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## **IOSCO publishes interim recommendations on unregulated financial markets and products**

The International Organization of Securities Commissions' (IOSCO) Technical Committee has published [\*Unregulated Financial Markets and Products – Consultation Report\*](#) (Report) prepared by its Task Force on Unregulated Financial Markets and Products (Task Force). The Report contains interim recommendations for regulatory action designed to improve confidence in the securitisation process and the market for credit default swaps (CDS).

The Task Force was established by the Technical Committee in November 2008 in response to concerns expressed by the G20 regarding the crisis and the pivotal role that certain unregulated market segments and products had played in the evolution of capital markets.

The interim recommendations contained in the Report address issues of immediate concern with respect to:

- securitised products, including asset-backed securities (ABS), asset-backed commercial paper (ABCP) and structured credit products such as collateralised debt obligations (CDOs), synthetic CDOs, and collateralised loan obligations (CLOs); and
- CDS.

Kathleen Casey, Chairman of IOSCO's Technical Committee, said:

“The Task Force has focused on these particular areas of unregulated financial markets and products due to the significance of securitisation and CDS to credit availability in the real

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economy, their contribution to the management of individual and systemic risks, their recent rapid growth and the important role they play in global markets.

“In proposing these interim recommendations IOSCO believes that a measured regulatory response is required, taking into account industry initiatives, to strengthen the operation of the securitisation and CDS markets. IOSCO further believes that implementing these regulatory actions may assist in restoring confidence in, and promoting the fairness, efficiency and orderliness of, international financial markets.

“Based on the responses we receive to this consultation paper and further reflection by Technical Committee members, IOSCO will finalise its recommendations and consider how best to implement those recommendations in the interest of fostering consistent regulatory approaches across markets.”

## **Interim Recommendations**

While IOSCO encourages industry responses in the securitisation process and CDS market the Task Force recognises that industry initiatives alone will not be sufficient to restore transparency, market quality and integrity and has therefore formulated a number of interim recommendations to address the following concerns associated with both these areas. IOSCO will further consider which additional standards are necessary for the purpose of consistent implementation by national regulators of final recommendations.

## **Securitisation**

### ***Interim Recommendation 1 – Wrong Incentives***

1. Consider requiring originators and/or sponsors to retain a long-term economic exposure to the securitisation;

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2. Enhance transparency through disclosure by issuers of all checks, assessments and duties that have been performed or risk practices that have been undertaken by the underwriter, sponsor and/or originator
3. Require independence of experts used by issuers; and
4. Require experts to revisit and maintain reports over the life of the product.

## ***Interim Recommendation 2 – Inadequate risk management practices***

1. Mandate improvements in disclosure by issuers including initial and ongoing information about underlying asset pool performance and the review practices of underwriters, sponsors and/or originators including all checks, assessments and duties that have been performed or risk practices that have been undertaken. Disclosure should also include details of the creditworthiness of the person(s) with direct or indirect liability to the issuer;
2. Strengthen investor suitability requirements as well as the definition of sophisticated investor in this market; and
3. Encourage the development of alternative means to evaluate risk with the support of the ‘buy-side’.

## ***Interim Recommendation 3 – Regulatory structure and oversight issues***

IOSCO recommends that jurisdictions should assess the scope of their regulatory reach and consider which enhancements to regulatory powers are needed to support TC interim recommendation #1 and #2 in a manner promoting international coordination of regulation.

## **Credit Default Swaps**

### ***Interim Recommendation 4 – Counterparty Risk and Lack of Transparency***

In forming the interim recommendations below, the Task Force considered the establishment of central counterparties (CCPs) for the clearing of standardised CDS as an important factor in addressing the issues of counterparty risk and transparency.

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1. Provide sufficient regulatory structure for the establishment of CCPs to clear standardised CDS, including requirements to ensure:
  - a. appropriate financial resources and risk management practices to minimise risk of CCP failure;
  - b. CCPs make available transaction and market information that would inform the market and regulators; and
  - c. cooperation with regulators;
2. Encourage financial institutions and market participants to work on standardising CDS contracts to facilitate CCP clearing;
3. CPSS-IOSCO Recommendations for CCPs should take into account issues arising from the central clearing of CDS;
4. Facilitate appropriate and timely disclosure of CDS data relating to price, volume and open-interest by market participants, electronic trading platforms, data providers and data warehouses;
5. Establish an appropriate framework to facilitate information sharing and regulatory cooperation between IOSCO members and other supervisory bodies in relation to CDS market information and regulation; and
6. Encourage market participants' engagement in industry initiatives for operational efficiencies.

## ***Interim Recommendation 5 – Regulatory structure and oversight issues***

IOSCO recommends that jurisdictions should assess the scope of their regulatory reach and consider which enhancements to regulatory powers are needed to support TC interim recommendation #4 in a manner promoting international coordination of regulation.

On the basis of the interim recommendations for these markets, the Report also identifies the need for further consideration of the other unregulated financial markets and products before general recommendations can be developed.

The Task Force is co-chaired by the Australian Securities and Investments Commission and the Autorité des Marchés Financiers of France.

The closing date for responses to the Report is 15 June 2009.

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## NOTES FOR EDITORS

1. The [Unregulated Financial Markets and Products – Consultation Report](#) is available on the IOSCO website.
2. IOSCO is recognized as the leading international policy forum for securities regulators. The organization's broad membership regulates more than 95% of the world's securities markets and IOSCO is the world's most important international cooperative forum for securities regulatory agencies. IOSCO members regulate more than one hundred jurisdictions and its membership continues to grow steadily.
3. The [Technical Committee](#), a specialised working group established by IOSCO's Executive Committee, is made up of fifteen agencies that regulate some of the world's larger, more developed and internationalised markets. Its objective is to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. Ms. Kathleen Casey, Commissioner of the United States Securities and Exchange Commission is the Chairman of the Technical Committee. The members of the Technical Committee are the securities regulatory authorities of Australia, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Ontario, Quebec, Spain, Switzerland, United Kingdom and the United States.
4. IOSCO aims through its permanent structures:
  - to cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets;
  - to exchange information on their respective experiences in order to promote the development of domestic markets;
  - to unite their efforts to establish standards and an effective surveillance of international securities transactions;
  - to provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses.

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