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## PRESS RELEASE

### **IOSCO Technical Committee Outlines Action Plan to Strengthen Capital Markets Against Financial Fraud, Reports on Progress to Develop a Code of Conduct for Credit Rating Agencies, and Issues Principles on Client Identification and Beneficial Ownership for the Securities Industry**

(Amman, Jordan) In February 2004, the Technical Committee of the International Organization of Securities Commissions formed a special Chairmen's Task Force to organize and coordinate IOSCO's response to recent high-profile incidents of securities fraud and market abuse. This Task Force, under the joint chairmanship of Commissioner Roel C. Campos of the U.S. Securities and Exchange Commission and Chairman Lamberto Cardia of the Italian Commissione Nazionale per le Società e la Borsa, has focused on certain areas of concern, including:

1. Corporate governance and the role of independent directors;
2. Auditor oversight and the effectiveness of audit standards;
3. Regulatory oversight;
4. The use of complex corporate structures, such as "special purpose vehicles" and complex shareholding structures;
5. The role of market intermediaries and market "gatekeepers," such as investment banks and broker-dealers, in modern securities markets;
6. The role of private-sector information analysts, such as securities analysts and credit rating agencies, in modern securities markets; and,
7. Offshore financial centers.

The Task Force's fact-finding exercise to date indicates that, in many cases, the issues implicated in recent financial scandals are adequately addressed by ongoing IOSCO work and by various international regulatory standards and best practices, such as IOSCO's Principles on Auditor Oversight and Auditor Independence. In a few areas, particularly relating to bond issuance disclosure and offshore financial centers, the Task Force believes additional principles or best practices may be necessary to deal with potential weaknesses in the international financial system.

The Task Force is preparing a final report analyzing the issues of concern and recommending projects designed to assess and improve implementation of existing regulatory principles or develop new principles, as appropriate. The Technical Committee intends to share the report among IOSCO members and with the Financial Stability Forum in order to help financial regulators identify possible weaknesses in the international financial regulatory system, improve implementation of existing standards, and enhance regulatory risk identification and assessment.

The Technical Committee is releasing the attached issues paper at the conclusion of its meeting at the IOSCO Annual Conference in Amman, Jordan, in the interest of improving public awareness of IOSCO's work in areas vital to improving investor protection in global financial markets. Andrew Sheng, Chairman of the Hong Kong Securities and Futures Commission and Chairman of the IOSCO Technical Committee, noted:

The IOSCO Technical Committee is committed to addressing recent high-profile incidents of international securities fraud and corporate governance failures. Our special Task Force has made excellent progress in analyzing the issues raised by these events and, going forward, we will develop vigorous and robust regulatory responses.

Also during its Annual Conference in Amman, the U.S. Securities and Exchange Commission, as head of a special Chairmen's Task Force, reported on the progress of the group in developing a Code of Conduct for Credit Rating Agencies (CRAs) designed to address many of the concerns raised by this industry and the role it plays in modern financial markets.

Mr. Roel Campos, Commissioner of the U.S. Securities and Exchange Commission, stated:

Credit rating agencies play an extremely important role in how global capital markets function. However, like many other important actors in today's markets, recent financial scandals, rightly or wrongly, have raised questions about how rating agencies ensure the quality and integrity of the rating process, how they address potential conflicts of interest, and how investors can be able to compare the 'track records' of different rating agencies when assessing how much weight to give a particular rating. The Code of Conduct for Credit Rating Agencies, which the Chairmen's Task Force is currently developing, will be designed to address each of these concerns.

The proposed Code of Conduct will follow the general structure of the Technical Committee's Statement of Principles Regarding the Activities of Credit Rating Agencies, published by the Technical Committee in October 2003. The Principles laid out high-level objectives that rating agencies, regulators, issuers and other market participants should strive toward to improve investor protection and the fairness, efficiency and transparency of securities markets and reduce systemic risk.

Following publication of the CRA Principles, a number of securities regulators and rating agencies suggested that more specific and detailed guidance on how the Principles should be implemented in practice would be useful. This guidance would serve as a code of conduct for CRAs, thereby helping ensure that a converged standard of CRA conduct existed throughout the world, irrespective of market circumstances and legal and regulatory structures.

The Chairmen's CRA Task Force met in Rome in late April to discuss the details of a proposed draft of the Code of Conduct. The Task Force plans to seek comment from the credit rating agency industry and the Basel Committee on Banking Supervision in June. The Task Force will also seek broader comment from the public (including issuers and investors) as well as interested governments in July or August.<sup>1</sup> The Task Force plans to complete the Code of Conduct by September 2004.

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<sup>1</sup> On 30 March 2004, the German Bundestag passed a resolution in support of IOSCO's development of a Code of Conduct for credit rating agencies and highlighting key points for consideration. See Deutscher Bundestag, 15th Legislative Period, Document 15/2815, 30.03.2004 ("Improving the Integrity, Independence and Transparency of Rating Agencies through a Code of Conduct").

Client and beneficial owner identification is central to achieve the principal objectives of securities regulation: the protection of investors; ensuring the markets are fair, efficient and transparent; and the prevention of the illegal use of the securities industry. Given the importance of effective client identification processes, and complementing the work of the Financial Action Task Force regarding its newly revised *Forty Recommendations*<sup>2</sup> to combat money laundering, the Technical Committee at this conference has adopted a statement of *Principles on Client Identification and Beneficial Ownership for the Securities Industry* (May 2004).<sup>3</sup> Jonathan Davis, President of Mexico's Comisión Nacional Bancaria y de Valores (CNBV) and Chairman of the IOSCO Task Force that produced this statement of principles commented on their publication:

These principles address key issues that have an impact over the whole spectrum of securities regulation. It is essential that the true identity of market users be established through adequate client identification processes that are based on comprehensive information and records.

IOSCO, based in Madrid, Spain, is the primary forum for international cooperation among securities regulators and is recognized as the international standard-setter for the securities sector. IOSCO currently has 171 members from more than one hundred jurisdictions.

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<sup>2</sup> Available on the FATF's website at [http://www.fatf-gafi.org/pdf/40Recs-2003\\_en.pdf](http://www.fatf-gafi.org/pdf/40Recs-2003_en.pdf).

<sup>3</sup> To be published shortly on the IOSCO website at [www.iosco.org](http://www.iosco.org).

## Attachment

### Outline of Action Plan to Strengthen Capital Markets against Financial Fraud

Over the past several years, the International Organization of Securities Commissions has undertaken a number of substantive projects designed to improve securities market regulation and enforcement cooperation among its members. These projects have included principles regarding securities market regulation generally,<sup>1</sup> as well as sets of regulatory principles for areas such as auditor oversight,<sup>2</sup> auditor independence,<sup>3</sup> ongoing disclosure and material developments reporting,<sup>4</sup> non-financial disclosure,<sup>5</sup> securities analyst conflicts of interest,<sup>6</sup> and the activities of credit rating agencies.<sup>7</sup> IOSCO has also conducted substantial work on mechanisms designed to improve cooperation and information-sharing among securities regulators investigating and prosecuting violations of securities laws and regulations, including the development of an IOSCO Multilateral Memorandum of Understanding<sup>8</sup> with an accompanying accession review process that has already succeeded in encouraging a number of jurisdictions to enact laws permitting their securities regulators to share information and cooperate with the regulators' foreign counterparts. Each of these principles as well as the Multilateral MOU were designed to address recognized vulnerabilities that posed threats to the integrity and stability of global capital markets.

Recent high-profile, global financial and securities fraud scandals, particularly the scandal involving Italy's Parmalat Group, have underscored for IOSCO that an additional review of these and other areas may be necessary. In response to these frauds, during its last meeting in February, IOSCO's Technical Committee commissioned a high-level Chairmen's Task Force to review the circumstances giving rise to the Parmalat matter, assess what implications the matter holds for the stability and integrity of global capital markets, and suggest avenues for further Technical Committee work. This Task Force is being chaired by the Italian CONSOB and the US SEC.

#### Proposed Work of the Task Force

The work of the Chairmen's Task Force will have three parts.

As a first step, the Task Force will assess the public information about the Parmalat matter and summarize this information for the Technical Committee. The Parmalat matter is currently subject to ongoing enforcement investigations in Italy, the United States and elsewhere, and many of the facts surrounding

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<sup>1</sup> "Objectives and Principles of Securities Regulation," (1998, updated October 2003).

<sup>2</sup> "Principles for Auditor Oversight," (October 2002).

<sup>3</sup> "Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence," (October 2002).

<sup>4</sup> "Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities," (October 2002).

<sup>5</sup> "General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Conditions and Results of Operations," (February 2003).

<sup>6</sup> "IOSCO Statement Of Principles For Addressing Sell-Side Securities Analyst Conflicts Of Interest," (October 2003).

<sup>7</sup> "IOSCO Statement Of Principles Regarding The Activities Of Credit Rating Agencies," (October 2003).

<sup>8</sup> IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (May 2002).

the case have yet to be fully established. The Task Force will base its review solely on public information known to be reliable.

As a second step, the Task Force will highlight for the Technical Committee key issues that the available information indicates securities regulators will wish to consider or reconsider. Given the ongoing nature of law enforcement activities with regard to Parmalat, the Task Force will avoid drawing conclusions that may prejudice these investigations. Rather, the Task Force will focus on issues raised by the Parmalat matter that may merit further attention by regulators, without commenting on whether these issues are directly implicated in the Parmalat case itself. The Task Force will also discuss whether and how these issues are currently addressed by existing IOSCO principles, or whether they call for the development of additional principles. Issues likely to be considered during this step of the Task Force's work include:

1. Corporate governance, including the role of independent directors on an issuer's corporate board, the rights of minority shareholders, and mechanisms (including the enforcement of accounting principles) to protect against conflicts of interest presented by related-party transactions;
2. Auditor oversight, including auditor independence, the effectiveness of audit standards and the supervisory activity, the role independent board committees, and issues related to mandatory auditor rotation;
3. Regulatory oversight, such as the nature and effectiveness of financial and non-financial disclosure requirements, issues relating to regulatory gaps resulting from the multiplicity of regulators, cross-border and domestic regulatory information-sharing, and the transparency and regulation of corporate bond markets;
4. The use of complex corporate structures, including complex financial and shareholding structures and the use of special purpose accounting vehicles, and whether their use poses particular regulatory issues;
5. The role of market intermediaries and gatekeepers, such as investment banks, lawyers and broker dealers, and the types of due diligence obligations they may have and to whom these obligations are owed;
6. The role of private-sector information analysts such as securities analysts and credit rating agencies and the degree to which these analysts can, do or should play a role in detecting issuer vulnerabilities and their conflicts of interest; and,
7. Offshore financial centers and whether and to what degree "under-regulation" and "non-cooperation" in these jurisdictions can pose problems for effective market oversight, taking into account the internationalization of securities markets.

A non-public report detailing the facts involved in the Parmalat matter and an analysis of these regulatory issues was considered by the Task Force at its meeting in late April.

As a third and final step, the Task Force will recommend to the Technical Committee further actions as potential responses to the issues raised. Depending on the issues raised, these recommendations might include:

1. The development of new IOSCO principles and standards, where the Task Force has identified regulatory issues that are not adequately addressed by current approaches, with an emphasis on detecting and prosecuting financial fraud;
2. The development of mechanisms to accelerate implementation of existing IOSCO principles and standards, where these principles and standards are appropriate and effective to address the identified issues, but widespread implementation is not yet complete;
3. Proposals to assess implementation of existing IOSCO principles and standards, where these principles and standards are deemed appropriate and effective by the membership, but where a lack of implementation itself presents cross-border regulatory vulnerabilities; and
4. Proactive and periodical exchange of information among regulators, concerning cross-border activity of issuers and intermediaries.

The Task Force will also consider other possible approaches to dealing with the issues it identifies, including regulatory risk identification and management, in the interest of better allocating regulatory resources to address possible regulatory vulnerabilities before they occur.

As part of its analysis, the Task Force will consider ongoing Technical Committee projects related to the regulatory issues identified. Several current projects involve issues that the Technical Committee had previously recognized as potential regulatory concerns. The import of these projects has been highlighted by the events surrounding the Parmalat matter. These ongoing projects include:

1. An assessment of implementation of the IOSCO Core Principles among IOSCO members;
2. A review of bond market transparency, including the transparency of bond market pricing mechanisms;
3. International disclosure standards for debt issuances;
4. An assessment of implementation of IOSCO Auditor Oversight Principles; and,
5. A review of information-sharing and cooperation capabilities among traditionally “non-cooperative” jurisdictions and a discussion of proposals to foster further cooperation going forward.

Depending on the circumstances and the stage of the project, the Task Force may recommend that some of these projects be accelerated or take into account the findings of the Task Force.