

# **Principles Regarding Cross-Border Supervisory Cooperation**

## **Final Report**



**OICU-IOSCO**

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## Chapter 1 Executive Summary

The recent financial crisis has reinforced in securities regulators their view that efficient and effective markets require fair, effective and comprehensive market regulation vigorously implemented and enforced by securities and other market regulators with comprehensive inspection, enforcement and oversight powers and backed by adequate resources and staff expertise. However, the nature of the financial contagions that have spread across national boundaries have also highlighted that fair, effective and comprehensive regulation and oversight limited to the national level may not be sufficient to prevent future financial crises. Over the past several decades, modern securities markets, and many market participants, have become fully *globalized*, with operations stretching across borders, drawing on investment capital around the world and looking for investment opportunities in many different countries. At the same time, and for the foreseeable future, market oversight remains a *local* affair, with national or provincial-level regulators implementing legislation passed by their jurisdictions' legislatures.

While the causes of the financial crisis continue to be debated, it is clear that, in many cases, securities market regulators (like nearly all market participants) were operating at times with incomplete information. As the crisis unfolded and regulators sought solutions, it also became clear that some of this incomplete information resulted from the global nature of many modern market participants, with information critical to not just regulators but also markets scattered throughout the world. While such a situation may or may not present difficulties during *normal* times, incomplete information during times of market stress can complicate the work of both regulators and markets. Making matters even more difficult, national regulatory and legislative solutions to address the current crisis may prove inadequate or even contradictory – potentially leading to either regulatory gaps or regulatory arbitrage – if these solutions fail to take into consideration the global nature of many market participants and the need to coordinate regulatory responses to properly address the diffuse nature of market information today.

In other words, without enhanced supervisory cooperation and information-sharing among the world's securities market regulators, many of the regulatory reforms that have been proposed around the world may prove insufficient to the tasks for which they are being designed. While regulators have different supervisory approaches, each has a common interest in information-sharing and cooperation based on earned trust in each others' regulatory and supervisory systems.

This Report analyzes the different types of regulated entities that operate in the markets and how their operations have globalized. Based on this analysis, the Report offers suggestions as to how regulators can enhance cross-border cooperation to better supervise the entities they regulate that have expanded their operations across borders. The Report also suggests that regulators expand the notion of supervisory cooperation to establish mechanisms to consider and evaluate the global market. Instead of narrowly focusing on entity-specific oversight, regulators should explore opportunities to further collaborate on identifying, assessing and mitigating emerging risks and seek to address and evaluate them on a global basis.

This Report likewise describes different types of collaborative mechanisms that securities regulators may use to foster greater supervisory cooperation, including ad hoc discussions, memoranda of understanding (MOUs), supervisory colleges and networks of regulators. This

Report analyzes the advantages and disadvantages of each form. These mechanisms, however, should not be viewed independently of each other. An ideal cross-border supervisory cooperation strategy by a securities regulator will rely on as many of these mechanisms as appropriate because their interlocking and self-reinforcing character improves the quality, scope and timeliness of the information a regulator is likely to receive from its overseas counterparts.

Before supervisory cooperation can be effectively implemented, obstacles that hinder these efforts must be considered and if possible removed. The Report highlights several existing obstacles to cooperation that regulators should be aware of and, depending on the circumstances, may wish to address in order to make supervisory cooperation more effective. These obstacles include legal and organizational impediments to sharing information. IOSCO members have each implemented regulatory and supervisory programs, consistent with their legislative mandates, that suit the needs of their markets and investors. Arrangements for implementing or enhancing supervisory cooperation will necessarily reflect the differing regulatory and oversight programs of the regulators.

While the goal of enhancing supervisory cooperation arrangements among IOSCO members does not seek to promote any particular approach to supervision, more consistent implementation of IOSCO principles by IOSCO members will lead to converged approaches to supervision thereby facilitating collaborative oversight of regulated entities that are globally active.

Finally, this Report distills this discussion of the critical elements of supervisory cooperation into a set of principles designed to guide IOSCO members in developing cooperative supervisory arrangements amongst themselves, tailored to their own markets and circumstances and their own legal powers and requirements. These principles include:

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### ***General Principles Relating to Cooperation***

1. Authorities should, on the basis of mutual trust, consult, cooperate and be willing to share information to assist each other in fulfilling their respective supervisory and oversight responsibilities for regulated entities operating across borders, such as intermediaries, collective investment schemes, hedge funds, credit rating agencies, clearing organizations, trade warehouses and markets.
2. Where obstacles to supervisory information-sharing exist, authorities should undertake to address such obstacles.
3. Authorities should consult with each other and share risk analysis assessments and information to support the identification, assessment and mitigation of risks to markets and investors.
4. Authorities should consult, cooperate and, to the extent possible, share information regarding entities of systemic significance or whose activities could have a systemic impact on markets.
5. Authorities should cooperate in the day-to-day and routine oversight of internationally-active regulated entities.

6. Authorities should provide advance notification and consult, where possible and otherwise as soon as practicable, regarding issues that may materially affect the respective regulatory or supervisory interests of another authority.

#### ***Principles Relating to the Mechanisms for Cooperation***

7. Mechanisms for supervisory cooperation should be designed to provide information both for routine supervisory purposes and during periods of crisis.
8. Authorities should undertake ongoing and *ad hoc* staff communications regarding globally-active regulated entities as well as more formal periodic meetings, particularly as new or complex regulatory issues arise.
9. As appropriate, authorities should enter into memoranda of understanding to share relevant supervisory information in their possession.
10. In the event of significant cross-border linkages, affiliations, combinations or mergers among regulated entities such as exchanges, intermediaries, credit rating agencies and clearing organizations, authorities should commit to and establish colleges for working together in the oversight of the combined entities.
11. IOSCO should use the Standing Committee networks for consultation in identifying, assessing, and where appropriate, addressing emerging regulatory issues and risks that may have material cross-border implications in areas such as, for example, issuer disclosure and governance, market transparency, conflicts of interest among market intermediaries and risks that may be arising on the perimeters of current regulation.

#### ***Principles Relating to the Mechanics, Process, Terms and Conditions of Cooperation***

12. Requests for information should make clear the supervisory reasons underlying the requesting authority's interest so that the requested authority is better able to understand the nature, scope and purpose of the request, whether it has a related interest in the matter, and whether it may have additional unsolicited information that may be of assistance to the requesting authority.
13. Where requested information is in the possession of unsupervised third parties, an authority should use its best efforts to gather the information or, where permitted by law, obtain that information on behalf of the requesting authority or assist the requesting authority in obtaining the information directly from the third party.
14. In connection with regulated entities that operate across borders, authorities should establish procedures for cooperation, including, where applicable, for discussion of relevant examination reports, for assistance in analyzing documents or obtaining information from a regulated entity and its directors or senior management, and for collaboration regarding the timing, scope and role of authorities with respect to any cross-border on-site visits of a regulated entity.
15. Supervisory information obtained from another authority should be used only for purposes agreed upon by the authorities.

16. Supervisory cooperation arrangements should describe the processes the parties should use if an authority subsequently determines that it needs to use requested supervisory information for law enforcement or disciplinary purposes, such as obtaining the consent of the requested authority and handling such information in accordance with the terms of existing MOUs for enforcement cooperation.
17. Authorities must establish and maintain appropriate confidential safeguards to protect all non-public supervisory information obtained from another authority.
18. Supervisory cooperation arrangements should describe the degree to which an authority may onward-share to a third party any non-public supervisory information received from another authority, and the processes for doing so (such as, for example, obtaining the consent of the requested party before onward-sharing any non-public supervisory information received). Where appropriate, authorities should consider whether abbreviated mechanisms for onward-sharing could be developed in appropriate circumstances, for example for third authorities (foreign or domestic) with a direct regulatory interest in the regulated entity.

Accompanying this Report is an annotated Sample Supervisory Memorandum of Understanding that may serve to assist IOSCO members when designing bilateral supervisory arrangements. This Sample Supervisory MOU is not designed to serve as a model MOU. Rather, it describes the issues and possible provisions that may prove effective for supervisory cooperation arrangements, and illustrates some (though clearly not all) of the ways different jurisdictions might approach regulatory and legal issues that might arise when constructing such arrangements in practice. Fundamentally, the terms of any arrangement will have to be determined by the parties to such an arrangement and will necessarily reflect their own legal and regulatory circumstances and needs.

## Chapter 2 Introduction

The recent financial crisis has reinforced in securities regulators their view that efficient and effective securities markets require fair, effective and comprehensive regulation vigorously implemented and enforced by securities and other regulators with comprehensive inspection, enforcement and oversight powers and backed by adequate resources and staff expertise. However, the nature of the financial contagions that have spread across national boundaries have also highlighted that fair, effective and comprehensive regulation and oversight at the national level may not be sufficient to prevent future financial crises. Over the past several decades, modern securities markets, and many market participants, have become fully *globalized*, with operations stretching across borders, drawing on investment capital around the world and looking for investment opportunities in many different countries. At the same time, and for the foreseeable future, market oversight remains a *local* affair, with national or provincial-level regulators implementing legislation passed by their jurisdictions' legislatures.

Legislatures and financial regulators throughout the world have recommitted themselves to strengthening their financial regulatory systems to address the weaknesses that the recent market crisis has uncovered. In many cases, however, the global nature of many market participants (large investment banks, credit rating agencies, investment advisers, hedge funds, *et al.*) will likely make purely domestic responses to regulatory weaknesses less than fully effective. Globally-active market participants often maintain significant portions of their operations, data, staff, capital and assets in multiple jurisdictions. While regulators often respond by mandating that a regulated entity's overseas operations must comply with domestic standards and oversight requirements prior to being permitted to engage in domestic business, confirmation and enforcement of these requirements can prove challenging. Even where securities regulators have in place enforcement cooperation mechanisms such as the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMOU),<sup>1</sup> the *day-to-day* information outside of an enforcement context that a regulator needs in order to exercise effective oversight may be difficult to access without the assistance and cooperation of the relevant counterpart.<sup>2</sup> While regulators have different supervisory approaches, each has a common interest in information-sharing and cooperation based on earned trust in each other's regulatory and supervisory systems.

IOSCO is a leader in developing global policies for securities regulators and consistent implementation by members of IOSCO principles facilitates cooperation in the oversight of

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<sup>1</sup> The IOSCO MMOU is accessible via the Internet at:  
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf>.

<sup>2</sup> Laws and rules in a number of jurisdictions require regulated entities to provide the relevant regulator with certain types of information, regardless of where they are located, as a condition for being registered or licensed in their jurisdictions. However, in light of laws relating to sovereignty and information access, it can be difficult for a regulator to know whether a regulated entity is adhering to these requirements absent the assistance of local regulatory counterparts. While enforcement cooperation between securities regulators via an IOSCO MMOU request or through a bilateral enforcement cooperation mechanism may uncover whether a regulated entity has been providing all the information required of it, keeping appropriate records, and acting as otherwise mandated under the law, enforcement cooperation mechanisms (including the IOSCO MMOU) usually require that the requesting authority be actively investigating a suspected breach of domestic securities regulations. Enforcement cooperation arrangements typically do not contemplate the exchange of information for prudential or oversight purposes, where no specific violations are suspected.

regulated entities that operate across borders. IOSCO also has extensive experience in developing international cooperative standards in the enforcement context and is thus well-suited to develop principles for cooperation among securities regulators.<sup>3</sup> The IOSCO Technical Committee formed the Task Force on Supervisory Cooperation as a means to consider in depth how its members can implement ways to oversee the activities of global market participants and to develop mechanisms to improve cross-border supervisory cooperation among securities regulators. IOSCO has encouraged cooperation among its members and recognized the importance of supervisory cooperation. The *IOSCO Objectives and Principles of Securities Regulation* contain principles directed at the supervision of regulated market participants and are considered necessary components of an effective securities regulatory program. While each IOSCO member has implemented a regulatory program that best suits the needs of its investors (often mirroring the IOSCO Objectives and Principles of Securities Regulation in doing so), the enhancement of supervisory cooperation among IOSCO members may lead to a recognition by more IOSCO members of the benefits of consistent implementation of IOSCO regulatory principles, possibly further enhancing the supervision of the global and domestic markets and market participants.

This Report lays out a set of principles that IOSCO members can use when developing supervisory cooperation arrangements, including MOUs, supervisory colleges and regulatory networks. Such arrangements are meant to enhance domestic oversight of regulated entities and should not be seen as replacing or superseding the domestic regulatory obligations of any regulator. Indeed, enhancing supervisory cooperation among regulators should not be seen as an exercise of dividing oversight responsibilities among regulators. Rather, it should be viewed as a mechanism to assist regulators in fulfilling their obligations to their own domestic investors and markets. At the same time, by coordinating with each other in the oversight of globally-active regulated entities, regulators should be able to better monitor emerging risks to the global markets.

This Report analyzes the need for supervisory cooperation independent of an enforcement context. It describes the forms of cooperation that may be effective to supervise globally-active regulated entities, particularly with regards to their compliance operation, financial condition, and risk exposure – all elements of global operations that have been implicated as contributing to the financial crisis, and information about which regulators frequently now share only on an ad hoc basis, if at all.

Absent supervisory cooperation of some type, IOSCO members likely will find it increasingly difficult to exercise adequate oversight over regulated entities in their markets that operate across borders. As market participants' businesses reach across borders, regulators will continue to need to expand their oversight to those overseas portions of their regulated entities' businesses. If regulators limit their oversight to only those operations contained within their borders, they may be unable to fully monitor their domestic market, to the detriment of investors. Only when regulators have a global view of their regulated entities' operations will they likely be able to fully assess whether there are regulatory areas that need to be addressed. Absent such cooperation, the most viable alternative may require a securities regulator to respond by mandating that all critical elements of a regulated entity's operations take place only within its borders – a requirement likely to prove incompatible

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<sup>3</sup> In 1991, the Technical Committee published the enforcement-related Principles for Memoranda of Understanding. These principles led to the establishment of the IOSCO MMOU in 2002, which is regarded as the benchmark for international enforcement-related cooperation.



with a globalized financial market and that may eventually result in market isolation and fragmentation. Supervisory cooperation among regulators also has the added benefit of potentially making more efficient multiple reporting requirements resulting from regulated entities operating in multiple markets.

## Chapter 3 The Objectives of Securities Regulation in an Era of Globally-Connected Capital Markets

In 1998, IOSCO first published its *Objectives and Principles of Securities Regulation* (IOSCO Principles), an international consensus of core principles around which a robust and effective securities regulatory system should be built. While the IOSCO Principles have been updated since 1998, and are in the process of being reviewed, the three fundamental objectives of securities regulation identified in 1998 remain unchanged: (1) the protection of investors, (2) ensuring that markets are fair, efficient and transparent, and (3) the reduction of systemic risk.<sup>4</sup>

These three objectives are closely related and, in some respects, overlap, as is reflected in the variations these three tenets have taken within national regulation. Many of the requirements that help to ensure fair, efficient and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many measures that reduce systemic risk also protect investors. Thorough surveillance and compliance programs, effective enforcement, and close cooperation with other regulators give effect to all three objectives.

While the IOSCO Principles set out three overarching objectives that securities regulators should seek to achieve when developing a regulatory system, they also provide more detailed guidance for regulators developing the specifics of their regulatory framework. For example, when describing how the objective of protecting investors can be achieved, the IOSCO Principles state that investors should be protected from misleading, manipulative or fraudulent practices. Investors should receive full disclosure of information material to their decisions, which also requires high quality and internationally accepted accounting and auditing standards to be in place. Protecting investors also requires that only duly licensed or authorized persons who are properly capitalized should be permitted to hold themselves out to the public as providing investment services. Market intermediaries should meet certain minimum standards, and treat investors in a just and equitable manner. There should be a comprehensive system of inspection, surveillance and compliance programs. Furthermore, when a breach of law occurs, investors should be protected through the strong enforcement of the law. Investors should have access to a neutral mechanism or means of redress and compensation for improper behavior.

When describing how to ensure that markets are fair, efficient, and transparent, the IOSCO Principles highlight the significance of the regulator's approval of exchange and trading system operators and review of trading rules. For example, the IOSCO Principles describe how market structures should not unduly favor some market users over others. Regulation should detect, deter and penalize market manipulation and other unfair trading practices. Investors should be given fair access to market facilities and market or price information, and regulation should promote market practices that ensure fair treatment of orders and a price formation process that is reliable. Regulations should also promote market efficiency by requiring timely and widespread dissemination of relevant information, which is reflected in the price formation process. Markets should also be transparent – i.e., the information about trading (both for pre-trade and post-trade information) should be made publicly available on a real-time basis.

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<sup>4</sup> IOSCO Objectives and Principles of Securities Regulation (May 2003), available via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

Perhaps particularly relevant to securities markets today in light of the recent financial crisis, the IOSCO Principles state that, to achieve the reduction of systemic risk, regulation should aim to reduce the risk of failure by regulated market intermediaries by, for example, setting capital and internal control requirements. While not unnecessarily stifling legitimate risk taking, regulation should promote and allow for the effective management of risk and help ensure that capital and other prudential requirements absorb some losses and check excessive risk taking. In addition, margin requirements are an important buffer against risk. Likewise, an efficient and accurate clearing and settlement process that is properly supervised and utilizes effective risk management tools is essential. Finally, transparency is essential to reduction of systemic risk, with comprehensive disclosure by issuers and market participants providing investors, other market participants and regulators with an indication of risk in the market. This, in turn, can help eliminate concentration of the types of *hidden* risk that has recently threatened the stability of the financial system.

Finally, the IOSCO Principles recognized the need for global cooperation and information sharing as tools to mitigate market disruptions. Specifically, the IOSCO Principles noted that “[i]nstability may result from events in another jurisdiction or occur across jurisdictions so regulators’ responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.”

## Chapter 4 Supervision of Regulated Entities in a Global Market

Effective oversight that satisfies the three central objectives of securities regulation depends on effective and thorough supervision and enforcement,<sup>5</sup> which can help ensure that regulated entities comply with the rules and operate in ways that promote the safety, fairness and stability of the overall financial system. In general, certain market participants are subject to regulation and supervision in the jurisdictions in which they operate or provide services. In some instances, market participants will establish a physical presence within a jurisdiction in which they intend to provide services. Alternatively, some market participants provide services in a jurisdiction from remote locations without establishing a physical presence within a jurisdiction. Regardless of the means – whether by establishing a physical presence or electronic presence – the provision of services to investors within a jurisdiction typically results in the market participant becoming subject to the laws and regulation of the jurisdiction.

The first line of regulation is typically a registration or licensing requirement. A registration process assists a regulator in assessing an applicant’s ability to operate in compliance with applicable regulatory requirements. Depending on the type of registrant, registration requirements typically mandate that the registrant provide the regulator with information regarding such things as its planned regulated activities, financial health, corporate governance structure and management. Registration requirements usually are designed not just to protect investors against fraud or fraudsters, but also to help ensure that the proposed market participant is adequately capitalized, that its risk positions are properly monitored and that internal controls are in place to prevent unauthorized activities or conduct of the type that can place the entire entity at risk.

Thereafter, as a regulated entity, the registrant is typically subject to continuing oversight requirements and subject to inspection and examination.<sup>6</sup> As the IOSCO Principles recognize, a “regulatory system should ensure an effective and credible use of inspection . . . and implementation of an effective compliance program.” Accordingly, once registered, a regulated entity may be required to file periodic reports or to keep specified books and records that are subject to review by the regulator. Further, a regulator may establish a formal inspection and examination program in which the regulator assesses the regulated entity’s activities to ensure compliance with applicable regulatory standards. On-site supervisory visits and inspection and examination programs typically provide regulators with the ability to review the books, records and premises of a regulated entity, interview management and employees, and analyze the entity’s operation. Inspections and examinations may occur at the offices of the regulated entity but in many instances occur by the entity providing its books and records to the regulator for review and evaluation.

There are several types of inspections and examinations that can be part of a comprehensive oversight program, depending on the types of regulated entities involved and the nature of the

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<sup>5</sup> For purposes of this report, the term “supervision” includes review of filed reports, market surveillance, examinations and other mechanisms by which a regulator confirms day-to-day compliance by regulated entities with securities laws, regulations, prudential regulatory requirements, self-regulatory organization (SRO) rules, and internal requirements, even absent suspicion that a violation may have occurred.

<sup>6</sup> In some jurisdictions, the supervisory function is conducted by an entity that is separate from the regulator.

regulation and oversight regime.<sup>7</sup> Because regulators often lack the resources necessary to frequently inspect or examine the large number of regulated entities within their jurisdiction, risk-identification or risk-assessment methodologies are sometimes used to identify those risks that warrant additional inspection and examination. Such a methodology might include, for example, an internal database for examiners and managers to use to identify and prioritize risks and to recommend regulatory, examination or other actions that could be taken to address or mitigate the risks identified. A regulator may then sort and analyze its risk information to identify potential high-risk areas, prioritize risks for examination attention and allocate program resources. Risk-assessments may also be used for inspection and examination training initiatives to educate examiners about risk details, identifiable focus areas and examination program priorities. Risk information might also be shared with other members of the regulator's staff for their consideration in evaluating policy priorities.

Since many regulated entities do not limit their activities to within their home borders, the ability to assess a registrant's global activities may be extremely useful in assessing its local activities and whether it is operating in compliance with domestic regulatory requirements. Similarly, threats to systemic stability are not necessarily confined to domestic activities and may include the behavior of individual market participants in other jurisdictions. Effective oversight of regulated entities in a modern globally-connected market is far more complicated today than it was in the past when regulated entities were often located in only one jurisdiction, and frequently in only one city.

As such, supervisory cooperation across borders is a necessary element of a regulatory system and separate from the enforcement cooperation that IOSCO members have so successfully developed over the past decade. The challenge for IOSCO members today is to determine how they can enhance their relationships with each other to better oversee global market participants in the future. By coordinating supervisory efforts with their counterparts, regulators should realize a more comprehensive oversight program at home.

Even in cases where regulators require their globally-active regulated entities to provide them with information on their worldwide operations, information provided by the regulated entity alone may be insufficient for supervisory purposes. Recent financial scandals have included several cases where issuers or regulated entities have provided regulators and auditors with forged documents and falsified data. The ability to confirm information provided by a regulated entity from independent sources often requires accessing information or witnesses located in other jurisdictions. Further, the full significance of information about offshore activities may not be clear from its face, so regulators may benefit from contextual information and analysis provided by other regulators. While IOSCO members have had great success in the past acquiring such information in an enforcement context via the IOSCO Multilateral Memorandum of Understanding (MMoU) and other bilateral enforcement MOUs, these enforcement cooperation arrangements may prove inadequate where

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<sup>7</sup> In accordance with national practice, these types of examination can include: *risk-based examinations* that seek to determine the extent, scope, and danger of emerging risks; *periodic examinations* designed to periodically test a regulated entity's compliance with applicable laws and regulations pursuant to a schedule set by the regulator; *cause examinations* to confirm concerns about violations of the securities laws based on press reports, complaint letters, information provided by other regulators, tips, or other indications of wrongdoing; *oversight examinations* (in those jurisdictions with SROs) designed primarily to test the quality of the SRO's examinations of its members or test directly SRO members' compliance with applicable securities laws and the SRO's rules; and *oversight inspections* to examine the SRO's themselves for compliance with relevant laws and rules.

confirmation of routine information gathered as part of a regulator's examination is concerned. Moreover, certain jurisdictions, based on considered policy choices, restrict the ability of regulated entities to directly provide information to regulators abroad. This has important implications for overseeing entities that seek to operate across borders. Indeed, in these instances, cooperation becomes all the more important.

Broadly speaking, there are two different scenarios where the cross-border activities of regulated entities call for an enhanced degree of supervisory cooperation and coordination. The nature of the cooperation and coordination, however, may differ under each of the scenarios. The first involves a regulated entity located in one regulator's jurisdiction, but which also has affiliate offices located abroad. In light of the fact that an affiliate's activities may have important implications for a regulated entity, a regulator may need to obtain the assistance of the counterpart charged with oversight of the affiliate in assessing, for example, the affiliate's financial condition, compliance culture or risk profile.

Second, a considerable degree of supervisory cooperation likely will be necessary in situations where a regulated entity provides services in multiple jurisdictions and thus is subject to regulation by multiple regulators. Typically, a regulated entity will be required to register and be subject to the regulation of each jurisdiction in which it operates. Close supervisory cooperation between the regulators charged with overseeing such entities is important, both to avoid placing these regulated entities in situations where they face (unnecessarily) conflicting regulation, but perhaps also to limit duplicated effort and unnecessary costs to both the regulated entities and the regulators involved.<sup>8</sup> They also allow for different approaches to supervision that regulators might take to benefit each other, providing the partner regulators with a *second perspective* that might shed light on issues that one perspective alone might miss.

For jurisdictions that have adopted a form of shared oversight (for example, a form of mutual recognition, or a *home-host* model), cooperation can take the form of leaving supervision of the foreign-based entity entirely to the home regulator. This type of cooperation predicated on a common or comparable set of laws and rules and a legal regime that supports such an approach. However, in some other instances, such an approach may not be legally possible or practically feasible. Indeed, different regulators with whom a regulated entity is registered often administer and enforce differing regulatory and supervisory regimes. In this latter circumstance, regulators, through consultation, cooperation and collaboration, may need to assist one another in checking for compliance with their respective requirements through either, or both, information-sharing or cross-border on-site visits.

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<sup>8</sup> In some cases, conflicting regulation may be an unfortunate but unavoidable risk to global market participants because different regulators may operate under different legal systems or have different regulatory philosophies or policies. In other situations, however, the conflicts may be inadvertent and not reflect any real differences in regulatory philosophy or policy. In such cases, a degree of supervisory cooperation may eliminate the conflict without sacrificing the policy goals of either regulator. Likewise, some duplicated regulatory requirements may be unavoidable and reflect genuine regulatory needs; in other cases, regulatory duplication and overlap might be minimized through supervisory cooperation and information-sharing, to the benefit of both regulators and the entities they regulate.

## **Chapter 5   Obstacles to Cooperation**

As with enforcement cooperation, legal obstacles are likely to be the greatest impediment to the implementation and enhancement of supervisory cooperative arrangements, restrictions on the ability of regulators to obtain and share relevant information with their overseas counterparts are a source of concern. Other challenges also exist. Sometimes regulators are hesitant to engage in cooperative supervision arrangements due to the concern that by doing so they would be relinquishing their oversight responsibilities to another regulator. Regulators may also be concerned that they will lose control of the oversight of their domestic market participants. A third concern might be that they lack sufficient resources to adequately provide other regulators with meaningful assistance without undermining their own oversight programs. One of the goals of IOSCO in developing more comprehensive oversight principles is to address these concerns in the hope that at the end of this process all IOSCO members will recognize the utility of enhanced cooperation.

At the outset, regulators should recognize that supervisory cooperation is a mechanism for enhancing domestic oversight. It is not a mechanism for altering regulatory obligations or limiting regulatory responsibility with respect to regulators that have regulated entities in common. While ultimately each regulator remains obligated to oversee its markets and protect its investors, regulators may come to the conclusion that having the same oversight tools that are developed by consistent implementation of IOSCO principles might assist them in achieving their goals. These obligations are not lessened, allocated or changed by the existence of supervisory cooperation arrangements.

Further, regulators may recognize significant benefits from the oversight of other regulators in the activities of regulated entities in their jurisdiction. As a practical matter, it is likely inevitable that they will have similar interests in regulated entities in another jurisdiction as well. Fundamentally, supervisory cooperation, like enforcement cooperation, is an exercise in reciprocity and the recognition of shared goals; the assistance one regulator provides another today is quite possibly the same assistance that that regulator will call upon from another in the near future, and the information that one regulator provides another may well be the missing piece of a puzzle that will allow the other regulator to notify the first of a significant risk to its own market.

To address these concerns, IOSCO and individual member jurisdictions should consider undertaking further work to promote supervisory cooperation, including enhancing staff cooperation, through periodic review and improved communications, as well as by helping ensure that information and documents are gathered in accordance with the procedures applicable in a jurisdiction by persons appointed or designated by the regulator.

In addition, IOSCO members should consider the benefits to the global financial system of permitting counterpart regulators from other jurisdictions to communicate with, obtain information or documents from, or (where permitted by law) even conduct on-site visits of, entities subject to regulation in one jurisdiction that are located in the territory of another. However, to help ensure that such access does not tread on important national sovereignty issues, the context for such regulatory access should be clarified. Such a framework should be developed in a manner that will not prejudice the respective positions of regulators and their governments concerning the principles of international law which may be applicable to them with regards to procedures for obtaining information located in another jurisdiction.

That said, for supervisory cooperation to be effective, provisions of local laws pertaining to confidential information should not impede the possibility of regulators sharing critical market-related information.

Finally, regulators should recognize that, absent supervisory cooperation of some type, they will in many cases be unable to exercise effective oversight over regulated entities in their markets that operate across borders. One superficially attractive alternative to supervisory cooperation – a requirement that critical elements of a regulated entity’s operations take place only within one’s borders – likely will prove incompatible with a globalized financial market if widely adopted, with resulting market isolation and fragmentation a very real risk.



## Chapter 6 Cross-Border Cooperation in the Supervision of Different Types of Regulated Entities

When considering means to establish and enhance the supervision of globally-active regulated entities, regulators need to evaluate the nature of these entities, how their operations are conducted across borders, and the degree to which information that the regulator requires domestically is available for entities with operations abroad. Since these entities, regardless of their legal structures, typically are financially and legally exposed to other markets in ways that purely domestic entities are not, regulators need to keep in mind how these entities are regulated in the other jurisdictions in which they operate, the existence of any regulatory differences with these jurisdictions, and the nature of how they are supervised abroad so that they can carry out their regulatory mandates.<sup>9</sup> Generally speaking (and absent an arrangement whereby one regulator relies on the oversight provided by a “home” regulator with regard to entities based in the home regulator’s market), when a foreign-based market participant registers to provide services in a jurisdiction, the securities regulator will require the registrant to provide it with information regardless of where that information may reside. Access to information and confirmation of its accuracy, however, may require the assistance of an overseas regulator and, for a variety of reasons discussed more fully below, effectively analyzing these cross-border regulatory factors requires a degree of supervisory cooperation and information sharing that may exceed what has been typical in the past.

### A. Market Intermediaries

*Market intermediaries*, generally speaking, are those persons and entities in the business of managing individual portfolios, executing orders, dealing in or distributing securities and providing information relevant to the trading of securities.<sup>10</sup> Investment advisors, for example, are a type of market intermediary that is principally engaged in the business of advising others about the value of securities or the advisability of investing in, purchasing or selling securities.<sup>11</sup>

The first contact an investor typically has with the financial markets is with a market intermediary and it is with a market intermediary that an investor will maintain a direct, on-going relationship. Accordingly, the regulation of market intermediaries focuses heavily on the protection of investors. The recent crisis, however, has revealed the devastating impact that the activities of large, global market intermediaries can have on the financial markets. Consequently, in addition to focusing on investor protection, regulators have been considering ways to oversee the activities of market intermediaries for purposes of monitoring systemic risk. In short, given what market intermediaries do, securities regulators tend to focus on three aspects of an intermediary in terms of ongoing supervision and surveillance:

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<sup>9</sup> The Technical Committee recognizes that its members take different unique approaches to regulating and supervising market participants. This report does not opine on or otherwise evaluate the merits of any particular regulatory or supervisory approach. The differences in regulatory or supervisory approaches may determine the type of information, if any, that regulators may need and may share for the purposes of fulfilling their supervisory responsibilities. See e.g., *Multi-jurisdictional Information Sharing for Market Oversight*, Final Report, April 2007.

<sup>10</sup> IOSCO Objectives and Principles of Securities Regulation (May 2003).

<sup>11</sup> *Id.*

- (1) the risk profile of the firm,
- (2) its financial condition, and
- (3) its compliance culture with respect to conduct of business requirements.

Initial registration requirements, ongoing obligations to make and keep certain books and records, regulatory reporting requirements and the regulator's ability to monitor a market intermediary via its inspection and examination program should provide the regulator with sufficient information about all three of these facets of a regulated intermediary's domestic operations, and ideally should provide sufficient information about its overseas operations as well.

More specifically, while individual jurisdictions have established regulatory schemes that are unique to their markets, there is an international consensus that certain market intermediary regulation should include (among other things) criteria for entry, capital and prudential requirements, ongoing supervision and discipline of entrants, and mechanisms to address the consequences of default and financial failure. In addition, the regulation of market intermediaries may depend, in part, on their functions, i.e., whether the market intermediary trades on behalf of customers or whether the market intermediary has custody of customer assets. The primary focus of such regulation is on areas where market intermediaries' capital, their clients' money and public confidence may most be put at risk. Given the complexities of many modern firms, shared information among a firm's regulators in different jurisdictions should help provide a given regulator with a much clearer picture of the amount of risk the firm has taken on, its financial condition, its compliance operations, and how all three elements may have an effect on investors.

Market intermediaries are increasingly reaching across borders to provide their services in an effort to increase their client base. Some market intermediaries have established subsidiaries in foreign jurisdictions to provide services to investors located in foreign jurisdictions. Others have expanded the services they provide to their home jurisdiction clients, such as offering executions of foreign securities in foreign markets.

As regulators assess the financial market crisis, they have become increasingly aware of the gaps in oversight that exist for market intermediaries that operate globally. In addition, recent financial fraud cases have highlighted the need for regulators to work together in overseeing the activities of these entities. While market intermediaries' businesses have expanded beyond the borders of their home jurisdictions, regulators to a large extent have remained within their own borders when exercising their oversight powers. Although securities regulators have developed some cooperative oversight of global market intermediaries,<sup>12</sup> the current question is how, and how far, securities regulators can build upon, and learn from, these existing arrangements, to include more jurisdictions, and to create more robust regulatory oversight, on an ongoing rather than *ad hoc* basis.

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<sup>12</sup> A number of jurisdictions currently have in place bilateral supervisory cooperation MOUs that vary with regard to their terms. Not every jurisdiction, however, requires the existence of an MOU in order to provide supervisory assistance to a foreign counterpart since memoranda of understanding are only nonbinding statements describing the intentions of the parties, their legal capabilities to assist each other, and specifying the format requests for assistance should take.

Robust cooperative agreements may help regulators determine whether market intermediaries' activities present a systemic risk, for example, by allowing them to monitor capital reserves held across jurisdictions. Even if in many jurisdictions the internationally active market participants tend to be banks (and thus are covered by banking regulators' cross-border oversight arrangements), developing robust supervisory cooperation arrangements in the securities sector, to the extent that is subject to securities regulators' jurisdiction, may also allow securities regulators to evaluate threats to investor protection, for example, by checking to see whether market intermediaries that hold customer funds and assets in multiple jurisdictions are keeping them safe and in a manner consistent with securities regulatory requirements. Finally, since a market intermediary's compliance function plays an important role for both investor protection and systemic risk purposes (among many other things), regulators that share information about the compliance *culture* they observe in a market intermediary's offices in their jurisdiction, and any concerns they might have in this area, can enable other regulators to work together to determine whether any problems are local or indicative of entity-wide compliance issues.

## **B. Securities Exchanges and Markets**

When considering the term *market*, one generally envisions a place where investors can meet to buy and sell securities. A market can take various forms, from a traditional stock exchange where people interact on a physical trading floor to execute their customers' orders to a modern electronic trading system comprising computer screens located on the desks of market participants in remote locations who execute their customers' orders electronically. Modern securities markets range from stock exchanges to off-exchange or over-the-counter (OTC) markets, consisting of such things as dealer proprietary systems and electronic communications networks.

For purposes of the IOSCO Principles, the term *market* is defined as including traditional organized exchanges and off-exchange market systems,<sup>13</sup> facilities and services relevant to equity and debt securities, options and derivative products.

Regardless of the form, some degree of regulation of these markets is necessary to achieving even the basics of the regulator's objectives.<sup>14</sup> The core function of the trading markets is the execution of investors' orders and many integral components of the financial markets at large flow from the performance of this function. The execution of orders alerts investors as to the value of securities and their supply and demand. The quotes and trade execution reports that are generated by the markets are used by investors for price discovery and are indications of the opinions of other investors as to a security's value. The regulation of financial markets therefore focuses on transparency and its impact on investor protection. The facilitation of price discovery also fosters efficient markets, in turn boosting investor confidence.

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<sup>13</sup> When describing "off-exchange market systems," IOSCO included electronic bulletin boards and proprietary systems developed by intermediaries that typically offer their services to other brokers, banks and institutional investors who meet certain credit standards set by the operator.

<sup>14</sup> The form of the market does, however, impact the level of regulation. When determining the appropriate level of regulation for a market, regulators typically consider the characteristics of the market, including its structure, the sophistication of its users, its rights of access, and the types of products traded.

Regulators typically require markets that operate within their jurisdiction to register and be subject to regulation and oversight. The supervision of registered markets thereafter may include regulatory filing requirements, such as obligations to file changes to the operating rules of the market and requirements to make and keep certain books and records that are subject to inspection and examination by the regulator.

Those IOSCO Principles dealing with secondary markets are largely written for the regulation of individual markets. Some secondary markets, however, are interconnected with individual markets trading the same products by the same market participants. Modern stock exchanges and OTC markets operate across borders. In recent years, many securities markets have been exploring ways to expand their services to reach a greater number of investors. Some markets have established operations in foreign jurisdictions. Others have allowed remote access to their market from foreign jurisdictions. Some markets have expanded their product base, for example, by listing and/or trading the same securities (or derivatives thereof) that are listed/or traded in a foreign jurisdiction. Therefore, the information that securities regulators require of securities markets in their jurisdictions increasingly involves information that may be located abroad. Accordingly, cooperative supervision can be a necessary component of market supervision.

Some trading venues (particularly *demutualized* exchanges that operate as for-profit companies) operate markets in more than one country and thus present regulators with many of the same cross-border supervisory concerns outlined with regard to market intermediaries. Indeed, some of the first multilateral international supervisory cooperation arrangements among securities regulators were created as a result of mergers of stock exchanges operating in different jurisdictions.<sup>15</sup>

While OTC markets by their nature may not be as formalized as exchanges, the cross-border nature of the participants in these markets, and the securities and derivatives they trade, in many cases present even more problematic cross-border issues for regulators to tackle. Even some purely domestic OTC markets may trade derivatives in which the underlying product or reference price is traded, produced or derived on markets located abroad. The recent crisis has keenly focused regulators' attention on the OTC derivatives market and as jurisdictions consider this market and whether or how to regulate it, developing cooperative oversight arrangements regarding these markets may prove particularly important to protecting the wider market against systemic failures.<sup>16</sup>

The Technical Committee recently explored multi-jurisdictional information sharing for overseeing markets and has identified information that regulators may need to share when supervising two specific types of global activities of the markets: (1) the operation of a foreign market within a jurisdiction and (2) the listing and/or trading of the same or closely related financial instruments in different countries.<sup>17</sup> In both situations, the Technical

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<sup>15</sup> See, for example, the Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight between the U.S. SEC and the College of Euronext Regulators (January 25, 2007), which is accessible via the Internet at: [http://www.sec.gov/news/press/2007/2007-8\\_mou.pdf](http://www.sec.gov/news/press/2007/2007-8_mou.pdf).

<sup>16</sup> See, for example, *Unregulated Financial Markets and Products, Final Report* (IOSCO, September 2009), which is accessible via the Internet at : <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf>.

<sup>17</sup> See *Multijurisdictional Information Sharing for Market Oversight, Final Report*, April 2007 ("Market Oversight Report"). The Market Oversight Report defined a "market" as facilities for trading securities and/or derivative products, but not clearing facilities.

Committee's Market Oversight Report concluded that a regulator may need the assistance of a foreign counterpart when supervising the activities of a regulated market within its jurisdiction.

### **C. Clearing and Settlement Systems**

Once a trade execution has occurred, it must be cleared and settled. Clearing and settlement systems provide the process of presenting and exchanging data or documents in order to calculate the obligations of the participants in the system, to allow for the settlement of these obligations and the process of transferring funds and/or securities. They may also provide central counterparty services. Central counterparties (CCPs) that have appropriate risk management arrangements can reduce the risks that clearing and settlement systems' participants face and contribute to financial stability.<sup>18</sup>

As market intermediaries and securities markets have globalized, the clearing and settlement systems likewise have expanded their services to accommodate cross-border trading. For example, clearing and settlement systems have been considering means to permit foreign market participants to have direct membership in their systems. In addition, some clearing and settlement systems have established linkages with foreign clearing and settlement systems to facilitate cross border transactions. Further, some clearing and settlement systems have started to provide services for the clearing and settlement of transactions in foreign securities.

Because of the important role clearing and settlement systems play in the securities markets, the IOSCO Principles state that they should be subject to direct supervision, which includes review of the system mechanisms and operating standards. The systems should also be subject to inspection and periodic review by the regulator. In addition, clearing and settlement systems should provide regulators with reports and submit to periodic and, if necessary, special audits or examinations by their regulators. Because clearing and settlement systems are also important to monitoring the risk profiles of their individual participants, they should have risk management procedures.

IOSCO and the Committee on Payment and Settlement Systems (CPSS) have noted that CCPs can reduce systemic risk in the financial markets. The CPSS/IOSCO Report notes that the effectiveness of a CCP's risk control and the adequacy of its financial resources are critical to the market it serves. Accordingly, IOSCO and CPSS have recommended that CCPs be subject to transparent and effective regulation and oversight, and that central banks and securities regulators should cooperate with each other domestically and internationally in order to provide such oversight.

The financial market crisis has pushed the role that a CCP can play into the forefront of discussions among regulators regarding how to prevent such crises in the future. The creation of a central clearing facility or CCP for OTC derivatives has been cited repeatedly as a possible solution to at least some elements of the crisis, given that the lack of such facilities appears to have caused a crisis of confidence in the markets at certain critical junctures as

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<sup>18</sup> See the Committee on Payment and Settlement Systems and the Technical Committee of IOSCO, *Recommendations for Central Counterparties* (November 2004) (CPSS/IOSCO Report), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD176.pdf>.

concerns about counterparty risk increased.<sup>19</sup> Consequently, IOSCO and the CPSS recently established a working group to review the application of the 2004 CPSS/IOSCO Report to clearing of OTC derivatives.

Cooperative arrangements regarding the clearing and settlement of OTC derivatives, in particular, may be especially useful in monitoring systemic risk. In the wake of the current financial crisis, it is likely that CCPs generally will begin to play an even more important role in cross-border transactions, making supervisory cooperation among securities regulators vital if they are to succeed at their regulatory mandates.

#### **D. Collective Investment Schemes**

Collective investment schemes (CIS) include a variety of different types of investment vehicles, including authorized open ended funds that redeem their units or shares (continuously or periodically), closed end funds whose shares or units are traded in the securities market and unit investment trusts, contractual models and the European UCITS (Undertakings for Collective Investment in Transferable Securities) model.<sup>20</sup> Some jurisdictions may also regulate commodity pools, hedge funds, and even private equity funds in a manner similar to CIS, while others do not. At their heart, CIS involve entities that pool capital from a large number of investors to invest in a number of different investment opportunities, with the goal of achieving a degree of portfolio diversity in a manner that is more cost effective than what individual investors might be able to achieve on their own.

Because of their extensive (and increasing) use by both individual and institutional investors, the proper regulation of CIS is critical to achieving all of the objectives of securities regulation outlined above. The regulation and supervision of a CIS typically includes not only the scheme itself but also the operator of the scheme.<sup>21</sup> Typically, a CIS operator is the legal entity that has overall responsibility for the management and performance of the functions of the CIS, which may include investment advice and operational services. The IOSCO Principles identify the regulatory components of measuring an entity's eligibility to act as a CIS operator, which include, for example, considering the honesty and integrity of the operator, its competence to carry out its functions, its financial capacity, its specific powers and duties and its internal management procedures.

The IOSCO Principles also specify the components of a regulatory program that are necessary to supervise a CIS and its operator. The components identified include, among other things, registration and authorization of a scheme and the ability of the regulator to inspect the CIS operator. In addition, more than a decade ago, IOSCO developed supervisory principles for oversight of CIS operators, which describe the necessary components of a supervisory program for CIS operators.<sup>22</sup>

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<sup>19</sup> In addition, some jurisdictions are considering whether to establish a regulatory framework for trade repositories, which would collect data on OTC derivatives and provide data to regulators. Supervisory cooperation with respect to such entities could be guided by the principles set forth in this report.

<sup>20</sup> In some jurisdictions, closed end funds are not subject to special licensing or supervisory requirements and are, instead, regulated according to the terms of relevant exchange listing rules.

<sup>21</sup> See *Principles for the Supervision of Operators of Collective Investment Schemes* (IOSCO Technical Committee, September 1997), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf>.

<sup>22</sup> *Id.*

IOSCO has long recognized the cross-border nature of many CIS. In 1996, IOSCO issued a *Discussion Paper on International Cooperation in Relation to Cross-border Activities of CIS*.<sup>23</sup> This discussion paper analyzes the nature and extent of CIS cross-border activity and regulatory cooperation and considers strategies that regulators might use to make such cooperation function effectively and seamlessly. More recently, in 2002, the Technical Committee issued a report that assesses the issues of regulatory concern regarding CIS in the hope that international cooperation could be improved if regulators formed a common view of the risks inherent in the CIS business.<sup>24</sup>

### 1. Hedge Funds

In June 2009, the Technical Committee issued a report on hedge fund oversight.<sup>25</sup> Hedge funds are distinct from CISs, in part because, as the Technical Committee's report notes, there is no consistent definition of what a *hedge fund* is and because hedge funds typically are sold to sophisticated investors (not retail investors). That said, the June 2009 IOSCO Technical Committee report on hedge funds stated that a hedge fund typically can be identified as an entity displaying some combination of the following characteristics:

- Exemption from borrowing and leverage restrictions typically applied to CIS, with the result that many (but not all) hedge funds use high levels of leverage;
- Significant performance fees (often in the form of a percentage of profits) paid to the manager in addition to annual management fees;
- Investors are typically permitted to redeem their interests only periodically, e.g., quarterly, semi-annually or annually;
- The hedge fund manager often invests significantly in the fund along with outside investors;
- Derivatives are used, often for speculative purposes, and the fund is exempt from restrictions on the ability to short sell securities that may apply to CIS; and
- More diverse risks or complex underlying products are involved.

Hedge funds are typically run by a manager – a separate entity that establishes the investment profile and strategies, and makes investment decisions for the hedge fund. Furthermore, unlike many currently regulated CIS that market to retail investors, the exemptions that hedge funds have frequently enjoyed vis-à-vis their abilities to invest in derivatives, use of leverage, and short-selling lead some to argue that these exemptions increase the risk these investment

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<sup>23</sup> *Discussion Paper on International Cooperation in Relation to Cross-border Activity of Collective Investment Schemes*, Technical Committee of IOSCO (June 1996), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD52.pdf>

<sup>24</sup> *See Investment Management: Areas of Regulatory Concern and Risk Assessment Methods*, Report of the IOSCO Technical Committee (November 2002), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD136.pdf>

<sup>25</sup> *Hedge Fund Oversight, Final Report*, IOSCO Technical Committee (June 2009), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf>.

vehicles pose to the financial system itself, in addition to the risks posed to any given fund's investors. Others argue that hedge funds reduce volatility by selling overvalued assets and buying undervalued assets and play an essential role in maximizing the impact of available investment capital, thereby reducing systemic risk.

Hedge fund manager regulation is currently being considered in several IOSCO jurisdictions. Given that many hedge funds operate across borders, it is likely that supervisory cooperation will become an important component in any oversight of hedge funds. This will particularly be the case insofar as any hedge fund regulation is designed to address prudential or systemic risk concerns, since hedge fund assets and liabilities in other jurisdictions may have an impact on the health of the fund (or its parent firm) in its home market. In this regard, the Task Force on Unregulated Entities (TFUE) has prepared a template for the global collection of systemic risk information on hedge funds that regulators can use when gathering data from hedge funds managers in order to assess possible systemic risks arising from the hedge fund sector. The TFUE in its report noted that a common and consistent set of data would facilitate cross border sharing of systemic risk information among regulators and other authorities, where appropriate with a view to ensuring supervisory cooperation on the identification of possible systemic risks in the hedge fund sector.

Even where systemic risks are not a concern, supervisory cooperation may prove useful to regulators in detecting and deterring market abuse while helping ensure compliance with all applicable regulatory requirements. Nonetheless, jurisdictions contemplating supervisory cooperation arrangements regarding hedge funds, as distinct from CIS', may wish to take into consideration that the nature of hedge fund regulation in particular is in a state of flux. Consequently, such arrangements should recognize that the nature of regulation of these entities may vary from jurisdiction to jurisdiction, and, accordingly, cooperation arrangements may contemplate sharing information that a jurisdiction may not even demand of regulated entities in its own market.

## **E. Informational Intermediaries and Private-Sector Information Analysts**

Investors in today's globalized securities markets often face a staggering amount of information about the investment opportunities they are considering, not all of which is helpful, and some of which may not be accurate. Most investors will not have the resources, expertise or access necessary to confirm the accuracy of the financial information that an issuer provides, and even when a regulatory regime has in place prohibitions on deliberately providing investors with inaccurate or incomplete information, backed up by a strong enforcement program, the sheer amount of information that investors must analyze will, in many cases, overwhelm the typical retail investor. Even institutional investors with the resources and expertise necessary to analyze the information provided by an issuer through its financial disclosures nonetheless often desire an outside *second opinion* about the wisdom of a particular investment

Auditors, credit rating agencies (CRAs), and research analysts each play a critical role in the markets by analyzing information about issuers and providing investors with opinions about various facets of an investment. While different in many important respects, these market participants are similar insofar as they play an important function in confirming – or debunking – the *reputation* that an issuer seeks to build about itself to counter what economists describe as the “lemons problem” that buyers may face in a market where



asymmetrical information is common.<sup>26</sup> They are also similar in that regulators have been concerned about the many potential or actual conflicts of interest these entities may face.

### 1. Auditors

Independent auditors, required by the securities laws and regulations of most IOSCO jurisdictions, use standardized accounting principles to opine on the quality and comprehensiveness of the financial disclosures that an issuer makes. They do this so that investors can know that the financial disclosures mandated by a regulator present an accurate and fair accounting of the company's financial condition in all material respects, containing neither *sins of commission nor omission* with regard to the use of accounting standards required in the relevant jurisdiction. Reliable financial information is the cornerstone of investor confidence and at a minimum must provide investors with information about the financial position, results of operations, cash flow and changes in the ownership equity of an enterprise.<sup>27</sup>

Accounting and auditing standards provide necessary safeguards for the reliability of the financial information set forth in financial statements.<sup>28</sup> External auditors play a critical role in lending independent credibility to published financial statements.<sup>29</sup> Accordingly, auditor independence, in both fact and appearance, is necessary to support public confidence in financial statements and the financial market at large.

The regulation of auditors is, therefore, first and foremost concerned with ensuring that auditors are independent of the entity being audited. Standards of independence are meant to help ensure that an auditor is free of any influence, interest or relationship that might impair his or her professional judgment or objectivity or, in view of a reasonable investor, might impair such professional judgment or objectivity.<sup>30</sup> Likewise, the oversight of auditors is necessary to maintain and enhance investor confidence in published financial statements.

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<sup>26</sup> The "lemons problem" is a term originating with a paper by the economist George Akerlof titled, "The Market for Lemons: Quality Uncertainty and the Market Mechanism" in *The Quarterly Journal of Economics* (August 1970). In this paper, Akerlof uses the market for used cars as an example of the problems that arise when one side to an economic transaction intrinsically knows more about the qualities of the asset than the other. Buyers of used cars know that there are both good used cars and defective used cars (called "lemons") in any market, but they also know that they cannot know beforehand which is which prior to finalizing the transaction. Accordingly, the buyer will assume that the car is of average quality. This, however, penalizes the sellers of higher quality cars, who will not be able to get a high enough price to make selling the car worthwhile. Sellers of high-quality cars will therefore exit the market, leaving only average-quality cars and lemons – in turn, reducing the "average" price that buyers are willing to pay. This "lemons problem" repeats itself until the market comprises only defective cars. Sellers of high-quality cars – as with honest issuers of high-quality securities – may try to counteract the lemons problem by building a reputation for honesty and transparency, but such reputations can be exceedingly time-consuming to build. Accordingly, sellers may turn to some outward and independent demonstration of the quality of their product, in place of such a reputation, by, for example, contracting with an independent mechanic to certify as to the quality of the used car – or, in the case of issuers of securities, hiring an independent auditor to opine on the quality of the issuer's financial statements.

<sup>27</sup> See IOSCO Principles, Principle 10.6.

<sup>28</sup> *Id.*

<sup>29</sup> See *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, A Statement of the IOSCO Technical Committee (October 2002), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf>

<sup>30</sup> *Id.*

Accordingly, IOSCO has set forth components of what it believes should be part of an effective oversight program in its 2002 *Principles of Auditor Oversight*.<sup>31</sup>

These principles identify licensing as a first line of effective oversight. Auditors should have proper qualifications and competency before being licensed to perform audits. Continuing maintenance of professional competence is also seen as a necessary regulatory component. Regulatory oversight is then seen as necessary to monitor the quality and implementation of auditing independence and ethical standards.

As touched upon in the IOSCO Technical Committee's 2005 *Report on Strengthening Capital Markets Against Financial Fraud*, auditors may operate on a cross-border basis either by auditing companies that have global operations or by the auditors themselves establishing global operations.<sup>32</sup> In addition, issuers with subsidiaries in more than one jurisdiction often hire separate auditors to audit the financial statements of these related entities (although in some cases, these different audit firms are organized under a common umbrella network). Separate auditors may be used because local regulations may require that an auditor be licensed in that jurisdiction in order to conduct audits. Financial information from an issuer's separately-audited subsidiaries frequently must be included in the financial statements of the parent. The result is that the auditor for the overall organization must review and opine on the accuracy of the organization's consolidated financial statements when it itself did not conduct an audit of all of the organization's components. Under such a situation, problems can arise if an audit failure occurs at the local level and the parent auditor is unaware of the failure.

While recognizing the primary responsibility of auditor oversight bodies in relation to cooperative supervision of audit firms with a global footprint, IOSCO has encouraged its members to provide each other, whether directly or through coordinating with the auditor oversight body in their jurisdiction, with the fullest assistance permissible in efforts to examine or investigate matters in which improper auditing may have occurred and on any other matters relating to auditor oversight.<sup>33</sup> IOSCO has also encouraged its members to explore approaches to enhance cooperation among jurisdictions.<sup>34</sup>

## 2. Credit Rating Agencies

CRAs play an important role in the markets by providing investors with information about issuers of debt (or debt-like) securities. Specifically, CRAs opine on the credit risk of issuers and their financial obligations. Traditionally, CRAs helped investors analyze the credit risks of lending to a particular borrower or when purchasing an issuer's debt. Over the past decade, CRAs have extended this analysis to opining on the likelihood of default with regard to structured finance products, such as residential mortgage backed securities or the tranches of collateralized debt obligations. In general, credit ratings represent opinions as to the

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<sup>31</sup> *Principles of Auditor Oversight*, a Statement of the IOSCO Technical Committee (October 2002), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf>.

<sup>32</sup> *Strengthening Capital Markets Against Financial Fraud*, Report of the IOSCO Technical Committee (February 2005), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD192.pdf>.

<sup>33</sup> *IOSCO Principles of Auditor Oversight*.

<sup>34</sup> *Id.*

likelihood that the borrower or issuer will meet its contractual financial obligations as they become due and, as such, are not recommendations to buy or sell a security.<sup>35</sup>

Because of the importance that CRAs play in many markets, IOSCO has published principles that regulators, CRAs and other market participants might follow as a way to guard the integrity of the rating process and help ensure that investors are provided with ratings that are timely and of high quality.<sup>36</sup> To provide CRAs with more guidance on how the IOSCO CRA principles could be put into practice, in 2004 the IOSCO Technical Committee published its Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO CRA Code of Conduct).<sup>37</sup>

Currently, CRAs are not regulated in most jurisdictions. However, in light of the role that CRAs played in the recent financial market crisis, some jurisdictions have adopted new regulations covering CRAs (particularly those CRAs whose ratings are used for regulatory purposes) and many jurisdictions are currently considering ways to regulate CRAs. Furthermore, the G-20's November 15, 2008 Statement of the Summit on Financial Markets and the World Economy and its April 2, 2009 Declaration on Strengthening the Financial System both point to the IOSCO CRA Code of Conduct as the baseline consensus for domestic oversight of CRAs.

In an effort to avoid regulatory fragmentation, IOSCO has been considering mechanisms for enhancing cross-border cooperation among those regulators that have (or are planning to have) powers to inspect and oversee CRAs.<sup>38</sup> Because the larger CRAs operate on a global basis, cooperation among regulators in overseeing their activities likely will be necessary in order for these regulatory objectives to be achieved.

### 3. Research Analysts

Research analysts also study companies and industries. Like CRAs, they analyze disparate raw data and make forecasts, but, unlike CRAs, many also make recommendations about whether to buy, sell or hold particular securities. Investors often view analysts as experts on and important sources of information about the securities they cover and, accordingly, may rely on their advice.<sup>39</sup>

Research analysts employed by full-service investment firms can potentially face conflicts of interest that can interfere with the objectivity of their analysis. Specifically, conflicts arise

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<sup>35</sup> *The Role of Credit Rating Agencies in Structured Finance Markets*, Final Report, IOSCO Technical Committee (May 2008), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf>.

<sup>36</sup> *Statement of Principles Regarding the Activities Of Credit Rating Agencies*, IOSCO Technical Committee (September 2003), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf>.

<sup>37</sup> *Code of Conduct Fundamentals for Credit Rating Agencies*, IOSCO Technical Committee (Revised May 2008), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.

<sup>38</sup> *International Cooperation in Oversight of Credit Rating Agencies*, Note, Technical Committee of IOSCO (March 2009), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD287.pdf>.

<sup>39</sup> *Report on Analyst Conflict of Interest*, A Report of the Technical Committee of IOSCO (September 2003), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD152.pdf>.

because the firms may act in different capacities. For example, an investment firm may act as a retail broker for individuals that wish to buy or sell securities and as an underwriter for issuers of the same securities. Research analysts may be asked to assist with both services, in potentially conflicting capacities. If research analyst conflicts are not addressed, investor confidence in research may erode, which could negatively impact the market as a whole.

In 2003, IOSCO published principles for regulating research analysts in ways designed to reduce or manage conflicts of interest.<sup>40</sup> The IOSCO principles focus on (1) the identification and elimination, avoidance, management or disclosure of conflicts of interest faced by analysts; (2) the integrity of analysts and their research; and (3) the education of investors concerning the actual and potential conflicts of interest analysts face.

Because the regulation of research analysts in many jurisdictions is mainly geared towards those analysts who work for full-service investment firms, oversight of their activities would be integral to any oversight program developed for the firm for which they work. As noted above, because many market intermediaries, including full-service investment firms, have expanded operations globally, coordination of oversight of full-service investment firms may include any research analyst activities that are performed on a global basis.

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<sup>40</sup> See *IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest* (25 September 2003), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf>.

## Chapter 7 Cooperation in Identifying, Assessing and Mitigating Risk

In addition to facilitating the oversight of regulated entities that operate across borders, enhancement of supervisory cooperation among regulators can advance other regulatory interests as well. Securities regulators that become partners pursuant to cooperative arrangements can also assist each other in identifying, assessing and mitigating risks to investors, markets and financial stability by allowing them to share vital information and institutional intelligence about markets and market participants as a collective that, individually, may not otherwise be available or might not otherwise be available in a timely fashion.

The recent crisis has highlighted how market disturbances with significant impact on market or financial stability pay little heed to national borders. Viewed more broadly and in light of these risks, supervisory cooperation can extend beyond sharing documents and information in relation to particular regulated entities, to include sharing and collaborating on risk analyses conducted by regulators. This might involve sharing intelligence and assessments made across entire industry sectors and markets drawn from information collected from a large number of entities. These analyses and assessments would provide an opportunity for regulators to collaborate in identifying and assessing risks posed by cross-border activity and to international markets. The opportunities this collaboration would create would also provide a basis for developing coordinated programs and responses between regulators to mitigate those risks.

As described above, regulators typically assess risks in their markets for developing their own inspection and examination program priorities. This same type of analysis could be developed among regulators to analyze cross-border risks to the global markets. These analyses and assessments would ideally be conducted on a regular and anticipatory basis through a network of supervisors, as described below.

Examples of information and analysis which could be shared could include the following:

- *Industry sector risks:* While not attributable to individual firms, analysis about risk issues across a particular sector may be useful to share with other regulators who perform a similar role. For example, if a regulator identified thematic issues or problems in a particular sector (e.g., a recurring example of market misconduct among investment advisers), this information could be shared with other regulators who might then be in a better position to watch for similar activity in their own markets.
- *Financial information on a sectoral basis:* Financial information (e.g., leverage, liquidity and asset positions) on a sectoral basis may be an important set of information that regulators might wish to share to assist each other in forming a more complete view about the relative strength of a given firm. Such information may also assist securities regulators in determining whether a particular firm is exposed to risks that exceed industry norms, while also allowing regulators to note risk trends over time.
- *National and regional economic analysis:* Information about national and regional trends may also be important to other regulators in assessing the vulnerability of a given firm to adverse movements in a particular market.

The mechanisms to support this type of cooperation are likely to be different than the mechanisms developed for cooperation in supervising specific regulated entities. Risk assessment cooperation is more likely to take the form of periodic and ad hoc meetings and the unsolicited sharing of intelligence, rather than information provided in response to request about particular entities. This type of cooperation may be more effective if conducted on a multilateral basis, reflecting the global operations of global entities and the interconnected nature of the markets in which they operate.

## Chapter 8 Mechanisms for Supervisory Cooperation

An enhanced framework for exchange of supervisory information (whatever form it takes) should be designed to promote a more dynamic collaboration between regulators. Such a framework should allow regulators to further adapt to a transnational securities environment while enhancing regulatory oversight on a domestic level, and be sufficiently flexible to allow regulators to conclude bilateral supervision arrangements, when necessary. The framework should also seek to minimize the risks that a market participant will exploit a regulatory or supervisory gap between jurisdictions while fostering discussions and encouraging the development of supervisory cooperation best practices between IOSCO members. Finally, ideally, the framework should allow, whenever possible and appropriate, disclosure of non-compliant activities or operations of a regulated entity which could help regulators obtain relevant information from other regulators without having to solicit the information.

Securities regulators have long used information-sharing arrangements, typically known as memoranda of understanding or MOUs, to facilitate consultation, cooperation and the exchange of information in securities enforcement matters. These enforcement MOUs permit regulators who suspect there has been a violation of their laws and/or regulators to seek *ad hoc* assistance from their overseas counterparts when evidence of the possible violation may lie outside their jurisdictions. Most of these MOUs have been entered into on a bilateral basis. In 2002, however, IOSCO created the IOSCO MMoU, which has become the global standard for enforcement cooperation among securities regulators. Whether bilateral or multilateral in form, these MOUs have enhanced domestic and international enforcement efforts and proven invaluable to regulators in executing their domestic enforcement responsibilities.

More recently, securities regulators have come to recognize that effective supervision and oversight in today's global environment requires that regulators be equipped with tools for not only assistance in securities enforcement (which are by nature *ad hoc*, and focus on sharing information related to a particular possible violation), but also both *ad hoc* and ongoing regulatory cooperation in the supervision of regulated entities. Such cooperation is critical to help ensure the seamless and efficient regulation of globally active regulated entities, in a manner fully consistent with the laws and requirements of all the jurisdictions involved. Much of this collaboration and cooperation has developed on an *ad hoc* basis but more established forms, including MOUs and supervisory colleges, have also been established. Irrespective of the form taken, supervisory cooperation, like enforcement cooperation, necessitates that regulators have the legal ability to share non-public information with one another and to protect the confidentiality of such information.

The four different *mechanisms* for sharing entity-specific information and market-wide intelligence – *ad hoc* cooperation, memoranda of understanding, supervisory colleges and regulatory networks – each address different, albeit overlapping, types of information-sharing. All of these different mechanisms, however, likely will be useful to securities regulators for different purposes. As described in more detail below, each mechanism also buttresses the others, making all of them more effective when used in conjunction as part of a single overarching supervisory cooperation strategy among IOSCO members.

## **A. Ad Hoc Cooperation**

The speed of cross-border transactions and the rapid evolution of modern securities markets often necessitates that regulators cooperate on an *ad hoc* basis to address supervisory issues. Such issues may occur at the front end (for example in relation to regulatory approval processes), or during the life of the entity. Assistance may take the form of oral communications or a written exchange of letters and may or may not involve the exchange of non-public supervisory information. Ad hoc cooperation can take the form of either bilateral or multilateral information-sharing, and can be aimed at addressing anything from oversight of a specific regulated entity, to wide-ranging discussions regarding systemic risk issues and coordinated regulatory responses to a financial crisis.

The advantage of *ad hoc* cooperation is that it allows regulators flexibility to address emerging supervisory issues in real time without the delay necessary to negotiate a more formal arrangement. However, with ad hoc cooperation, on either a bilateral or multilateral basis, regulators may be reluctant to engage in meaningful supervisory cooperation without established confidentiality safeguards in place. Also, even where written letters are exchanged, the terms of such letters generally address only the particular cross-border transaction or discussion in question and do not have broader applicability.

## **B. Memoranda of Understanding**

With increasing frequency, regulators, both domestically and internationally, are using MOUs to facilitate regulatory cooperation. Such mechanisms can replace the need to address supervisory information-sharing issues on an *ad hoc* basis and address new information-sharing needs created by global financial conglomerates, cross-border affiliated markets and securities settlement systems' linkages. In most cases, such MOUs form the bedrock of any ongoing form of bilateral supervisory cooperation, and they often also form the basis for multilateral forms of oversight cooperation (such as supervisory colleges) and even for regulatory networks (discussed in more detail below) because they set forth the intentions of the parties and articulate provisions with respect to the confidentiality and use of any non-public information that the regulators agree to share or discuss. This, in turn, builds trust and allows for more effective and complete information-sharing and consultation, whether in a bilateral or multilateral context.

MOUs for regulatory cooperation can be bilateral or multilateral and vary in scope and purpose. For example, some IOSCO members have entered into MOUs with counterparts that cover information sharing and cooperation related to:

- financial services firms subject to oversight by with two or more authorities;
- clearing organizations subject to oversight by two or more authorities;
- linked markets in two or more jurisdictions or markets affiliated through a common ownership structure;
- the sharing of non-public issuer-specific information relating to the application of International Financial Reporting Standards by dually-listed companies; and/or



- financial groups subject to consolidated supervision by one authority, with material affiliates subject to supervision by one or more other authorities.

Some MOUs for supervisory cooperation are entity-specific in that they identify the firms or markets covered. Other supervisory MOUs are more comprehensive and cover a wide range of registered entities including, for example, broker-dealers, investment advisers, and clearing organizations. Such MOUs allow for flexibility over time as new products and global affiliations develop.

### *1. Structure.*

Supervisory MOUs describe the terms and conditions for sharing regulatory information with foreign counterparts. Such MOUs facilitate oral communications as well as provide a confidential mechanism for sharing relevant documents. Typically the structure of a regulatory MOU is similar to MOUs for enforcement cooperation and includes provisions for:

- Consultation including:
  - Periodic meetings;
  - Advance notification of:
    - Regulatory changes that could have a significant impact on covered entities, or
    - Material events that could adversely affect each other's markets or a firm's stability.
- Exchanging information held in regulators' files.
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- Procedures for cooperation in and arrangements for on-site visits of dually-regulated entities.
- Permissible uses of information:
  - Primary purpose is for conducting supervision and oversight;
  - Regulators should establish procedures for using the information for enforcement purposes.
- Confidentiality safeguards
  - Commitment to maintain confidentiality of non-public supervisory information;
  - Establish mechanisms for the onward sharing of non-public information by the authority receiving the information to:
    - Other domestic authorities; or
    - Third foreign authorities, for example, where a global firm has a number of affiliates around the world or is registered in multiple countries.
- Written execution of requests for assistance.
- Termination procedures.

## 2. *MOU Side-Letters*

The signatories to a supervisory MOU may also wish to attach *side-letters* to the MOU, describing their interpretation of certain aspects of the MOU or explaining in more detail their intentions. Such side-letters may, for example, discuss in more detail the nature of their inspections process, the types of legally enforceable demands for information that the regulator might face and how the regulator plans to proceed when a legally enforceable demand is made, or other important information that the regulators may wish to share regarding their procedures, regulations or laws.

## 4. *MOU Effectiveness, Advantages and Disadvantages*

Effective supervisory MOUs should be forward looking and address the need for cooperation now and in the future as circumstances change. For example, affiliated exchanges that today enjoy a fairly low level of integration may seek higher levels of integration in the future, ranging from technology synergies, to a common trading book, to cross-listings. Supervisory MOUs can help ensure that regulators are in a ready position to address such integration in a coordinated fashion in order to promote regulatory efficiencies and avoid duplicative or overlapping regulation and oversight. Effective supervisory MOUs should also be based on mutual trust and mutual assistance and put in place working arrangements that are based on the principle of reciprocity.

The advantage of MOUs is that they establish clear mechanisms for supervisory cooperation and the exchange of non-public information in a manner consistent with national laws. Also, where written in a comprehensive and broad fashion, they allow flexibility to address new and evolving regulatory issues. The disadvantage is the time often necessary to negotiate the arrangements, particularly where done on a jurisdiction-by-jurisdiction bilateral basis. MOUs may be prone to interpretation issues that may cause some regulators to read the scope of MOUs too narrowly, which can cause delays in obtaining effective and timely cooperation. Finally, unlike supervisory colleges or regulatory networks, MOUs are often regulatory task-oriented, in that they are often designed to facilitate the kinds of *routine* and firm-specific, tangible information exchange that regulators need in order to properly carry out their regulatory oversight programs. Where they are purely task-oriented, however, they may not be as useful as supervisory colleges and regulatory networks for sharing less tangible information about a group of firms or an entire market that might be useful to regulators when assessing market trends or broad emerging supervisory issues.

## C. **Supervisory Colleges**

Interest in supervisory colleges has grown substantially in light of the financial crisis. In its April 2008 *Report on Enhancing Market and Institutional Resilience* (FSB Report),<sup>41</sup> the Financial Stability Board (FSB) (formerly the Financial Stability Forum or FSF) recommended that “the use of international colleges of supervisors should be expanded so that, by end-2008, a college exists for each of the largest financial institutions.” In its April 2009 update to the FSB Report, the FSB noted that “supervisory colleges now exist for most of the financial institutions identified by the FSF WG, and many of them held face-to-face meetings by end-2008.”

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<sup>41</sup> *Report on Enhancing Market and Institutional Resilience* (7 April 2008), accessible via the Internet at: [http://www.financialstabilityboard.org/publications/r\\_0804.pdf](http://www.financialstabilityboard.org/publications/r_0804.pdf).

The FSB recognized that the design and membership of each college would need to be “tailored to the institution that it oversees in order to ensure that the college is able to operate in an effective and flexible fashion”.<sup>42</sup> While there is no uniform definition or structure for supervisory colleges, common elements include:

- Oversight of an identified regulated market participant;
- Two or more regulators, central banks or other financial authorities with a direct regulatory interest in the financial institution;
- Periodic face-to-face meetings;
- Emphasis on cross-border communication and oversight of firm-wide risk on an ongoing basis as well as during a crisis;
- Exchange of supervisory information, where appropriate and consistent with national laws; and
- Recognition that non-institution specific information may have a wider interest beyond those authorities with direct regulatory oversight.

In many cases, supervisory colleges may need to be supplemented by MOUs that establish frameworks for the exchange of non-public supervisory information with an emphasis on confidential safeguards, onward sharing of information and permissible uses of information.

In addition to the colleges established as a result of the FSB Report, other colleges of note include the College of Euronext Regulators (which consists of national securities regulators in Belgium, France, Netherlands, Portugal and the UK). The Euronext College closely coordinates in the oversight of the Euronext markets pursuant to a formal structure and MOU. This MOU allows for coordination in oversight while still respecting national laws and approval processes.

In addition, in April 2009, an international framework for information sharing and cooperation among financial authorities with regard to CCPs for credit default swaps (CDS) was created. This framework is intended to facilitate information sharing and cooperation among CDS CCP regulators and other interested authorities. While the direct members of the framework are financial regulators with direct authority over one or more existing or proposed CDS CCPs and relevant central banks (collectively, the OTC Derivatives Regulators’ Forum),<sup>43</sup> the framework recognizes the need to exchange views and share information on a regular basis with other regulators and financial authorities with potential interest in information on CDS CCPs.

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<sup>42</sup> See *FSB Report*, V.5.

<sup>43</sup> The OTC Derivatives Regulators’ Forum includes authorities from the following countries: Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Portugal, Spain, Switzerland, United Kingdom and United States. The European Union, Committee on Payment and Settlement Systems, and IOSCO also participate in this forum. See Federal Reserve Bank of New York, Press Release, *A Global Framework for Regulatory Cooperation on OTC Derivative CCPs and Trade Repositories* (September 24, 2009), which is accessible via the Internet at: <http://www.ny.frb.org/newsevents/news/markets/2009/ma090924.html>.

Supervisory cooperation arrangements that include the creation of a college of supervisors likely will entail deciding on a set of issues that may not otherwise be present when regulators conclude a purely bilateral cooperative arrangement. These issues include:

- How often the college of supervisors should meet as a group, and at what level;
- Which jurisdictions should comprise the college (which may involve a decision weighing the advantages of comprehensiveness offered by larger membership versus the flexibility possibly offered by a comparatively smaller group); and
- The scope of regulatory issues that the college will consider.

The advantage of supervisory colleges is that they provide a framework for ongoing dialogue among multiple financial authorities that have direct regulatory oversight of an institution with a view to obtaining a complete risk picture of the firm. The disadvantage is that, without an effective supplemental MOU, regulators may be reluctant to share firm-specific information pursuant to college mechanism structure in light of confidentiality concerns. Also, issues regarding membership in a college may prove complex as too many participants may be unwieldy and inefficient and too few could result in excluding regulators with legitimate oversight interest.<sup>44</sup> Finally, supervisory colleges tend to be narrowly constructed in that they are built around oversight of a particular entity.

#### **D. Networks of Regulators**

The mechanisms that have been used to oversee regulated entities typically provide more formalized means of information exchange between regulators. In addition to these more formalized agreements for coordinating the oversight of specific entities, regulators may wish to consider how they can more effectively communicate general regulatory concerns that exist at a higher, more market-wide level. Enhancement of supervisory cooperation does not necessarily need to be limited to joint oversight of common regulated entities. Indeed, another lesson that has been learned from recent events is that regulators may wish to consider means of cooperating on general regulatory issues, such as sharing individual regulator's analyses of regulatory risks, as a means to head off emerging problems. If regulators are successful at implementing more robust, specific oversight arrangements for common regulated entities, extending this cooperative relationship to engage in a more collaborative monitoring of global regulatory issues and assessing and mitigating risks may make sense.

One proposal to facilitate such regular and informal information sharing is the concept of forging "*networks*" of regulators, where such issues can be discussed. In this regard, it may be useful to consider IOSCO's own bylaws, in which IOSCO members have resolved to:

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<sup>44</sup> Supervisory colleges may be particularly useful for oversight cooperation where the cross-border linkages of an entity go beyond mere cross-border activity with affiliates in different jurisdictions, to situations where the entity as a whole effectively operates in multiple markets (*e.g.*, a cross-border stock exchange or a CCP with remote members).

- Cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets;
- Exchange information on their respective experiences in order to promote the development of domestic markets;
- Unite their efforts to establish standards and an effective surveillance of international securities transactions; and
- Provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses.<sup>45</sup>

To achieve these objectives, IOSCO members currently meet periodically through various committees, including the Presidents' Committee, Executive Committee, Technical Committee, Emerging Markets Committee, Working Committees and various dedicated Task Forces and Standing Committees. As a means for facilitating more collaboration in supervision and to provide a framework for more extensive dialogue, existing Standing Committee structures could be used to foster more informal supervisory collaboration, in addition to the work these committees and task forces currently undertake. Indeed, while such collaboration is unlikely to produce IOSCO *deliverables* (such as standing committee reports), the end results may be more useful to individual IOSCO members.

To this end, the Technical Committee may wish to consider recommending that each committee, including the Technical Committee, set time to discuss supervisory issues at each meeting. The Standing Committees may also wish to consider whether supervisory staff of each member should be in attendance to help make the discussions more productive and to facilitate direct communications between the relevant supervisory staff. Such a revised Standing Committee *mandate* could play an important role linking the detailed, firm-specific intelligence-sharing of bilateral MOUs with the wider intelligence-sharing of supervisory colleges by permitting a regular, free-floating sharing of relevant supervisory and oversight findings and regulatory concerns among a broad set of securities regulators.

Regulatory networks such as the IOSCO Standing Committees can provide an important high-level intelligence gathering aspect to a supervisory cooperation framework that also includes supervisory colleges and supervisory cooperation MOUs. Over time, these networks may become the appropriate mechanism for cooperation, collaboration and sharing of information, broad analyses and assessments to support the identification, assessment and mitigation of risks on a preemptive basis. They will also offer a forum in which risk assessments can be discussed and mitigation strategies developed. As with supervisory colleges, however, it is important that the members of any regulatory network have in place some type of formal understanding to protect the confidentiality of any information shared, in order to better facilitate the free flow of information within the network.

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See IOSCO Bylaws.

## Chapter 9 General Principles for Supervisory Cooperation

When considering means to enhance or establish supervisory cooperation, IOSCO members may find some guidance in the answers to the following questions:

- Which regulated entities operate in more than one jurisdiction and thus need to be overseen on a global basis?
- What degree of cooperation is necessary to satisfy each relevant regulator's obligation to oversee its regulated entities? For example, are regulators required to conduct on-site supervisory visits of regulated entities regardless of where they are physically located, or can regulators rely on the inspections and examinations of the regulator where the regulated entity is located and receive a copy of any resulting inspection report?
- Should there be information sharing arrangements? If so, what information should be shared?

Where answers to these questions lead regulators to conclude that supervisory cooperation arrangements of some form would be beneficial, the following basic principles for supervisory cooperation may be helpful in forming the basis for bilateral or multilateral MOUs. These principles recognize that coordinating supervision of, and sharing information concerning, regulated entities is important to maintain effective oversight, promote compliance with national laws, and foster the integrity of financial markets. Effective cooperation will help ensure the seamless and efficient supervision of regulated entities, while minimizing duplicative efforts.

In developing these principles, the Supervisory Cooperation Task Force gave consideration to a body of work developed by IOSCO related to international cooperation and information-sharing including:

- Principles for Memoranda of Understanding (September 1991);
- Mechanisms to Enhance Open and Timely Communication Between Market Authorities of Related Cash and Derivative Markets During Periods of Market Disruption (October 1993);
- Resolution on Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance (1994);
- Report on Cooperation between Market Authorities and Default Procedures (March 1996) and Client Asset Protection (August 1996);
- Guidance on Information Sharing (November 1997);
- Multilateral MOU Concerning Cooperation and Consultation and the Exchange of Information (May 2002); and

- Multi-jurisdictional Information Sharing for Market Oversight (April 2007).

The Task Force also considered recent work by regulators, central banks and other financial authorities to improve mechanisms for supervisory cooperation.

In general, supervisory cooperation arrangements likely will start by identifying activities or issues which, on an international level, create potential gaps in regulators' oversight abilities, and developing measures to monitor or address such gaps. In scoping the proposed framework of supervisory cooperation, regulators may take into account whether assistance can be rendered on a reciprocal basis, particularly with regard to aspects of institutional/prudential supervision of banks. Natural boundaries of regulatory cooperation are set by the existing competencies of the authorities, *i.e.*, a requesting authority may not have more extensive inspection and examination rights than the requested authority within its own jurisdiction. Regulators developing such arrangements may also wish to accommodate the particular role of SROs in certain jurisdictions, in order to properly take these organizations into account under the framework.

More specifically, supervisory cooperation arrangements likely will cover information sharing related to:

- (1) entities regulated in one jurisdiction but located in another jurisdiction;
- (2) regulated entities that have affiliates or branch offices located in other jurisdictions; and
- (3) entities regulated in multiple jurisdictions.

Much of the information critical to the oversight of globally-active regulated entities is general information that is routinely provided by the regulated entities to their regulators and then informally discussed among their staff. Supervisory cooperation arrangements are not intended to detract from the importance of those discussions. Rather, they add value to this dialogue by setting forth a framework for the exchange of requested written information in each regulator's possession potentially necessary to supplement this oral exchange, and by articulating a commitment to help obtain additional information on regulated entities where needed. Accordingly, supervisory cooperation arrangements should contemplate the sharing of all types of supervisory information, including information drawn from non-public reports provided by regulated entities and inspection or examination reports.

In addition to specifying the specific information to be shared, regulators may wish to discuss the scope and relevance of the information to be shared and the triggers that will generate the exchange of information under the agreement. By addressing these issues, regulators can establish more productive relationships and prevent undue cost or resource burdens. In this regard, regulators may wish to limit their information requests to those that are reasonable and not overly burdensome. In addition, regulators may wish to limit their information requests to those that relate to non-public information.

Irrespective of the form taken, mechanisms for supervisory cooperation could be effectively established by taking into consideration the following principles. These principles are not meant to lay out a description of what supervisory policies regulators should adopt, or what securities legislation IOSCO jurisdictions should or should not have in place (with possibly the single exception of legislation that securities regulators discover actively inhibits the type of supervisory cooperation they need in order to fulfill their regulatory mandates). Rather,

these principles are guideposts that IOSCO members may use to assist one another in reaching common regulatory objectives in an increasingly global securities market.

These General Principles for Supervisory Cooperation are:

***General Principles Relating to Cooperation***

1. Authorities should, on the basis of mutual trust, consult, cooperate and be willing to share information to assist each other in fulfilling their respective supervisory and oversight responsibilities for regulated entities operating across borders, such as intermediaries, collective investment schemes, hedge funds, credit rating agencies, clearing organizations, trade warehouses and markets.
2. Where obstacles to supervisory information-sharing exist, authorities should undertake to address such obstacles.
3. Authorities should consult with each other and share risk analysis assessments and information to support the identification, assessment and mitigation of risks to markets and investors.
4. Authorities should consult, cooperate and, to the extent possible, share information regarding entities of systemic significance or whose activities could have a systemic impact on markets.
5. Authorities should cooperate in the day-to-day and routine oversight of internationally-active regulated entities.
6. Authorities should provide advance notification and consult, where possible and otherwise as soon as practicable, regarding issues that may materially affect the respective regulatory or supervisory interests of another authority.

***Principles Relating to the Mechanisms for Cooperation***

7. Mechanisms for supervisory cooperation should be designed to provide information both for routine supervisory purposes and during periods of crisis.
8. Authorities should undertake ongoing and *ad hoc* staff communications regarding globally-active regulated entities as well as more formal periodic meetings, particularly as new or complex regulatory issues arise.
9. As appropriate, authorities should enter into memoranda of understanding to share relevant supervisory information in their possession.
10. In the event of significant cross-border linkages, affiliations, combinations or mergers among regulated entities such as exchanges, intermediaries, credit rating agencies and clearing organizations, authorities should commit to and establish colleges for working together in the oversight of the combined entities.
11. IOSCO should use the Standing Committee networks for consultation in identifying, assessing, and where appropriate, addressing emerging regulatory issues and risks that



may have material cross-border implications in areas such as, for example, issuer disclosure and governance, market transparency, conflicts of interest among market intermediaries and risks that may be arising on the perimeters of current regulation.

***Principles Relating to the Mechanics, Process, Terms and Conditions of Cooperation***

12. Requests for information should make clear the supervisory reasons underlying the requesting authority's interest so that the requested authority is better able to understand the nature, scope and purpose of the request, whether it has a related interest in the matter, and whether it may have additional unsolicited information that may be of assistance to the requesting authority.
13. Where requested information is in the possession of unsupervised third parties, an authority should use its best efforts to gather the information or, where permitted by law, obtain that information on behalf of the requesting authority or assist the requesting authority in obtaining the information directly from the third party.
14. In connection with regulated entities that operate across borders, authorities should establish procedures for cooperation, including, where applicable, for discussion of relevant examination reports, for assistance in analyzing documents or obtaining information from a regulated entity and its directors or senior management, and for collaboration regarding the timing, scope and role of the authorities with respect to any cross-border on-site visits of a regulated entity.
15. Supervisory information obtained from another authority should be used only for purposes agreed upon by the authorities.
16. Supervisory cooperation arrangements should describe the processes the parties should use if an authority subsequently determines that it needs to use requested supervisory information for law enforcement or disciplinary purposes, such as obtaining the consent of the requested authority and handling such information in accordance with the terms of existing MOUs for enforcement cooperation.
17. Authorities must establish and maintain appropriate confidential safeguards to protect all non-public supervisory information obtained from another authority.
18. Supervisory cooperation arrangements should describe the degree to which an authority may onward-share to a third party any non-public supervisory information received from another authority, and the processes for doing so (such as, for example, obtaining the consent of the requested party before onward-sharing any non-public supervisory information received). Where appropriate, authorities should consider whether abbreviated mechanisms for onward-sharing could be developed in appropriate circumstances, for example for third authorities (foreign or domestic) with a direct regulatory interest in the regulated entity.

## Chapter 10 Conclusion

The growing emergence of market participants engaging in regulated activities across borders, and of cross-border commercialization of financial products has heightened the need for cooperative efforts to improve the effectiveness of supervisory methods and approaches. Without proper cooperation between regulators it may be difficult to be aware of all the activities of a regulated entity. Such cooperation is particularly important when, as is commonly the case, the regulated entity is active in several jurisdictions.

The particular procedures used for the supervision of globally active market participants must reflect the domestic law of the places in which they operate and should take into account the possibility that relevant supervisory responsibility may continue to be shared among regulators. It is nevertheless possible to identify some general issues that should be considered as matters requiring closer supervisory cooperation, including the organizational structure of the regulated entity and its affiliates, the financial condition of the group,<sup>46</sup> intra-group exposures and group-wide exposures,<sup>47</sup> relationships with shareholders, management responsibility and the control of regulated entities.

Fundamentally, regulators, in establishing supervisory cooperation arrangements, should consider the nature of information to be exchanged and the parties with which such information may be onward shared for supervisory purposes. Regulators should be able to exchange information among themselves on various issues, including pending regulatory changes that may have a significant impact on the operations, activities, or reputation of a regulated entity, in the other jurisdiction, as well as material events that could adversely impact another regulator's markets or the stability of a regulated entity, in the other jurisdiction, including known changes in the operating environment, operations, resources, management, or systems and controls of the entity.

The development and application of the supervisory cooperation principles outlined above is important to helping ensure that national regulatory responses to the recent crisis are effective. Because so many regulated entities operate on a global basis, effective regulation of these entities requires regulators in the jurisdictions in which they operate to assist each other both in ensuring adequate oversight and in identifying and mitigating risks to investors and markets before these risks manifest themselves in harmful ways.

These principles may also prove useful to helping IOSCO members identify, assess and mitigate future dangers to financial market stability. The recent crisis has highlighted that disturbances with significant impact on the stability of our markets and financial systems pay little heed to national borders. While supervisory cooperation is not a substitute for effective regulation, it is possible that, had greater supervisory cooperation of the type outlined here existed prior to the onset of the current crisis, regulators may have been able to better identify the excessive risks many firms were taking on in other markets. Likewise, had these

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<sup>46</sup> See *Risk Concentration Principles*, Joint Forum on Financial Conglomerates (IOSCO Public Document No. 102, December 1999), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD102.pdf>.

<sup>47</sup> See *Intra-Group Transactions and Exposures Principles*, Joint Forum on Financial Conglomerates (IOSCO Public Document No. 101, December 1999), which is accessible via the Internet at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD101.pdf>.

principles been in place at the outset of the crisis, they may have enabled regulators to better identify emerging issues and develop coordinated responses more quickly, thereby reducing damage to the real economy.

## ANNEX A

### ANNOTATED SAMPLE MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION, COOPERATION AND THE EXCHANGE OF INFORMATION RELATED TO THE SUPERVISION OF CROSS-BORDER REGULATED ENTITIES

*The following is an annotated sample Supervisory MOU, which may serve to assist IOSCO members when designing bilateral supervisory arrangements. This Sample Supervisory MOU is not designed to serve as a model MOU. Rather, it describes the issues and possible provisions that may prove effective for supervisory cooperation arrangements, and illustrates some (though clearly not all) of the ways different jurisdictions might approach regulatory and legal issues that might arise when constructing such arrangements in practice. Fundamentally, the terms of any arrangement will have to be determined by the partners to such an arrangement and will necessarily reflect their own legal and regulatory circumstances and needs. The conclusion of a Supervisory MOU would be one means of giving effect to the principles for supervisory cooperation developed by the IOSCO Supervisory Cooperation Task Force. This sample MOU is intended to be comprehensive but also sufficiently flexible to cover the changing regulatory landscape and the growing role of securities regulators in considering issues of systemic importance and different regulatory approaches. At its core, a Supervisory MOU should facilitate the ability of authorities to discuss common regulatory issues, to get a full regulatory picture of globally active entities, and to share non-public supervisory information where necessary subject to confidentiality assurances and appropriate restrictions on the use of such information.*

In view of the growing globalization of the world's financial markets and the increase in cross-border operations and activities of regulated entities, the [insert name of regulator] and the [insert name of regulator] have reached this Memorandum of Understanding (MOU) regarding mutual assistance in the supervision and oversight of regulated entities that operate on a cross-border basis in the securities sector in the jurisdictions of both Authorities. The Authorities express, through this MOU, their willingness to cooperate with each other in the interest of fulfilling their respective regulatory mandates, particularly in the areas of: investor protection; fostering market and financial integrity; and maintaining confidence and systemic stability.

#### ARTICLE ONE: DEFINITIONS

*This section of an MOU is designed to clarify the meaning of commonly used terms in the MOU, including the authorities and regulated entities to be covered. Authorities should seek to strike a balance between definitions that are neither too prescriptive nor overly general. Such a balance will help avoid uncertainties over time as to whether the MOU applies in any given situation. The following are examples of some commonly used terms.*

For purposes of this MOU:

1. "Authority" means the [insert name of regulator] or [insert name of regulator]:

"Requested Authority" means the Authority to whom a request is made under this MOU; and

"Requesting Authority" means the Authority making a request under this MOU.

2. “Person” means a natural person, unincorporated association, partnership, trust, investment company or corporation.
3. “Regulated Entity” means [a financial market participant or other entity whose activities subject it to the supervision, oversight and/or authorization or registration of one of the Authorities.]

*Depending on their regulatory needs and other existing arrangements, authorities should determine the appropriate list to include here. This should dovetail with the scope section of the MOU thereby creating certainty as to the types of regulated entities covered by the MOU. For example, this term could include affiliated markets, intermediaries (e.g., brokers or advisers), collective investment schemes, hedge funds, issuers and clearing organizations. Authorities may also wish to pay special attention to entities active in the cross-border commercialization of financial products.*

4. “Cross-Border Regulated Entity” means a Regulated Entity subject to supervision and/or oversight by both Authorities.

*As above, and depending on the jurisdictions’ regulatory approach and legal framework, an MOU might include a term covering such things as: (i) entities authorized/registered in both jurisdictions; (ii) entities authorized/registered in one jurisdiction and subject to an exemption in the other jurisdiction; (iii) entities authorized/registered in one jurisdiction whose material affiliate is authorized/registered in the other jurisdiction; and/or (iv) entities subject to a home-host regime in the two jurisdictions.*

5. “Cross-border On-Site Visit” means any regulatory visit by one Authority to the premises of a Cross-Border Regulated Entity located in the other Authority’s jurisdiction, for the purposes of ongoing supervision.

*The above definition can be used where on-site visits of regulated entities are contemplated, and the exact definition will depend on the legal requirements of the authorities signing the MOU. For most arrangements, on-site visits will likely be to the premises of either Regulated Entities or Cross-Border Regulated Entities (i.e., dually regulated entities). Most regulators will not have the regulatory remit to conduct on-site visits of entities that are not registered with them.*

6. “Local Authority” means the Authority in whose jurisdiction a Cross-Border Regulated Entity operates.

*Where both authorities to an MOU operate pursuant to a home-host regulatory regime, it would be appropriate to include relevant definitions of “Home” and “Host” country and reliance on “Home country rule” where appropriate. However, this construct would not be applicable when entering into an MOU with an Authority that does not have such a regime under its legal system. Accordingly, regulators should be flexible in considering MOU frameworks that allow for various regulatory structures while still facilitating strong supervisory cooperation.*

7. “Emergency Situation” means the occurrence of an event that could materially impair the financial or operational condition of a Cross-Border Regulated Entity.
8. “Governmental Entity” means: [list other government agencies in each Authority’s jurisdiction that the Authority may be legally required to pass information on to for systemic risk or other purposes. *See paragraph 31.*]
9. [...]

## **ARTICLE TWO: GENERAL PROVISIONS**

*These provisions closely mirror those found in the IOSCO MMOU and are intended to appropriately characterize the MOU as a non-binding framework for cooperation rather than an international treaty or binding international agreement with legal force. In most jurisdictions, this distinction is essential in order for the securities regulator to have the legal ability to enter into an MOU.*

10. This MOU is a statement of intent to consult, cooperate and exchange information in connection with the supervision and oversight of Cross-Border Regulated Entities that operate in [add first jurisdiction] and [insert second jurisdiction], in a manner consistent with, and permitted by, the laws and requirements that govern the Authorities. The Authorities anticipate that cooperation will be primarily achieved through ongoing, informal, oral consultations, supplemented by more in-depth, ad hoc cooperation. The provisions of this MOU are intended to support such informal and oral communication as well as to facilitate the written exchange of non-public information where necessary.

[10(a). This MOU [also] is a statement to support the Authorities’ participation in [add title of the relevant supervisory college] that was established among [add the list of supervisory college participants] (“Supervisory College”) for the purpose of coordinating the supervision of [insert relevant regulated entity]. While the Authorities anticipate that cooperation with respect to [relevant regulated entity] will primarily be achieved through the Supervisory College, this MOU will facilitate the exchange of non-public supervisory information among members of the Supervisory College who are signatories to the MOU.]

*Most supervisory colleges, as they currently exist, do not have built-in mechanisms for the exchange of non-public information. Where members of the college are also signatories to such an MOU, the MOU could facilitate the exchange of non-public information among members of the college. The bracketed language above is an example of what such an addition to an MOU might look like.*

11. This MOU does not create any legally binding obligations, confer any rights, or supersede domestic laws. This MOU does not confer upon any Person the right or ability directly or indirectly to obtain, suppress, or exclude any information or to challenge the execution of a request for assistance under this MOU.
12. This MOU does not limit an Authority to taking solely those measures described herein in fulfillment of its supervisory functions. [In particular, this MOU does not affect any right of any Authority to communicate with or obtain information or documents from, any Person subject to its jurisdiction that is located in the territory of the other Authority.

*The bracketed language above recognizes that, where applicable, a regulated entity in one jurisdiction that chooses to operate in another jurisdiction, even if not physically located in that jurisdiction, may be legally required to meet certain registration requirements, make its books and records available and/or submit to inspections by the second authority. In some jurisdictions, however, direct communication with a foreign regulator may not be allowed under domestic laws. Accordingly, any such language would have to reflect the requirements and needs of the jurisdictions developing the arrangement.*

13. This MOU complements, but does not alter the terms and conditions of the following existing arrangements concerning cooperation in securities matters: (i) the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, to which the Authorities are signatories, which also covers information-sharing in the context of enforcement investigations; and (ii) [add any other relevant arrangement between the Authorities].
14. The Authorities will, within the framework of this MOU, provide each other with the fullest cooperation permissible under the law in relation to the supervision of Cross-Border Regulated Entities. Following consultation, cooperation may be denied:
  - a) Where the cooperation would require an authority to act in a manner that would violate domestic law;

Where a request for assistance is not made in accordance with the terms of the MOU;  
or

On the grounds of the national public interest.

15. The Authorities will periodically review the functioning and effectiveness of the cooperation arrangements between the Authorities with a view, *inter alia*, to expanding or altering the scope or operation of this MOU should that be judged necessary.

16. To facilitate cooperation under this MOU, the Authorities hereby designate contact persons as set forth in Appendix A.

*Depending on the scope of the MOU and the types of regulated entities covered, authorities may need to consider identifying a contact person for each relevant area of expertise.*

### **ARTICLE THREE: SCOPE OF SUPERVISORY COOPERATION**

*This section of an MOU is designed to clarify the entities covered by the MOU and the circumstances under which the need for cooperation is likely to be triggered. The scope may vary depending on the needs and global landscape of the authorities entering into the MOU. Examples of regulated entities that could be covered include: affiliated markets, intermediaries (brokers and advisers), collective investment schemes, issuers and clearing organizations. To note, the MOU is intended to only cover supervisory cooperation with respect to matters that fall within the remit of securities regulators. The following text provides examples of the type of provisions that might be included in this section.*

17. The Authorities recognize the importance of close communication concerning Cross-Border Regulated Entities, and intend to consult regularly at the staff level regarding: (i) general supervisory issues, including with respect to regulatory, oversight or other program developments; (ii) issues relevant to the operations, activities, and regulation of Cross-Border Regulated Entities; and (iii) any other areas of mutual supervisory interest.
18. Cooperation will be most useful in, but is not limited to, the following circumstances where issues of common regulatory concern may arise:
- a) The initial application of a Regulated Entity in one jurisdiction for authorization, registration or exemption from registration in the other jurisdiction;

The ongoing oversight of a Cross-Border Regulated Entity; or

Regulatory approvals or supervisory actions taken in relation to a Cross-Border Regulated Entity by one Authority that may impact the operations of the entity in the other jurisdiction.

19. **Advance Notification.** Each Authority will inform the other Authority in advance of, where practicable, or as soon as possible thereafter of:

- a) Pending regulatory changes that may have a significant impact on the operations, activities, or reputation of a Cross-Border Regulated Entity;

Any material event that could adversely impact a Cross-Border Regulated Entity. Such events include known changes in the operating environment, operations, financial resources, management, or systems and control of a Cross-Border Regulated Entity; and



Enforcement or regulatory actions or sanctions, including the revocation, suspension or modification of relevant licenses or registration, concerning or related to Cross-Border Regulated Entity.

20. **Exchange of Information.** To supplement informal consultations, each Authority intends to provide the other Authority, upon written request, with assistance in obtaining information not otherwise available to the Requesting Authority, and interpreting such information so as to enable the Requesting Authority to assess compliance with its laws and regulations. The information covered by this paragraph includes, without limitation:

- a) Information relevant to the financial and operational condition of a Cross-Border Regulated Entity, including, for example, reports of capital reserves, liquidity or other prudential measures, and internal controls procedures;

Relevant regulatory information and filings that a Cross-Border Regulated Entity is required to submit to an Authority including, for example: interim and annual financial statements and early warning notices; and

Regulatory reports prepared by an Authority, including for example: examination reports, findings, or information drawn from such reports regarding Cross-Border Regulated Entities.

*The paragraph directly above sets forth examples of the types of non-public supervisory information that regulators may seek to exchange. Authorities should consider whether to include as appendices to their MOUs non-exclusive, illustrative lists of types of information that may be of interest with respect to particular types of financial market participations. Where permitted by law, this section might also reference obtaining information on behalf of the other authority from unregulated third parties or assisting the Requesting Authority in obtaining the information directly from the third party.*

#### **ARTICLE FOUR: CROSS-BORDER ON-SITE VISITS**

*This section of an MOU is designed to establish procedures for cooperation in cross-border on-site visits. Authorities must be mindful of the sensitivities that cross-border on-site visits may create. In this connection, authorities should seek to reach an understanding regarding such visits and should work collaboratively with each other. This section may not be relevant where both authorities to the MOU operate pursuant to host-home regimes or who can otherwise legally rely on inspections performed by the home Authority. The paragraphs below are examples of what such a section might cover (where applicable).*

21. The Authorities intend to facilitate access to Regulated Entities and Cross-Border Regulated Entities operating in their respective territories.
22. Authorities should discuss and reach understanding on the terms regarding Cross-border On-Site Visits, taking into full account each others' sovereignty, legal framework and statutory obligations in particular in determining the respective roles and responsibilities of the Authorities.

Generally, the Authorities will act in accordance with the following procedure before conducting a Cross-border On-Site Visit.

- a) When establishing the scope of any proposed visit, the Authority seeking to conduct the visit will give due and full consideration to the supervisory activities of the other Authority and any information that was made available or is capable of being made available by that Authority.
- b) The Authorities will assist each other in reviewing, interpreting and analysing the contents of public and non public documents and obtaining information from directors and senior management of a Cross-Border Regulated Entities.
- c) The Authorities will consult with a view to reaching an understanding on the intended timeframe for and scope of any Cross-border On-Site Visit.

#### **ARTICLE FIVE: EXECUTION OF REQUESTS FOR ASSISTANCE**

*This section sets forth the procedures for making requests for assistance where the exchange of written information is needed.*

- 23. To the extent possible, a request for written information pursuant to Article Three should be made in writing, and addressed to the relevant contact person identified in Appendix A. A request generally should specify the following:
  - a) The information sought by the Requesting Authority;
  - b) A general description of the matter which is the subject of the request and the supervisory purpose for which the information is sought; and
  - c) The desired time period for reply and, where appropriate, the urgency thereof.
- 24. In Emergency Situations, the Authorities will endeavor to notify each other of the Emergency Situation and communicate information to the other as would be appropriate in the particular circumstances, taking into account all relevant factors, including the status of efforts to address the Emergency Situation. During Emergency Situations, requests for information may be made in any form, including orally, provided such communication is confirmed in writing as promptly as possible following such notification.

#### **ARTICLE SIX: PERMISSIBLE USES OF INFORMATION**

*This section is intended establish permissible uses for non-public information exchanged between the authorities under the MOU. For added clarity, this section has been separated from confidentiality, although the two clearly are interrelated. The following are examples of language that such a section might include (where applicable).*

- 25. The Requesting Authority may use non-public information obtained under this MOU solely for the purpose of supervising Cross-Border Regulated Entities and seeking to ensure compliance with the laws or regulations of the Requesting Authority.

26. This MOU is intended to complement, but does not alter the terms and conditions of the existing arrangements between the Authorities concerning cooperation in securities matters, as set forth in Paragraph 13. The Authorities recognize that while information is not to be gathered under the auspices of this MOU for enforcement purposes, subsequently the Authorities may want to use the information for law enforcement. In such cases, further use of the information should be governed by the terms and conditions of the relevant enforcement MOU.

*A paragraph such as that above might be used to avoid an overlap or duplication with the IOSCO MMOU. Accordingly, in the event that a request for supervisory cooperation leads to the opening of an enforcement inquiry or investigation, from that point on, cooperation should proceed under the terms of the IOSCO MMOU. Such terms have been specifically designed, and carefully negotiated, to address enforcement use and confidentiality in the context of enforcement investigations and proceedings.*

#### **ARTICLE SEVEN: CONFIDENTIALITY OF INFORMATION AND ONWARD SHARING**

*This section is intended to establish safeguards for the confidentiality of non-public information exchanged under the MOU and to provide parameters for the consideration of appropriate onward sharing to other governmental authorities. The following paragraphs are examples of language that such provisions might include.*

27. Except for disclosures in accordance with the MOU, including permissible uses of information under Article Six, each Authority will keep confidential to the extent permitted by law information shared under this MOU, requests made under this MOU, the contents of such requests, and any other matters arising under this MOU.
28. To the extent legally permissible, the Requesting Authority will notify the Requested Authority of any legally enforceable demand for non-public information furnished under this MOU. Prior to compliance with the demand, the Requesting Authority intends to assert all appropriate legal exemptions or privileges with respect to such information as may be available.
29. In certain circumstances, and as required by law, it may become necessary for the Requesting Authority to share information obtained under this MOU with other Governmental Entities in its jurisdiction. In these circumstances and to the extent permitted by law:
- a) The Requesting Authority will notify the Requested Authority.
  - b) Prior to passing on the information, the Requested Authority will receive adequate assurances concerning the Governmental Entity's use and confidential treatment of the information, including, as necessary, assurances that the information will not be shared with other parties without getting the prior consent of the Requested Authority.

*The paragraph above is an example of a provision designed to reflect that many securities regulators may be legally required, in certain circumstances, to share*

*certain supervisory information (particularly as it may relate to systemic issues) with financial ministries or other governmental authorities in their jurisdiction or possibly with third authorities. Authorities negotiating an MOU and wishing to include such a provision will need to define the applicable governmental entities for purposes of their arrangements. Also, to the extent such onward sharing is expected to be done on a routine basis, the Authorities may want to consider including mechanisms in the MOU that reflect confidentiality assurances from the other governmental entity or third authority in order to streamline the process for onward sharing.*

30. Except as provided in paragraph 28, the Requesting Authority must obtain the prior consent of the Requested Authority before disclosing non-public information received under this MOU to any non-signatory to this MOU. If consent is not obtained from the Requested Authority, the Authorities will consult to discuss the reasons for withholding approval of such use and the circumstances, if any, under which the intended use by the Requesting Authority might be allowed.
31. The Authorities intend that the sharing or disclosure of non-public information, including but not limited to deliberative and consultative materials, pursuant to the terms of this MOU, will not constitute a waiver of privilege or confidentiality of such information.

#### **ARTICLE NINE:       TERMINATION**

*Many information-sharing arrangements have sections that give the Authorities the flexibility to terminate the MOU in the unlikely event that circumstances require such a step. At the same time, such sections typically preserve the confidential safeguards that already have been afforded to information exchanged under the terms of the MOU. The following paragraph is an example of how such a section might be drafted.*

32. Cooperation in accordance with this MOU will continue until the expiration of 30 days after either Authority gives written notice to the other Authority of its intention to terminate the MOU. If either Authority gives such notice, cooperation will continue with respect to all requests for assistance that were made under the MOU before the effective date of notification until the Requesting Authority terminates the matter for which assistance was requested. In the event of termination of this MOU, information obtained under this MOU will continue to be treated in a manner prescribed under Articles Six and Seven.

## **ANNEX B**

### **TASK FORCE ON SUPERVISORY COOPERATION**

Chairmen: Ms. Kathleen Casey, Commissioner  
Securities and Exchange Commission (United States)

Mr. Jean-Pierre Jouyet, President  
Autorité des marchés financiers (France)

Deputy Chairmen: Mr. Ethiopis Tafara  
Securities and Exchange Commission (United States)

Mr. Xavier Tessier  
Autorité des marchés financiers (France)

Australian Securities and Investments  
Commission (Australia)

Chairman Tony D'Aloisio  
Mr. Steven Bardy

Comissão de Valores Mobiliários (Brazil)

Chairman Maria Helena Santana  
Mr. Eduardo Manhães Ribeiro Gomes

China Securities Regulatory Commission  
(China)

Chairman Fulin Shang  
Ms. Hua Yi Feng  
Dr. Tong Daochi

Autorité des marchés financiers (France)

Ms. Dora Balasz

Bundesanstalt für Finanzdienstleistungsaufsicht  
(Germany)

Mr. Karl-Burkhard Caspari  
Mr. Phillip Sudeck  
Mr. Thomas Schmitz-Lippert

Securities and Futures Commission  
(Hong Kong)

Mr. Martin Wheatley  
Ms. Christine Kung

Securities and Exchange Board of India

Chairman C.B. Bhav

Commissione Nazionale per le Società e la  
Borsa (Italy)

Chairman Lamberto Cardia  
Ms. Nicoletta Guisto

Financial Services Agency (Japan)

Vice Commissioner Masamichi Kono  
Mr. Kazunari Mochizuki  
Mr. Takashi Nagaoka

Comisión Nacional del Mercado de Valores  
(Mexico)

President Guillermo Babatz  
Ms. Angelica Gonzalez-Saravia

Authority for the Financial Markets (Netherlands)	Chairman Hans Hoogervorst Mr. Gert Luiting
Ontario Securities Commission (Ontario, Canada)	Chairman David Wilson Ms. Tula Alexopoulos Mr. Jean-Paul Bureaud
Autorité des marchés financiers (Quebec, Canada)	President Jean St-Gelais Mr. Louis Morisset Mr. Jean Lorrain
Comisión Nacional del Mercado de Valores (Spain)	Vice Chairman Fernando Restoy Mr. Santiago Yraola Mr. Antonio Mas
Swiss Financial Markets Supervisory Authority (Switzerland)	Vice Chairman Daniel Zuberbühler Mr. Marco Franchetti
Financial Services Authority (United Kingdom)	Ms. Verena Ross Mr. Jean-Paul Dryden
Commodity Futures Trading Commission (United States)	Chairman Gary Gensler Ms. Jacqueline Mesa
Securities and Exchange Commission (United States)	Mr. Robert J. Peterson Ms. Kelly Riley
IOSCO General Secretariat	Secretary General Greg Tanzer Mr. Tajinder Singh Mr. Mohamed Ben Salem
Contributing Author(s):	Robert J. Peterson Kelly Riley Gloria Dalton Babback Sabahi U.S. Securities and Exchange Commission