

IOSCO – A Global Standard Setter
Corporate Corruption, Integrity and Governance Symposium
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Introduction

Congratulations to the Independent Commission Against Corruption for hosting this symposium on issues of such importance to capital markets. It is my privilege and pleasure to speak today on the role of IOSCO as a global standards setter.

The International Organisation of Securities Commissions is the global standard setter for securities markets. As such, it is one of the standard setters working towards less corporate corruption, more corporate integrity and excellence in corporate governance.

IOSCO's principal concern is with investor protection and the integrity and stability of capital markets. Strengthened capital markets can better contribute to economic growth and prosperity across the world. And from this perspective, we see nothing more damaging to markets than corruption and financial fraud – and nothing more constructive than excellence in governance among the issuers of securities and other market participants. The subject matter of this symposium is very close to the heart of IOSCO and of securities regulators worldwide!

Background on IOSCO

The Organisation's role has evolved and grown over the past decade in response to two major forces, these being: Dramatic growth in capital markets and their increasingly global nature; and rising awareness among policy makers and regulators of the need to manage risks implicit in that growth, including the risks of corruption and fraud.

IOSCO is now recognised as the leading standard setter for securities regulation worldwide. Our standards come in the form of principles, codes and benchmarks, designed and promoted for implementation by regulatory agencies in developed and emerging markets worldwide. They are non-binding standards. But they draw substantial authority from IOSCO's broad membership, its high standing in the global financial

community, its rigorous standard setting processes and its extraordinary capacity to make decisions by consensus.

Members are expected to give practical effect to our principles and codes using the legal powers and organisational capabilities available to each within its home jurisdiction. The standards of IOSCO are, in the main, sufficiently high-level for policy makers and regulators to implement them through rules and processes best suited to their particular economic, political and cultural context.

IOSCO also plays critical roles in assisting implementation of its standards, especially in emerging markets, and in promoting cooperation between securities regulators across their national borders – and I will return to this aspect again later.

Clearly, IOSCO is an organisation faced with major challenges. But it is also one with two great strengths. First is a depth and breadth of membership almost unrivalled among international bodies. We have representation from more than 100 countries, with member regulators overseeing more than 90% of the world's securities markets. National regulatory agencies are full members of IOSCO. Other eligible bodies with appropriate responsibility for securities regulation may become associate members. Self-regulatory organizations or international bodies with appropriate interest in securities regulation are eligible for affiliate membership.

The Organisation actively draws input from members through three standing committees – these are the Executive Committee, under my Chairmanship, and two working committees – as well as four regional committees. The Asia-Pacific Regional Committee, for example, has 21 members including the Hong Kong Securities and Futures Commission and the China Securities and Regulatory Commission.

The second particular strength of IOSCO is its recognition and support by other bodies in the global financial community. The Basel Committee on Banking Supervision and the International Association of Insurance Supervisors have parallel standard setting roles in respect of banking and insurance. Since 1996, IOSCO and these two bodies have cooperated formally on matters of mutual concern through the so-called Joint Forum.

As would be expected, we take part in the Financial Stability Forum and, have close relationship at various levels with other global agencies including the World Bank, the IMF, the OECD, and the International Accounting Standards Board to name a few. Growth and globalization of the economies and capital markets bring us increasingly together while magnifying the importance of particular roles played by each organisation – in our case, standard setting for securities regulation in 100-plus countries and in the global capital market to which those countries increasingly belong.

IOSCO Principles

IOSCO's view of the world is grounded in the *IOSCO Objectives and Principles of Securities Regulation* – known as the IOSCO Principles --, a fundamental document that was formally adopted in 1998. This sets down three core objectives of securities regulation:

- the protection of investors;
- the efficiency, fairness and transparency of markets; and
- reduction in systemic risk.

The objectives are supported by 30 broadly-framed Principles which encompass: the responsibilities and powers of market regulators; the importance of cooperation between them; the basic requirements of securities issuers and market intermediaries; and the responsibilities and oversight of self-regulatory organisations. The Principles also deal with collective investment schemes and the functioning of secondary markets.

Together the Objectives and Principles form a baseline of IOSCO standards – standards which are not tightly prescriptive but do establish clear international expectations regarding regulation of securities markets. Over recent years, many members have worked diligently to ensure implementation of these standards in their national jurisdictions, and to measure previously-existing rules and practices against the IOSCO Principles. The standing of the IOSCO Principles has been reinforced through their use for the Financial Sector Assessment Programme undertaken by the IMF and the World Bank.

I can report on New Zealand's experience as one of the countries assessed under the Programme in recent years. The IMF feedback published in 2004 showed that most of the IOSCO Principles had been implemented in our securities market. Gaps existed in the regulation of financial intermediaries and collective investment schemes, and these are now being addressed through new legislation. As a result, comprehensive new measures against the manipulation of capital markets and against insider trading in securities will soon be adopted, with the Securities Commission acquiring new powers of enforcement in key areas. New Zealand expects to have before long a regulatory framework fully in accord with IOSCO baseline standards – although, I hasten to add, we will continue developing the New Zealand framework in light of experience and further standards setting by IOSCO.

Indeed, over recent years IOSCO has produced various, more specific standards and codes in key areas. We now have particular standards for regulation in regard for instance to the oversight and independence of auditors; to the disclosure and reporting practices of listed corporations; to securities analysts and their potential conflicts of interest; and to the activities of credit rating agencies. Research and consultation on other regulatory issues is ongoing. In effect, IOSCO has a comprehensive work programme that also includes assisting member regulators with their implementation of the IOSCO Principles.

Corporate governance

As mentioned, we see good corporate governance is something critically important to the integrity and stability of capital markets. IOSCO has not, and does not intend to, set standards for corporate governance but recognises, instead, the excellent work undertaken by others in the global financial community, most notably the Organisation for Economic Co-operation and Development. As you will know, revised OECD *Principles of Corporate Governance* were published in April 2004 – the world has robust high level standards for use in capital markets worldwide.

Needless-to-say, IOSCO shares the OECD view on corporate governance. It is about regulating relationships between boards, managers, shareholders and other stakeholders – and about structures and practices for setting corporate goals, and for monitoring and measuring performance towards those goals. As securities regulators we must concern ourselves not just with stock exchange-listed corporations but with all entities that issue securities. They take many different legal and commercial forms. In our view, concepts of good governance must be applied in all cases.

The OECD *Principles of Corporate Governance* are, of course, widely recognised in the financial community. Like IOSCO's Principles, they are, according to the Financial Stability Forum, one of 12 key sets of standards for sound financial systems. They are also used in assessments by the World Bank and the IMF. We see them as highly compatible with IOSCO standard setting – and as underpinning more specific principles, codes and rules developed for good governance in particular jurisdictions worldwide.

Like IOSCO standards, the OECD Principles of Corporate Governance are primarily a tool for policy makers and regulators to work with. We must always be realistic about the gap between our global principles and codes, and the actual regulation of capital markets. I think OECD Secretary-General Donald Johnston sums up the role of the OECD Principles very well when he says “*they will not eradicate criminal behaviour, but such activity will be made more difficult as rules and regulations are adopted in accordance with the Principles ... our efforts will also help to develop a culture of values for professional and ethical behaviour on which well functioning markets depend.*” We take much the same view of IOSCO standard setting.

Financial fraud

Let me turn directly now to criminal behaviour and its consequences in capital markets. We, like all others in the global financial community, are appalled at the financial scandals accompanying the collapse of Enron in the United States, Parmalat in Italy and other multinational corporations in the earlier part of this decade. These cases reveal major failings in corporate governance – and indeed, corruption and fraud of the kind most corrosive to market stability and integrity. IOSCO's response over the past four years has included a comprehensive review of issues raised particularly in the Parmalat collapse, from a securities regulation perspective. We set up an IOSCO Task Force of

Chairmen from leading regulatory agencies to examine the issues and to make recommendations on improving regulation worldwide.

The Task Force's analysis resulted in early 2005 in an IOSCO report entitled *Strengthening Capital Markets Against Financial Fraud* – a landmark report that has helped confirm the future direction of IOSCO as a global standard setter. The Task Force highlighted seven areas of most concern, these being:

- corporate governance issues around independent directors on boards, the protection of minority shareholders and related party transactions;
- issues around the independence of auditors, and the effectiveness of audit standards and of auditor oversight;
- the effectiveness of financial and non-financial disclosures by corporations;
- the transparency and regulation of bond markets;
- the role and obligations of market intermediaries;
- the use of complex corporate structures; and
- the role of private sector information analysts.

Of course, none of these are new areas for regulatory focus. In fact, the Task Force found that most of the issues raised in the Parmalat case and the other financial scandals have already been addressed in existing regulatory principles and standards.

What *Strengthening Capital Markets Against Fraud* does call for is greater effort to implement relevant standards, including the IOSCO Principles and especially in the seven areas just listed. The renewed importance attached to implementation – and to clarifying and extending standards in key areas – reflects our stronger appreciation of how deliberate wrongdoers can circumvent corporate governance principles and securities regulation. We also have gained a stronger appreciation of how damaging corruption and fraud can be to markets worldwide.

The Task Force called also for greater effort at cooperation between securities regulatory agencies so they can exchange information across borders and provide mutual support on matters of enforcement. For IOSCO, the financial scandals have reinforced the importance of international enforceability in securities regulation.

I will spend the remainder of my time today on two of the areas highlighted by the Task Force and on IOSCO initiatives to improve cross-border cooperation. These should provide some further insight into our standard setting role, particularly in relation to worldwide efforts at deterring, stopping and prosecuting corruption and fraud.

Board issues

First, corporate governance issues surrounding the independence of directors, related party transactions and minority shareholder protection. On such issues, IOSCO turns immediately to the OECD *Principles of Corporate Governance* – they are the global standards, with recognition from securities regulators worldwide.

The OECD Principles emphasize the duties which the directors of a corporation owe to shareholders and their obligation to exercise independent judgment when board decisions are made. The Principles also deal with the risks inherent in related-party transactions where there is risk that controlling shareholders or managers will mis-use corporation assets – and they deal with the need for minority shareholders to be protected from abusive actions by controlling shareholders.

The Task Force noted that many of the issues raised by the financial scandals are already addressed by the OECD, although only at a high level. And on closer examination, IOSCO believes we need greater clarity in standard definitions of “independent directors” and in how the responsibilities of those directors are described. We want to work with the OECD on adding such clarity, and also on further developing standards in relation to minority shareholders and related-party transactions. It is a matter of IOSCO using its expertise in support of another global standards setter for mutual benefit and for improved regulation in capital markets worldwide.

Let me make a further point here stepping out of my IOSCO role for a moment and telling you about an issue of particular personal interest to me. Corporate governance may be generally strengthened in developed and emerging markets when more women are appointed corporate directors. That sounds provocative but in fact, there is an increasing body of research to suggest that more women in boardrooms could resolve many governance issues.

One study, for instance, at the Cranfield University Centre for Developing Women Leaders in the United Kingdom indicated that listed companies with women directors had significantly better records of corporate governance than companies with all-male boards. Likewise, studies undertaken for The Conference Board of Canada show high correlation between multiple women directors on boards, strong governance practices and superior corporate performance. When Canadian companies with two or more women on the board in 1995 were tracked over the following six years, these companies most often became revenue and profit leaders in their industries. Inspiring, don't you think!

The research reflects strong capabilities for complex problem solving among women in business, and an inclination towards openness and integrity. These make many women particularly effective at corporate governance.

On the other hand, there is still a substantial gender gap in boardrooms worldwide. In the United States this year, a survey among Fortune 500 companies shows women in just 14.7% of all available board seats and only 64 companies have 25% or more of their directors as women. In my own country of New Zealand, it is even worse – women hold just 7% of directorships among the top 100 listed companies.

The world really does have to work harder at rolling back gender discrimination in the boardroom and getting more value from the female talent pool. We now have evidence

that this will not just improve corporate governance, but also raise corporate performance – and of course, the two should always go hand in hand.

Auditor issues

The IOSCO Task Force I mentioned earlier also highlighted issues around the oversight of external auditors, and audit independence and effectiveness – issues that featured prominently in the financial scandals. Indeed, the Task Force puts a strong focus on the incidence of “audit failure” due to one or more of the following factors:

- outright fraud by corporate managers who deceive the auditors;
- fraud by audit firm staff, working in conjunction with corporate managers;
- malpractice or negligence on the part of the auditors; and
- deficiencies in audit standards such that compliant auditors are unable to detect financial discrepancies.

IOSCO has long been active on some of these issues. Since 2002, we have had a set of specific *Principles for Auditor Oversight*. These call for, among other things, for each jurisdiction to have an oversight body which is independent of the audit profession and acting clearly in the public interest.

The implementation of these standards by IOSCO members has been surveyed in recent years. We wanted to know just how well policy makers and regulators are going in respect of auditor oversight. Of 57 jurisdictions participating in the survey we found 82% did indeed have one or more bodies with formal responsibility for overseeing auditors, although in many cases these bodies do not have the preferred level of independence from the audit profession. Overall the survey results are pleasing, but there is clearly more work to do.

IOSCO has also published separate *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor’s Independence*. These set standards for boards in the selection and monitoring of external auditors. In regard to audit standards, we certainly support the take up of International Auditing Standards by an increasing number of jurisdictions worldwide. These standards are, of course, set by the International Auditing and Assurance Standards Board (IAASB).

IOSCO is encouraging global adoption of IAASB auditor-related standards. The external audit is the first external independent line of enforcement of financial reporting standards and financial reporting law. Audit is one of the vital filters that ensure that users of financial statements can have confidence in them. An audit is not guaranteed to find corruption or fraud but it does increase the likelihood of such things being found. Failure in this area can be extremely damaging to investors and to the efficiency and fairness of capital markets – as Parmalat and other cases remind us!

Cross-border cooperation

The financial scandals also serve to highlight the importance of international cooperation between securities regulators – another area in which IOSCO is setting standards. We all see the rapid growth of cross-border investment and the rise of complex international corporate structures. These trends are obviously accompanied by increased risks to investors and to the efficient and fair operation of markets – and the risks include corruption and fraud, as we have seen.

To keep pace with the trends and to address the risks, securities regulators recognize the necessity of much improved cross-border cooperation for information exchange in enforcement matters. IOSCO has addressed this necessity through its *Multilateral Memorandum of Understanding on Consultation, Cooperation and Exchange of Information*, adopted by IOSCO in 2002 and since then, open for all members to join.

The IOSCO MOU creates a solid platform for cooperation between securities regulators provided they have comparable legal powers and organisational capabilities for the gathering and exchange of information in enforcement cases that span across borders. Regulatory agencies become full signatories only when they – and their home jurisdictions – are found to be meeting what are effectively global standards for international regulatory enforcement cooperation.

To date, 30 IOSCO member regulators have met these standards and been admitted to the IOSCO MOU as full signatories.

Increasing this number is a major priority for IOSCO. Indeed, we have taken the momentous step of requiring all members to either become a full signatory by 1 January 2010, or to have joined Appendix B of the document by that date and formally committed to becoming a full signatory without significant further delay. That deadline was adopted at the IOSCO Annual Conference a year ago – a measure of just how important we see cooperation. The Hong Kong Securities and Futures Commission and the Securities Commission of New Zealand are both signatories to the IOSCO MOU.

For some regulators, there is substantial work required to secure the legal authority and the capabilities necessary to comply with the terms of the IOSCO MOU. They must be sufficiently empowered within their home jurisdictions to gather and exchange certain types of information specified in the IOSCO MOU on an equal basis with securities regulators in other jurisdictions. When IOSCO members from the Asia-Pacific region were surveyed on these issues late last year, they confirmed high levels of support for cross-border cooperation – but they also confirmed the extent of legal impediments to meeting the IOSCO standards in this regard. The organisation will be working hard over the next five years to assist members – and not all, I might add, are from emerging markets – in acquiring the powers and capabilities required.

Looking ahead, IOSCO has a broad vision for securities regulation in a global capital market. We want regulators engaging with each other across borders whenever

appropriate for regulatory oversight and enforcement in a seamless, effective manner. In fact, this is occurring to some extent today.

To give a New Zealand example, the Securities Commission successfully used the IOSCO MOU in an insider trading case, in its pursuit of former insiders now living in either the United States or Europe. The New Zealand Securities Commission secured the cooperation of regulators in those jurisdictions to pursue claims arising from share sales in a large New Zealand public corporation during 2002. To date, US-based defendants have agreed to pay more than NZ\$7 million by way of compensation and NZ\$350,000 as a contribution to our costs. Proceedings continue against two other defendants. It is, indeed, a landmark case for New Zealand with substantial implications for investor confidence and capital market integrity. Without cross-border cooperation, we doubt the same positive outcomes could have been achieved.

Concluding comments

I will conclude by emphasizing the importance that IOSCO attaches to issues under discussion at this symposium: Corruption and fraud undermine the capital market integrity and financial stability with which we are most concerned. Excellence in corporate governance is highly beneficial for achieving the outcomes we seek.

As the global standard setter for securities regulation, we focus on the protection of investors, on the efficiency, fairness and transparency of markets, and on the reduction of systemic risks. Our standards guide and direct regulatory agencies, securities issuers and market intermediaries towards these broad objectives.

We have responded to Enron, Parmalat and other financial scandals with a thorough examination of the issues most relevant to securities regulation. Our conclusions give greater impetus to IOSCO's standard setting work – and particularly, to efforts for greater implementation of our principles and codes among IOSCO members.

Our conclusions also add impetus to our cooperation with other standard setters in the global financial community. I have mentioned the OECD and its *Principles of Corporate Governance*, the leading standards in this area. We are making valuable contributions in working with the OECD and other bodies on issues of common concern.

Indeed, cooperation is a critical theme in all areas of work for IOSCO. Ultimately, we see the deterrence and detection of corruption and fraud as a cooperative effort among as many capital market participants and stakeholders as possible. Our Task Force against financial fraud notes in its report that, "*it takes the constant vigilance of all stakeholders – issuers, investors, auditors, analysts, market operators, market intermediaries, regulators and other enforcement agencies – to minimize market misconduct.*"

In this regard, cross-border cooperation among regulators is also of critical importance. IOSCO has established a mechanism for this – the IOSCO MOU adopted in 2002 and

endorsed in 2005 as a benchmark for international cooperation— and we expect regulators worldwide to increasingly meet the global standards for effective cooperation through this mechanism.

IOSCO has come a long way over the past decade. But we have a full agenda still and a deep appreciation of the regulatory challenges that are constantly emerging in capital markets worldwide. There is a Chinese proverb: *“To get through the hardest journey, we need to only take one step at a time ... but we must keep on stepping”*. That, I think, aptly describes the IOSCO approach to global standard setting, and to helping maintain the integrity and stability of capital markets worldwide.
Thank you.

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