

APPENDIX ONE

PROMOTING FAIR AND TRANSPARENT REGULATION

DISCUSSION PAPER

I. Setting The Foundation for Open and Fair Securities Markets

Deep and liquid capital markets are the essential building blocks of today's economy, supplying the funds for economic growth and job creation. The firms that participate in the markets price risk, allocate capital, provide investors with advice and investment opportunities, and supply the liquidity needed to make markets work efficiently.

Just as capital markets underpin economic growth and job creation, transparent and fair regulatory systems are essential to the development of deep and liquid capital markets. A system of regulation that is transparent to market participants instills the confidence needed to attract both the suppliers and users of capital to make the best use of the markets.

Governments, regulators and the international financial institutions have undertaken substantial projects designed to improve the quality of the financial systems world-wide. Attention is now focused on building fair and transparent regulatory systems – grounded in the principles of market integrity and investor protection – to oversee those markets. Consistent with those goals and the principles of prudential regulation, discriminatory practices and considerations, such as the nationality of individuals or the place of origin of firms, should not be permitted to influence regulatory policies or actions.

This paper is based on the assumption that a country's relevant laws should promote fair and transparent regulation. The principles outlined in this paper are not intended to prevent a regulator from taking measures for prudential or legitimate public policy reasons recognized under the World Trade Organization, including protecting investors, ensuring that markets are fair, efficient and transparent, and reducing systemic risk.

A consensus view, supporting the development of active, sound and efficient markets based upon established principles for capital market regulation, is rapidly emerging. In September 1998, the International Organization of Securities Commissions (IOSCO) issued a paper entitled “The Objectives and Principles of Securities Regulation” that urged the adoption by all regulators of processes and regulations that are:

- consistently applied;
- comprehensible;
- transparent to the public; and
- fair and equitable.

The International Monetary Fund (“IMF”) is developing a broad-based “Code on Good Practices and Transparency in Monetary and Financial Policies” that complements IOSCO’s work.

The securities industry, which today operates on a global basis, supports the IMF and IOSCO efforts to establish principles of fair and transparent regulation. The securities industry strongly believes that by making regulation and the operation of regulators accessible and transparent and by treating foreign and domestic licensed market participants fairly and equitably, governments, regulators and international financial institutions will promote the best markets for investors throughout the world.

Building on the emerging regulatory consensus, this paper provides the views of the securities industry on fundamental regulatory principles and practices that will provide a fair and level playing field for market participants. It also sets the foundation for building strong and vibrant markets worldwide. Moreover, we strongly believe that the principles promoting fair and transparent markets are broadly applicable to all financial services firms participating in the global capital markets. In this regard, we are actively seeking the support of financial services firms worldwide in promoting these principles.

II. Guiding Principles of Fair and Transparent Regulation

- A. Rules, regulations and licensing requirements should be considered and imposed, and regulatory actions should be taken, only for the purpose of achieving legitimate public policy objectives that are expressly identified, including, for example, investor protection, maintaining fair, efficient, and transparent markets, and reducing systemic risk.*

- B. *Regulation should be enforced in a fair and non-discriminatory manner.*
1. *Regulations and regulators¹ should not discriminate among licensed market participants on the basis of the nationality or jurisdiction of establishment of the shareholders of a market participant or the jurisdiction of establishment of any entity that owns or controls the equity or indebtedness of a market participant.*
 2. *The relationship between a regulator and a licensed market participant should be governed by the standards set forth in relevant rules and regulations, and should not be subject to political or other extraneous or improper considerations.*
 3. *The introduction of new securities products and services by firms should be governed by the standards set forth in relevant rules and regulations*
- C. *Regulations should be clear and understandable.* Clear and understandable regulations and rulings provide market participants with the predictability and necessary knowledge to comply with regulations. Opaque or ambiguous regulations and rulings create uncertainty among investors and licensed market participants.
- D. *All regulations should be publicly available at all times.* All regulations should be made, and at all times remain, publicly available, including requirements to obtain, renew or retain authorization to supply a service. Disciplinary actions should not be taken based on violations of regulatory standards that were not in effect at the time the relevant activity took place.

¹ The term “regulator” is intended to cover all bodies that are authorized pursuant to law to play a role in the licensing and supervision of the activities of financial services firms, as well as the bodies that formulate rules, regulations and policies relating to such firms. Where the legislature or authorized regulator delegates its authority to a non-governmental entity such as a self-regulatory organization or trade association, the term is intended to encompass such an entity.

- E. *Regulators should issue and make available to the public final regulatory actions and the basis for those actions, in order to enhance public understanding thereof.*

III. Rulemaking and Implementation

A. *The rulemaking process*

1. *Regulators should utilize open and public processes for consultation with the public on proposals for new regulations and changes to existing regulations.* A reasonable period for public comment should be provided. Any hearings at which formal promulgation or adoption of new regulations or changes to existing regulations are considered, if open to a member of the public, should be open to all members of the public. Regulators should not take arbitrary regulatory action against those who participate in the consultation process.
2. *In considering whether rules, regulations, licensing requirements or actions are necessary or appropriate, regulators should also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.*

B. *Communicating and implementing new rules*

1. *New rules and regulations that provide advice for market participants should be made available to them and the public in a timely and efficient manner.* Such changes should be made available, in writing, by electronic media or other means of distribution so that all market participants have reasonable access to such material.
2. *Market participants should be given a reasonable period of time to implement new regulations.* The effective date of a new regulation should provide a reasonable period for market participants to take the steps needed to implement the new regulation under the circumstances.

C. *Interpretations of rules*

1. *Regulators should establish a mechanism to respond to inquiries on rules and regulations from market participants.* The titles and official addresses of the relevant regulatory offices should be provided.
2. *Interpretations and the grants or denials of regulatory relief or exemptions should be made available to the public.* Such interpretations, relief or exemptions should generally apply or should be applied upon proper request, to substantially similar licensed market participants and new products. Under limited circumstances it may be appropriate to delay the publication of individual grants of relief for reasonable periods of time to address legitimate competitive concerns.

IV. Licensing and New Product Procedures

A. *Procedures for licenses and introduction of new securities products and services.*

1. *Criteria governing licensing of firms and the introduction of new securities products and services by firms should be in writing and accessible, and should be the basis on which decisions are made.* All regulations and related explanatory materials governing the consideration and issuance of licenses to firms and the introduction of new securities products and services by firms should be reduced to writing and made publicly available to potential applicants upon request. No licensee should be denied a license, and no new securities product or service should be prohibited, on the basis of any factor not identified in such written regulations or explanations.
2. *The introduction of new securities products and services by firms should be governed by the standards set forth in relevant rules and regulations.* Where particular requirements are established in connection with the introduction of a product or service, such requirements should govern the introduction of complying products and services. In order to promote flexibility and efficiency in the capital markets, such standards and requirements should

enable firms, to the maximum possible degree consistent with principles of prudence and investor protection, to introduce complying new products and services on the basis of sound internal procedures for compliance without additional regulatory review.

3. *Information supplied by applicants as part of an application process should be treated confidentially. Such information should be disclosed only in accordance with existing rules permitting public disclosures, such as those that may be triggered by the granting of a license or product approval.*
4. *Regulators should promptly review all applications by firms for licenses and required product or service approvals and should inform the applicant of any deficiencies.* No application for a license or approval that provides all information required pursuant to regulation and is made in good faith by an applicant that meets required criteria should be refused review and action by the relevant regulator. Action on all applications received should be taken within a reasonable period. Licenses should enter into force immediately upon being granted, in accordance with the terms and conditions specified therein.
5. *Where an examination is required for the licensing of an individual, regulators should schedule such examinations at reasonably frequent intervals.* Examinations should be open to all eligible applicants, including foreign and foreign-qualified applicants.
6. *Fees charged in connection with licenses and the introduction of new securities products and services should be fair and reasonable and not act to prohibit or otherwise unreasonably limit licensing requests or the introduction of new product and services.*

B. *Licensing of entities and their employees*

1. *An applicant's competence and ability to supply the service should be the criteria used for licensing entities and employees.* The terms and conditions for granting licenses should be made explicit, including education, experience, examinations and ethics. Procedures and criteria should not unfairly distinguish between domestic and foreign applicants. In addition, there should be no quantitative limits on the number of licenses to be granted to a particular class of market participants who are otherwise qualified.
2. *When imposing licensing requirements, regulators should endeavor to give consideration to comparable testing or other procedures confirming the qualifications of an applicant that already have been completed in another jurisdiction.* The ability of qualified and experienced market professionals to provide services in a foreign jurisdiction may be promoted where testing or other procedures used in the professional's home jurisdiction may satisfy all or part of the foreign jurisdiction's licensing requirements.

C. *Denials of licenses and product and service approvals*

1. *When denying an application for a license or a required securities product or service approval, regulators should, upon request, provide an explanation for that action.* Any total or partial denial of any application for a license or a required new product or service approval should, upon request, be accompanied by a written statement of explanation from the relevant regulator detailing the reasons for the denial, including the particular requirements of the regulations governing the issuance of such license or required approval that were not satisfied. Applicants should be given the opportunity to resubmit applications or to file additional or supplementary materials in support of their applications.
2. *Applicants should be afforded meaningful access to administrative or judicial appeal of a denial of a license or a required product or service approval (or failure to act on an application).*

3. *An appeal of a denial of a license or a required product or service approval should be decided within a reasonable time period after the appeal is filed.* An applicant's decision to pursue an appeal (whether formal or informal) should not prejudice its existing licensed operations.

V. Implementation of Regulatory Standards

A. Inspections, audits, investigations and regulatory enforcement proceedings²

1. *All inspections, audits, investigations and regulatory enforcement proceedings should be conducted pursuant to established regulatory and judicial standards and should not arbitrarily discriminate based on improper or other extraneous criteria like nationality.*
2. *All inspections, audits, and investigations should be conducted in a manner that does not impinge on the rights of licensed market participants and their directors, officers and employees.*
2. *A regulatory authority³ should not publicly disclose the fact that it is conducting an enforcement related inspection, audit or investigation of a particular entity until a determination has been made by the regulatory authority to take remedial or other enforcement-related action, unless otherwise subject to a legally enforceable demand unless made in connection with a generally applicable disclosure requirement imposed on the entity.* The inspection, audit or investigation should be conducted at all times with due attention to the privacy and confidentiality concerns of all affected parties, including licensed market participants, their directors, officers, employees, and clients.

² The term "regulatory enforcement proceedings" means administrative or judicial action authorized by the relevant regulatory authority and is intended to cover civil, administrative or criminal proceedings that involve a financial services firm and/or its employees based on their financial services activities.

³ The term "regulatory authority" is intended to cover all regulatory bodies involved in the inspection, auditing, investigation or prosecution of the activities of financial services firms. Depending on the system, the term may encompass criminal and judicial authorities as well as non-governmental entities such as self-regulatory organizations.

B. *Regulatory proceedings to impose a sanction*

1. Notice and opportunity to be heard

- a. *Notice of applicable law and regulation.* A regulatory proceeding to impose a sanction should only be instituted based on the violation of laws or regulations that were in effect at the time that the relevant activity occurred and where the subject of the proceeding had timely notice of them.
- b. *Notice of determination to take action.* Licensed market participants should be notified in a timely manner both when: 1) a determination has been made to hold a regulatory proceeding concerning the conduct of that participant; and 2) a decision in, or on the status of, that proceeding has been made.
- c. *Opportunity to be heard.* Except in situations where emergency temporary relief is necessary, in all regulatory proceedings, licensed market participants should be given a reasonable opportunity to be heard and to submit, on the record, position papers and other documentary evidence.

2. Representation by counsel and access to evidence

- a. *Right to legal counsel.* The subjects of a regulatory proceeding should have the right to have legal counsel of their choice represent them in all meetings with, and interviews by, regulatory authorities. A regulatory authority should not suggest or imply that the attendance of counsel will in any manner alter the character of the proceedings being conducted, the level of supervisory review to be undertaken, or the manner in which the regulatory authority carries out its functions.
- b. *Access to evidence.* The subjects of a regulatory proceeding should, upon request, be permitted reasonable access to all documents and records that are relevant to the subject matter involved in the pending regulatory action. Documents and records

to which access is denied based on privileges generally recognized in such proceedings should not be admissible in evidence in such regulatory proceeding.

- c. *Burden of proof.* The burden of proof to demonstrate that a licensed market participant has not conducted its business in accordance with the relevant law and regulation should rest with the regulatory authorities.

3. Sanctions and Appeals

- a. *Sanctions.* Sanctions by a regulatory authority should be imposed in a fair and nondiscriminatory manner based on the relevant facts and with an effort to treat similarly situated persons and entities in a similar manner. The basis for any decision to impose sanctions by a regulatory authority should be explained in a writing that is made available to the subjects of the proceeding.
- b. *Appeals.* The subjects of a regulatory proceeding should have available to them a forum for appealing the decisions rendered and sanctions imposed. The body considering a particular level of appeal should be separate from that which made the decision or imposed the sanction that forms the basis of the appeal. Appeals to a regulatory authority should be decided in a timely manner and appeal determinations should be explained in a writing that is made available to the subjects of the proceeding.

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