detect and deter misconduct by individuals. Supervision of firms can be flexible to provide more intense scrutiny of firms and individuals whose scale of activity poses potentially more risk.

Market regulators may conduct regular or scheduled examinations and inspections involving detailed reviews of books, records, policies, process maps, risk logs, and other documents, and may also conduct both scheduled and unannounced audits. Such examinations and inspections can aid in determining whether a firm is abiding by its established plan for internal controls, general compliance rules, and governance norms. They may also provide important information regarding individual conduct and help to improve and reinforce firm internal controls. Both inspections and examinations allow regulators to ask open-ended questions and follow-up on answers to obtain a more comprehensive view of how individuals within a firm interact with professional counterparties and clients.

Inspections and examinations can be conducted to address a specific issue or concern. However, most market regulators more routinely engage in structured compliance reviews. Such compliance reviews can extend to an evaluation of a regulated entity's compliance with the regulatory framework – including conduct rules – that apply to it, as well as an assessment of an entity's internal control systems and governance structures.[6] In certain jurisdictions, the regulatory framework may also require firms to conduct periodic testing or audits of the firm's compliance and internal control systems to evaluate their effectiveness, and require firms to modify them as necessary to ensure continued compliance.

While regulators may have a similar purpose for conducting compliance reviews, their approach to performing such reviews may vary with respect to method, content and frequency. A regulator may seek copies of an entity's books and records (including electronic records) to review in the regulator's own office or as part of an on-site compliance review at a firm's premises. Both approaches enable a regulator to evaluate an entity's business activities for compliance with applicable laws and rules, and with the entity's own compliance procedures. An on-site visit may help a regulator determine if an entity's governance structure and internal

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6 Regulators often facilitate supervisory oversight by requiring the creation and retention of detailed records of transactions that do not occur on exchanges, other types of trading platforms, or central clearing entities. For computer-based trading, some market regulators require detailed contemporaneous audit trails and employ computer-based analysis of trading patterns to detect possible rule violations and offer relatively contemporaneous guidance to individuals. For telephonic and physical trading, recording of trading may help establish accountability for individual misconduct in the wholesale markets.

control systems are operating as described in the entity's policies and procedures, and other books and records.

A market regulator may use a risk-based approach pursuant to which it selects for compliance reviews certain regulated entities that have risk profiles suggesting potential non-compliance, misconduct, or emerging risks that require heightened scrutiny.

Regulators may also decide, based on observations during an ongoing review, to change the method, scope and/or frequency of future compliance reviews or to broaden the scope of an ongoing inspection, including a formal compliance review. If the regulator observes that a firm does not adequately comply with a rule or other legal obligation, or does not have the required records to document compliance, a regulator may want to expand the scope to assess the possibility of individual misconduct by firm employees.

A regulator may tailor its approach to concluding a compliance review based on the particular circumstances, including a detailed oral exit interview, formal written communication, or a referral for further regulatory scrutiny, including enforcement action.

Some regulators review aggregate or individualized firm data to monitor regulated firms and help assess compliance risks. Observations from this data can help scope more in-depth supervisory efforts. Additionally, regulators often combine observations from this data with surveillance alerts to more fully understand potential misconduct by firms or individual firm employees.

The broad range of supervisory tools available to market regulators allows them to adjust their supervisory focus and resources efficiently based on market events and evidence of misconduct. Supervisory powers are characteristically flexible and can be adjusted to focus on the particular misconduct risks that arise in financial markets.

5.3.2 Market surveillance and data analysis

Some market regulators proactively conduct surveillance of markets, with attendant data analysis, which also discourages individual misconduct. Market surveillance encompasses ongoing scrutiny of market place activities, which can give regulators broad insight into potential market misconduct or other problems, and can also give regulators information that is critical to their ability to bring enforcement actions addressing misconduct (see section 5.4). It also may include analysis of reports that consolidate a variety of data sources, including raw market data and trade reports submitted by firms and individuals. Market regulators can aggregate and analyze transaction data from multiple markets to obtain a clearer picture of market dynamics, supervise overall market conditions, and identify any anomalies. For example, regulators may conduct surveillance to:

- Identify potential insider trading;
- Detect potential market manipulation;
- Discern patterns and trends in individual trading misconduct;
- Obtain a broad, cross-market perspective on a given set of individuals' activities;
- Detect evidence of cyber breaches related to the markets; and

- Monitor systems outages that could impact the financial system.

Market regulators' analyses of data from multiple markets may reveal possible individual misconduct that might otherwise be hidden by examination of data in just one market. For example, regulators might identify sudden increases in prices or volumes across markets, indicating a potential manipulation or attempt at price manipulation, which might be less evident if data from only one market was analyzed. In addition, trade surveillance may provide regulators with market data a short time after the transactions occur, especially if the market trades take place on central exchanges or on separate computer-based systems with robust audit trails. Real-time trade surveillance may enable regulators to intervene, if necessary, at the time that problematic transactions take place, thereby potentially minimizing the negative impact of such transactions.

Market surveillance is often more than the collection and cursory analysis of market data. It often encompasses detailed analysis of market data from a variety of sources to gain market insight bearing on individual misconduct.

A centralized system for external sources, including whistleblowers and other regulators, to submit complaints and referrals on a confidential basis may enhance a regulator's risk monitoring processes, in addition to serving as an integral component of an enforcement framework (see section 5.4).

Regulators can also incorporate observations from firms' or regulators' own risk monitoring into their broader supervisory efforts, leveraging risk analyses to set supervisory priorities going forward.

5.3.3. Approaches to supervisory oversight

Many market regulators have comprehensive compliance programs requiring firms to establish policies and procedures, internal control systems, and supervisory programs to oversee firm employees. Market regulators may use diverse approaches to carrying out such supervisory oversight.

In some jurisdictions, the regulatory framework establishes SROs. SROs may have authority to carry out all, or just a portion of, the supervisory functions for which the market regulators are responsible. SROs also may have power to bring enforcement actions. As an additional layer of supervisory oversight, regulators may conduct direct reviews of the SRO's work to evaluate the effectiveness of the SRO's supervision. Regulators also may evaluate the SRO's work by conducting compliance reviews of the firms recently subject to a review by the SRO. Some market regulators also require firms to self-report incidents involving a violation of the laws or rules governing the firm's activities.

It is widely acknowledged that a good culture cannot be regulated for and that primary responsibility should therefore rest with industry, senior managers, individuals and the firms themselves. Nonetheless, supervisory strategies may directly or indirectly help to encourage a better firm environment or culture, and may be used to identify and evaluate firms where the environment or culture is weak and poses conduct risks. Even if culture cannot be precisely defined or directly measured, key indicators may be developed that can be used by supervisors to make more informed judgements around it. Some regulators therefore gather management information on cultural indicators, and the steps firms take to address associated risks.

In this way, supervision can also be thought of as not just adherence to specific rules, but adherence to broader conduct expectations.

5.3.4 Thematic supervision

Given that many conduct issues or risks are common across firms in the same sector, or sometimes across multiple market sectors and, recognizing that regulatory resources are usually limited, some regulators have supplemented supervision through inspections, examinations, and surveillance with issues-based or "thematic" supervision. Thematic supervision involves regulators considering a particular rule, issue or risk and undertaking work with a representative sample of firms within a sector or across sectors to investigate compliance, approaches and any common failings. Supervisors using thematic supervision will usually have intelligence or a hypothesis about failings or potential failings within the wider market in terms of a particular rule or in relation to an issue. This form of supervision can be conducted *via* on-site inspections and examinations, surveys and questionnaires, data requests or desk-based analysis to gain an understanding of risks and their drivers, as well as compliance with rules and requirements in the sector or sub-sector. As well as addressing specific issues with the sample of firms participating in the thematic review, regulators often publish the results of such reviews so that a much broader group of regulated firms can learn from the good and bad practices identified. Follow-up thematic work may also be undertaken at a later date with the same or a different sample of firms to see if the findings of the first thematic review have been embedded. While not identifying specific firms, the results of thematic reviews are often published or otherwise shared with the sector, including restatement or clarification of expectations and recognition of good practice.

5.3.5 Synergy with enforcement tools

Supervisory tools are particularly effective when combined with vigorous enforcement tools that bridge the gap between individual misconduct and individual and firm liability. These include the extension of liability beyond individual employees to firms and managers through various means, including through principles such as vicarious liability, controlling person liability, and liability for failure to supervise.

5.4 Enforcement

Enforcement describes the tools utilized to impose sanctions against individuals and firms for violations of laws and regulations, both as a means of punishment for those violations as well as a mechanism to prevent and deter future misconduct.[7] Enforcement therefore has an *ex ante* and *ex post* effect with respect to potential misconduct. Enforcement may also have a role in remediating the damage done by misconduct through measures such as disgorgement, which, depending on the jurisdiction, is the return to investors or other affected parties, or the payment to the government, of ill-gotten gains and restitution, which is the return of all investor funds, including any losses.

Market regulators view enforcement as fundamental to an effective conduct regime as it underlies, supports and gives force to all other aspects of the regime. A framework for enforcement works alongside the regulatory framework that imposes *ex ante* requirements on

[7] IOSCO's Report on *Credible Deterrence in the Enforcement of Securities Regulation* contains an extensive discussion of factors that may credibly deter misconduct in securities markets. This Chapter draws upon the Credible Deterrence Report, emphasizing many of the factors discussed in the report.

firms and individuals and a system for supervision of these market participants.[8] The 2009 G20 Report On Enhancing Sound Regulation And Strengthening Transparency, stated that to achieve the objectives of regulatory frameworks, a regime not only requires sound regulations but also effective enforcement;[9] "[n]o matter how sound the rules are for regulating the conduct of market participants, if the system of enforcement is ineffective – or is perceived to be ineffective – the ability of the system to achieve the desired outcome is undermined."[10]

Market regulators have a wide range of enforcement tools for investigating possible instances of misconduct and imposing sanctions on wrongdoers which are generally applicable to both wholesale and retail markets. In addition, the responsibility for enforcement of a market conduct regime may be shared with other authorities, such as criminal authorities and SROs. Some jurisdictions use private rights of action as a means of enlisting investors, counterparties, other market participants and the public in the enforcement of their conduct regime and achieving remediation of wronged parties.

5.4.1 Surveillance and detection

A fundamental component of an effective enforcement program for addressing misconduct risk is the ability to detect misconduct when it occurs. To this end, market regulators employ an array of tools aimed at detecting potential wrongdoing. As described in greater detail in the preceding section on supervision, central to a market regulator's ability to detect misconduct is market surveillance, which can be described as a collection of tools and technologies to analyze the markets and detect misconduct, manipulation and other abusive practices in the markets. The public, including those operating in the financial markets, can also help in detecting misconduct and, as a consequence, market regulators have developed tools to facilitate the collection and analysis of tips and complaints received from the public about suspected or actual misconduct.

Market regulators also view insiders and employees of the entities where misconduct may be occurring as another valuable source of information on potential misconduct. Whistleblower programs, which both protect and/or reward insiders for providing authorities with information on misconduct, are a tool used by market regulators to help in detecting misconduct. Finally, market regulators also receive valuable information that can support an enforcement action through referrals from other government supervisory agencies and other regulators internationally.

5.4.2 Investigatory powers

Following the detection of instances of potential misconduct, market regulators then need the ability to thoroughly investigate those possible violations. Critical to an effective investigation is the ability to obtain records and information sufficient to reconstruct transactions, identify the individuals and firms involved in the transaction and to obtain beneficial ownership information. Accordingly, market regulators employ a variety of tools for investigating misconduct, including powers to inspect and obtain information and documents from the registered individual or firm and to obtain relevant information from registered and non-

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8 See section 5.3 for a detailed discussion of market supervision.

9 G20 Working Group 1 *Enhancing Sound Regulation and Strengthening Transparency Report* (March 25, 2009), p.44.

10 Id.

registered individuals or entities, such as books, records (including electronic records) and testimony.

5.4.3 Criminal or civil/administrative actions

Market regulators may institute enforcement actions in various tribunals; the enforcement of conduct regimes can be deployed via administrative, civil, quasi-criminal or criminal proceedings, depending on the legal system in question. As described below, these types of enforcement proceedings can lead to a wide variety of significant sanctions, including monetary penalties, and non-monetary penalties and measures. In some cases, enforcement proceedings can also lead to criminal penalties if a market regulator has criminal authority.

In regard to the non-criminal—administrative or civil—enforcement actions, certain regulatory systems rely exclusively on administrative actions, while other regulatory systems employ both administrative and civil actions. For example, under certain conduct regimes, the regulatory authority has the jurisdiction to take administrative actions against both regulated and unregulated entities. Under other legal systems, the market regulator has authority to bring administrative actions against regulated entities but institutes civil actions in cases of unregulated individuals or entities.[11] Market regulators may also be authorized to choose whether to bring an administrative or civil enforcement action depending on the nature and scope of the violation in question or the sanction sought.

While criminal actions are typically the purview of a jurisdiction's criminal authorities, some market regulators have the authority to institute criminal actions on their own behalf while others can undertake quasi-criminal proceedings in circumstances where full criminal proceedings are deemed unnecessary or inappropriate. Under some legal systems the conduct authority has the primary responsibility of conducting the investigation into possible wrongdoing but then passes on those cases deemed to warrant criminal action to the separate criminal authority. Under other legal systems, criminal authorities conduct their own investigations into instances of misconduct, however, most systems also allow for the regulatory authority to refer a case of misconduct to the criminal authorities for possible criminal action. Some systems rely solely on criminal actions, in which case the regulatory authority must pass cases of misconduct to the separate criminal authority. It should be highlighted that the burden of proof in criminal proceedings is typically significantly higher than that required at the administrative or civil level.

5.4.4 Bringing enforcement actions against individuals and firms

Market regulators view the sanctioning of both individuals and firms as integral to an enforcement regime. Indeed, strong regulation that holds both individuals and firms accountable and deters misconduct promotes public confidence in financial services and is a key factor in the development of effective markets, financial services and economies.

Sanctioning firms for misconduct is an important focus of market regulators because it sends a clear message to firms and the market, which will encourage shareholders and boards, who are in a position to bring about necessary reforms at firms, to take corrective action to address past wrongdoing and prevent future wrongdoing. Significant enforcement actions incentivize

[11] However, it is noted that there are some legal systems where market regulators are able to bring administrative, civil and criminal actions against non-registered entities and individuals.

shareholders and boards to be more vigilant in overseeing management actions to ensure controls are in place.

Individual accountability is also important in large part because the conduct of firms is governed and carried out by individuals. Some market regulators therefore focus on wrongdoing committed by individuals who hold positions of seniority or have the authority to direct certain functions of a firm. In addition, market regulators may apply their enforcement authority against individuals who act as gatekeepers or compliance personnel for companies and firms, such as accountants, auditors and lawyers, because gatekeepers, as well as compliance officials, play a critical role in ensuring that institutions follow relevant laws and regulations designed to protect investors and promote fairness in the marketplace.

In bringing an enforcement action, market regulators are mindful of the statutory, regulatory, and general law means by which individual liability is extended to all individuals who are liable as aiders and abettors, controlling persons, or otherwise in a position where another individual's misconduct is also imputed to them.

5.4.5 Sanctions, penalties and remedies

Market regulators use a wide variety of sanctions to punish misconduct and deter wrongdoing. As a general matter, regulators aim for sanctions to be effective, proportionate and dissuasive. Thus, sanctions reflect the seriousness of the misconduct and aim to both punish the perpetrator as well as deter others. Sanctions can include monetary penalties, criminal penalties or other actions, such as injunctions that, for example, may remove people from positions in which they can harm investors. In addition, some market regulators may also obtain court-ordered preliminary injunctions and asset freezes.

Monetary penalties, sanctions and remedies

Regulators use a variety of approaches to impose monetary sanctions on individuals and firms. Specifically, market regulators often seek the imposition of monetary sanctions from courts or other tribunals as a consequence of alleged civil or criminal wrongdoing. Market regulators also may be able to impose similar sanctions through an administrative process in some jurisdictions.

Monetary sanctions include fines and penalties. There are also remedies that can be financial in nature, in other words monetary remedies, such as disgorgement and restitution. The broad goal of the latter two remedies is to restore investors to the position they were in before the perpetrator's misconduct and to prevent perpetrators from benefiting from their misconduct. In some jurisdictions, disgorgement refers to a monetary sanction whereby the wrongdoer must pay the government the amount of any profit gained or loss avoided as a result of the wrongdoing.

Monetary sanctions in the form of penalties constitute fines above and beyond the disgorgement of unlawful profits. Penalties punish the wrongdoer for egregious conduct. Some regulators are of the view that penalties should be of a sufficient size so as to prevent firms and individuals from seeing monetary sanctions as simply an acceptable cost of business. In addition to punishing a specific wrongdoer, penalties also have a strong deterrence function. Recidivists are often subject to more stringent penalties.

Non-monetary sanctions, remedial or other measures

Market regulators may also impose a variety of non-monetary sanctions or measures against wrongdoers. Like monetary sanctions, non-monetary sanctions or measures may be imposed as part of a court process or pursuant to a regulator's administrative authority. Non-monetary sanctions or measures can take many forms, depending on the seriousness of the misconduct, whether the wrongdoer is an individual or a firm, and the degree to which the sanction will support the regulators' objectives. Types of non-monetary sanctions or measures include:

- Public censure;
- Revocation, restriction, conditioning or suspension of a license or registration to conduct business in certain areas of the markets;
- Barring an individual from (i) associating with certain other persons or groups or (ii) participating in the market in which the misconduct took place;
- Barring an individual for conducting business in the market where the misconduct took place (or in a specific area of the market);
- Barring (permanently or temporarily) an individual from serving as an officer or a director of a company;
- Appointment of third-party receivers, monitors or administrators to conduct ongoing independent oversight or certain functions; and
- Other remedial measures.

Criminal sanctions

For particularly egregious, willful or reckless or intentional misconduct, criminal penalties on firms or individuals may be appropriate, depending on the law of the relevant jurisdiction. In some cases, a market regulator can impose criminal penalties under its own authority. In other cases, market regulators do not have criminal powers but have the authority to refer a matter to criminal authorities along with any relevant evidence.

Criminal penalties can take the form of significant prison terms and/or substantial monetary penalties. In some jurisdictions, criminal penalties may be imposed in addition to civil or administrative sanctions that are assessed against a wrongdoer.

Emergency relief

In addition to sanctions that are assessed after wrongdoing has occurred, market regulators can also use emergency relief or measures to halt ongoing illegal activity that may cause harm to investors or the marketplace in the near future. In many circumstances, emergency relief must be imposed by a court or other tribunal but, in some cases, a market regulator may impose emergency relief through its own administrative authority. Emergency relief is often sought through an injunction, temporarily preventing an alleged wrongdoer from taking some form of action or participating in wrongful activity. In many regimes, the market regulator must offer preliminary proof of any violation of laws or regulations in order to obtain such interim injunctive relief.

Another form of emergency relief used by market regulators is asset freezes, whereby third parties (*i.e.*, financial institutions) are notified of the order and to bar the movement of funds through financial accounts. Asset freezes are particularly important in helping to prevent the dissipation of investor funds during the pendency of an investigation into potential misconduct. Asset freezes are usually obtained through court orders.

5.4.6 Enforcement by SROs

In a number of jurisdictions, a feature of securities and derivatives regulation, and therefore in the enforcement of conduct regulation, is the use of SROs to monitor parts of the financial services industry, although the role of SROs varies by jurisdiction.

Imposing an obligation on the industry to police itself through SRO enforcement is viewed by some regulators as a powerful tool for addressing misconduct risk.

Annex A – IOSCO's work to date concerning principles relevant to market conduct

As the first stage of its work, the Task Force conducted a comprehensive review of the IOSCO Principles and Standards,[12] identifying five categories of conduct expectations, namely Honesty, Upholding Market Integrity, Conflicts Management, Competence, and Communication and Confidentiality (as mentioned in section 3.2 above).

A more detailed analysis of what these five categories entail for individuals is set out in sections A.1 to A.5 below. This shows how the expectations of conduct set out in the table in section 3.2 above are reflected in obligations imposed on individuals. These obligations are generally imposed either through jurisdictions' specific or general statutory obligations or through general law principles. As previously mentioned, these obligations are not exclusive to participants in wholesale markets, but are broadly applicable to all market participants, including those in the retail markets. However, these obligations may be of particular importance in the context of wholesale markets due to the characteristics of wholesale markets (identified in Chapter 2 above) that may lead to increased misconduct risk.

In addition to these categories, regulators impose organizational, control and governance requirements on firms and their individual employees for their actions. These are set out in further detail in sections A.5 and A.6 below.

A.1 Honesty

Honesty is vital to markets as it allows participants to rely on the representations and undertakings of others. Obligations on individuals based on this expectation are usually expressed in the form of prohibitions against statements and conduct that are misleading or deceptive. These obligations are also generally imposed on all market participants, and so they are not exclusive to participants in wholesale markets.

A.2 Upholding Market Integrity

Upholding market integrity is important as market participants (and their clients) need to have confidence that they are all playing by the same rules and that markets reflect genuine forces of supply and demand.

This expectation is most often expressed in prohibitions on individual conduct covering the following.

- Causing, or attempts at causing, artificial pricing in the market;
- Creating a false or misleading appearance of trading;

[12] In this section, the IOSCO Principles and Standards refer to IOSCO's *Objectives and Principles of Securities Regulation* and other standards and policies set out in IOSCO reports or resolutions approved by IOSCO. Some of the IOSCO Principles and Standards relate specifically to wholesale market conduct, whereas others cover conduct in financial markets more generally, but are also applicable to wholesale market activity.

- Disseminating false or misleading information with respect to a financial instrument, including the instrument's issuer;
- Creating, or attempts at creating, an abusive controlling position in a financial market; and
- Misuse of information or insider trading.

A.3 Conflicts of interest management

Conflicts management is important as it can help, along with other regulatory requirements, to enable firms' clients to have confidence that firms will not use their position to privilege themselves or others (including other clients) at the expense of their clients. It may therefore help to give clients the confidence that they can rely on participants to make decisions on their behalf.

Market participants are generally required, at both the individual and firm level, to take steps to avoid or manage potential and existing material conflicts. Obligations imposed on individuals based on this expectation seek to ensure that material conflicts of interest are properly dealt with.

A.4 Competence

Competence is important for clients who must have confidence that market participants are capable – with appropriate human, technical and financial resources – of meeting their commitments, including understanding of both the technical and regulatory expectations placed upon them.

Obligations on individuals based on this expectation seek to ensure that individuals are capable of performing the functions that they have been assigned. They are generally imposed through specific statutory or other regulatory obligations, which may include the following:

- Minimum qualification requirements: these are intended to ensure individuals employed by financial firms are capable of performing their assigned duties and activities, and have the experience and expertise to perform the responsibilities they are assigned;

- Licensing or entry requirements and processes: these are intended to give regulators the opportunity to assess whether individuals meet competency standards and maintain them on an ongoing basis. This may include reference checks (and may also be used to provide indicators of the individual's personal integrity); and
- Ongoing training requirements: these may be imposed on individuals to ensure their knowledge and expertise is maintained and updated. In some cases this training also addresses ethical issues and so helps ensure integrity.

In wholesale markets the individual-level authorization requirements are closely tied to the firm-level authorization process. Firms may also be required to report the names of their officers and employees at the point of authorization or registration. Individual registration requirements may also be made public and include an ongoing obligation to maintain and meet standards to remain registered.

A.5 Communication and confidentiality

Expectations around communication and confidentiality help to address the frequent information asymmetry between parties in wholesale markets.

Obligations on individuals based on this expectation often include:

- A general obligation to communicate relevant information clearly and in a timely way: while this obligation is normally a firm-level obligation, individuals who interact with counterparties are also required to comply with this obligation.

- An obligation to maintain client confidentiality: while there are often firm-level obligations to maintain confidentiality, individuals acquire and hold confidential client information and may inappropriately disclose or misuse it. As such, it would be expected that individuals would be subject to requirements that they secure and maintain the confidentiality of sensitive information and do not misuse it.

A.6 Organizational, control and governance requirements

Organizational, control and governance requirements are intended to assist firms in preventing and reducing misconduct risk through identifying, punishing and deterring individual conduct at their firm which does not meet the expectations of conduct set out above. They are generally imposed through, and expressed as, general principles, specific rules, and statutory obligations.

Market regulators require authorized or regulated firms to organize and control their businesses responsibly and effectively and to manage risk adequately. This generally includes requirements about the activities of risk management, internal audit and compliance functions.

There is also a more general expectation that regulated market participants will provide assistance to regulators as they enforce obligations on individuals and firms through surveillance and investigation.

A.7 Holding Individuals Accountable

Firms and their senior managers may be held accountable for the failure of their employees to meet individual-level obligations or to comply with the organizational and control requirements around this. This may be done through aiding and abetting liability, controlling person liability, or liability for failure to supervise. In some jurisdictions, market regulators seek to enhance responsibility by requiring firms to comply with their own codes of conduct as part of their regulatory regimes. Some jurisdictions seek to increase accountability by ensuring senior managers are responsible for the development of a firm's culture that would, in turn, strengthen compliance with individual- and firm-level expectations of conduct.

IOSCO work relevant to market conduct

The Table below consists of two parts – the first part sets out brief summaries of relevant IOSCO Principles and Standards, while the second part sets out more detailed descriptions of relevant sections of the IOSCO Principles and Standards relevant to each of the conduct expectation set out in the table in section 3.2 above.

Part I: List of Relevant IOSCO Reports

IOSCO Report	Brief Description
IOSCO Objectives and Principles of Securities Regulation and Methodology August 2013	This report sets out 38 principles of securities regulation, which are based on three objectives: (i) protecting investors, (ii) ensuring that markets are fair, effective and transparent, and (iii) reducing systemic risk. The accompanying methodology sets out guidance on assessing 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. Principle 31 is particularly notable because it addresses 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. According to the report, 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.
International Conduct of Business Principles July 1990	This reports set out conduct of business (COB) principles for “those firms and their employees and representatives who deal or advise in securities and all kinds of derivative instruments (futures, options, etc.).” COB principles are defined in the Report “as those principles of conduct which govern the activities of those who provide financial services and which have the objectives of protecting the interests of their customers and the integrity of the markets.”
Model Code of Ethics June 2006	Developed by the IOSCO SRO Consultative Committee (SROCC), the Model Code of Ethics aims to provide a framework that could strengthen a culture of ethical behavior and guide the financial services industry in all the places that no explicit set of rules can hope to cover. The Code recommends that firms engaged in the financial services industry adopt the following ethical principles: • Integrity and Truthfulness • Promise Keeping • Loyalty – Managing and Fully Disclosing Conflicts of Interest • Fairness to the Customer • Doing No Harm to the Customer or the Profession • Maintaining Confidentiality.

Principles for the Regulation and Supervision of Commodity Derivatives Markets September 2011	This report was prepared in response to a request by the G20 for work on the regulation and supervision of commodity derivatives markets. The principles help to ensure that the physical commodity derivatives markets serve their fundamental price discovery and hedging functions, while operating free from manipulation and abusive trading schemes.
Principles For Financial Benchmarks July 2013	This report creates an overarching framework of principles for benchmarks used in financial markets, including conflicts of interest for benchmark administrators. The report describes how principles should be implemented by benchmark administrators and submitters.
International Standards for Derivatives Market Intermediary Regulation June 2012	This report furthers the G20 commitments to reform the OTC derivatives market by providing high-level international recommendations for the regulation of market participants that are in the business of dealing, making a market or intermediating transactions in OTC derivatives. The recommendations in the report are intended to address: • Derivatives Market Intermediaries (DMIs) obligations that should help mitigate systemic risks; • Requirements intended to manage counterparty risk in the OTC derivatives markets; and • Protecting participants in the OTC derivatives markets from unfair, improper or fraudulent practices.
Investigating and Prosecuting Market Manipulation May 2000 **(and Addendum to Report on Investigating and Prosecuting Market Manipulation** April 2013**)**	This report identifies measures, including civil and criminal liability that can be effective in the detection, investigation and prosecution of fraudulent and manipulative activity. It also recommends that regulators should have effective tools to prevent and detect, market manipulation, to investigate, prosecute, and deter market manipulation, and the ability to cooperate at all stages of a matter. The Addendum to IOSCO's report on Investigating and Prosecuting Market Manipulation is an update that reflects the latest market conditions.
Credible Deterrence in the Enforcement of Securities Regulation June 2015	This report seeks to identify and promote awareness of factors that may credibly deter misconduct in securities and investment markets. It explains that deterrence is credible when would-be wrongdoers perceive that the risks of engaging in misconduct outweigh the rewards and when non-compliant attitudes and behaviors are discouraged. The report emphasizes that enforcement and remediation deter misconduct and promote public confidence, consumer protection and market integrity. The report focuses primarily on those factors that are within the remit of enforcement programs.
Risk Management and Control Guidance For Securities Firms and Their Supervisors May 1998	This report provides guidance about controls ("basic internal accounting controls and risk management policies and procedures") for securities firms and their supervisors. This guidance relates to risk management and control policies and procedures and internal control systems. The objective of this paper is to promote domestic and international risk management and control structure awareness for firms and regulators.
Compliance Function at Market Intermediaries March 2006	This paper sets out a number of supplementary principles to IOSCO Principle 23[13] with means for implementation to assist intermediaries to increase the effectiveness of their compliance function. Compliance is intrinsic to the operations of market intermediaries because they must have systems or processes

13 Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

	in place to help ensure that they are complying with all applicable laws, codes of conduct and standards of good practice in order to protect investors and to reduce their risk of legal or regulatory sanctions, financial loss, or reputational damage.
Report on Market Intermediary Management of Conflicts that Arise in Securities Offerings November 2007	This report sets out guidelines for regulators and market participants to consider when addressing conflicts of interest that arise when market intermediaries are involved in securities offerings, and, in particular, how to address the management of information flows in conflicted situations. It also discusses the management of information flows when conflicts arise.

Part II

1. Honesty

IOSCO Report	Relevant Content	Scope of application
International Conduct of Business Principles July 1990	The report articulates the key principle of honesty and fairness: namely that in conducting its business activities, a firm (including its employees and representatives) should act honestly and fairly in the best interests of its customers and the integrity of the market.	Firms and individuals
Model Code of Ethics June 2006	Recommends the following relevant Guiding Ethical Principles that apply to individuals: • Integrity and Truthfulness • Promise Keeping • Maintaining Confidentiality	Individuals
Objectives and Principles of Securities Regulation August 2013	Principle 31 states that market intermediaries should 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. Principle 31 also states that market intermediaries should include operational procedures and controls that ensure the integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner as well as the appropriate segregation of key duties and functions, particularly those 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.	Firms and individuals

2. Uphold market integrity

IOSCO Report	Relevant Content	Scope of application
International Conduct of Business Principles July 1990	Sets out in Principle 7 (Compliance) that a firm (its employees and representatives) should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of customers and the integrity of the market.	Firms and individuals
Investigating and Prosecuting	Section VIII recommends that regulators responsible for enforcing laws, regulations and rules that prohibit manipulative conduct should have: i) effective tools to prevent and detect manipulation with	Firms and individuals

Market Manipulation May 2000	sufficient clarity and flexibility to allow prosecution of novel manipulative schemes; and ii) adequate authority to investigate and prosecute market manipulation and/or the ability to work with other domestic authorities that investigate and prosecute market manipulation.	
Principles for The Regulation and Supervision of Commodity Derivatives Markets September 2011	This report sets out a number of key Principles aimed at ensuring that firms and individuals observe market standards and avoid illegal behavior. It provides that Market Authorities should have rules, compliance programs, sanctioning policies and powers to prohibit, detect, prevent and deter abusive practices on their markets, including manipulation or attempted manipulation of the market. It also outlines the following specific practices or principles, which may be applicable to individuals, which need to be prevented: • causing, or attempts at causing, artificial pricing in the market; • creating false or misleading appearance of active trading; • disseminating false or misleading information in respect of the market or conditions that affect the price of any commodity derivatives contract; • creating, or attempts at creating, a corner or squeeze, in which an abusive controlling position is accumulated in the physical and/or futures or OTC markets, forcing those holding short positions to settle their obligations, by purchase or offset or otherwise, to their detriment; • abuse relating to customer orders; • “wash trades”, involving no change of beneficial ownership or economic purpose; • collective trades, which seek improperly to avoid exposure to the pricing mechanism of the market; • violation of applicable position limits; • concealment of a position holder’s identity; and • misuse of information.	Firms and individuals
International Standards for Derivatives Market Intermediary Regulation June 2012	Recommendation 7 sets out that DMIs should be subject to business conduct standards including, among other things, prohibitions against fraud, misrepresentation, manipulation and other abusive practices.	Firms and individuals
Objectives And Principles of Securities Regulation August 2013	Two key principles address this issue: (i) Principle 31 provides that market intermediaries should 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; and (ii) Principle 36 sets out that regulation should be designed to detect and deter manipulation and unfair trading practices. This may be addressed through a number of mechanisms including direct surveillance, inspection, reporting complemented by vigorous enforcement of the law and trading rules, many of which will apply directly to individuals.	Firms and individuals

Credible Deterrence in The Enforcement of Securities Regulation June 2015	The credible deterrence report sets out the objective that strong regulation that holds individuals and entities accountable and deters misconduct promotes public confidence in financial services and is a key factor in the development of efficient markets, financial services and economies. It outlines a number of factors by which this may be achieved. Factor 5 (sanctions) addresses individuals in particular and advocates strong punishments – no profit from misconduct and individual accountability.	Firms and individuals

3. Conflicts management

IOSCO Report	Relevant Content	Scope of application
International Conduct of Business Principles July 1990	Principle 6 (Conflicts of Interest) sets out that a firm (including its employees and representatives) should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its customers are fairly treated.	Firms and individuals
Model Code of Ethics June 2006	Four relevant guiding ethical principles were recommended to firms engaged in the financial services industry, namely: • Loyalty – Managing and Fully Disclosing Conflicts of Interest • Fairness to the Customer • Doing No Harm to the Customer or the Profession • Maintaining Confidentiality	Firms and individuals
Report Market Intermediary Management of Conflicts that Arise in Securities Offerings November 2007	Part 2 of the report sets forth general approaches for addressing conflicts and means for their implementation. In particular, Part 2 states that a market intermediary and its senior management should be aware that there is the potential for a conflict of interest to arise if it participates in a securities offering and also provides financial services to other clients and/or has a proprietary interest in the transaction. They should be aware that the potential for conflicts can also arise because of services provided by other entities of the group of which it is a member. The market intermediary needs to identify and address those conflicts so that client interests are not impaired. This will call for addressing conflicts on a whole of group basis. The report further adds that "the senior management of the market intermediary and the group are responsible for setting and preserving the culture of the market intermediary. Conflicts may in some cases need to be considered, in addition to the assessment by the compliance function, at a management level above the individual business unit or entity that has the relevant conflict. This would help to ensure that an appropriate assessment is made of the nature of the conflict and the response to such conflict." Also, it states that effective identification and addressing of conflicts are facilitated through policies and procedures endorsed and supported by senior management.	Firms and individuals
Principles for Financial Benchmarks July 2013	Principle 3 sets out provisions regarding conflicts of interest that are relevant to the conduct of individuals. Specifically, to protect the integrity and independence of Benchmark determinations, administrators should document, implement and enforce policies and procedures for the identification, disclosure, management, mitigation or avoidance of conflicts of interest. Administrators should review and update their policies and procedures as appropriate. There should be segregation of reporting lines within the administrator and adequate supervision and sign-off by authorized or qualified	Firms and individuals

	employees prior to releasing benchmark determinations. The framework should, among other things, seek to ensure that it has in place effective procedures to control the exchange of information between staff engaged in activities involving a risk of conflicts of interest and adequate remuneration policies that ensure all staff who participate in the benchmark determination are not directly or indirectly incentivized by benchmark levels.	
Objectives and Principles of Securities Regulation August 2013	Sets out three relevant principles regarding acting in a client's interest and addressing conflicts of interest, including: (i) principle 8 states that the Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed, or otherwise managed; (ii) principle 23 provides that 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; and (iii) principle 31 says that market intermediaries should 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.	Firms and individuals

4. Competence

IOSCO Report	Relevant Content	Scope of application
International Conduct of Business Principles July 1990	Sets out two key principles that apply to firms (including its employees and representatives), namely: (i) principle 2 (Diligence) states that in conducting its business activities, firms and employees should act with due skill, care and diligence; and (ii) principle 3 (Capabilities) provides that a firm should employ effectively the resources and procedures needed for the proper performance of its business activities.	Firms and individuals
Compliance Function at Market Intermediaries March 2006	Sets out two key principles that apply to firms and employees, namely: (i) topic 4 (Qualification of Compliance Personnel) states that compliance staff should have integrity, an understanding of relevant rules, the necessary qualifications, industry experience and professional and personal qualities to enable them to carry out their duties effectively; and (ii) topic 7 (cross-border compliance arrangements) provides that where market intermediaries operate on a cross-border basis, the compliance function must understand the applicable laws in each jurisdiction in which the market intermediary operates, and take steps to help ensure that it has the necessary personnel and expertise to comply with them.	Firms and individuals
International Standards for Derivatives Market Intermediary (DMI) Regulation June 2012	Made two recommendations relevant to individuals: (i) Recommendation 12, which states that DMIs should be required to maintain risk management systems and organization to properly identify and manage their OTC derivatives related business risks. According to this recommendation DMIs should ensure that their agents or employees involved in OTC derivatives activities possess the necessary levels of knowledge and expertise to understand the risks and obligations resulting from OTC derivatives transactions and the operation of OTC derivatives markets in general. Individuals acting on behalf of DMIs should have the education, training and experience necessary to perform OTC derivatives activities competently or to supervise the performance of OTC derivative	Firms and individuals

	activities, including understanding the structure, features and risks of each derivative transaction or product; and (ii) Recommendation 13, which states that DMI's management should apply procedures and systems of that provide reasonable assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and procedures.	
Principles for Financial Benchmarks July 2013	Principle 4 (Control Framework for Administrators) discusses an appropriate control framework for administrators for the process of determining and distributing the benchmark. One of the topics in this respect is that the framework should ensure that benchmark determinations are made by personnel who possess the relevant levels of expertise, with a process for periodic review of their competence; and that staff training, including ethics and conflicts of interest training, and continuity and succession planning for personnel, should also be provided periodically.	Firms and individuals
Objectives And Principles of Securities Regulation August 2013	Principle 29 states that regulation should provide for minimum entry standards for market intermediaries. According to the report, these standards should include requirements for the authorization, licensing and registration of market intermediaries. According to the report, the licensing and supervision of market intermediaries, including its staff, should set minimum standard for them and provide consistency of treatment for all similarly situated market intermediaries.	Firms and individuals

5. Communication and confidentiality

IOSCO Report	Relevant Content	Scope of application
International Conduct of Business Principles July 1990	Principle 5 (Information for Customers) sets out that a firm should make adequate disclosure of relevant material information in its dealings with customers.	Firms and individuals
Model Code of Ethics June 2006	The code sets out a guiding ethical principle for individuals to maintain confidentiality when interacting with clients. It refers to firms and their employees developing a relationship of personal trust and confidence with clients and employers by safeguarding information entrusted to the professional. A professional must refrain from using confidential information, or appearing to use it, for unethical or illegal advantage. Information that employees obtain through their employer's work would not be used by the employee either personally or through a competitor.	Firms and individuals

Annex B
Market Conduct Task Force Members

Australian Securities and Investments Commission, **Australia**

Comissão de Valores Mobiliários, **Brazil**

Autorité des marchés financiers, **France**

Bundesanstalt für Finanzdienstleistungsaufsicht, **Germany**

Securities and Futures Commission, **Hong Kong**

Securities and Exchange Board of India, **India**

Commissione Nazionale per le Società e la Borsa, **Italy**

Financial Services Agency, **Japan**

Securities Commission, **Malaysia**

Comisión Nacional Bancaria y de Valores, **Mexico**

The Netherlands Authority for the Financial Markets, **Netherlands, The**

Ontario Securities Commission, **Ontario**

Autorité des marchés financiers, **Québec**

Monetary Authority of Singapore, **Singapore**

Comisión Nacional del Mercado de Valores, **Spain**

Swiss Financial Market Supervisory Authority, **Switzerland**

Capital Markets Board, **Turkey**

Financial Conduct Authority, **United Kingdom**

Commodity Futures Trading Commission, **United States of America**

Securities and Exchange Commission, **United States of America**