

**CONSULTATION REPORT**

**AN OVERVIEW OF THE WORK  
OF THE  
IOSCO TECHNICAL COMMITTEE**



**OICU-IOSCO**

**TECHNICAL COMMITTEE  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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**This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Technical Committee or any of its members.**

## Preamble

Since its creation in 1983, IOSCO has rapidly developed into the most important standard setter in the field of securities regulations. In order to continue to be able to publish timely and clear guidelines, recommendations and standards for the regulatory community and the securities industry, the Technical Committee of IOSCO is requesting comments on its work program for the immediate years. In this consultation report an overview is given of the committee's current and planned work. The Technical Committee invites interested parties to provide input on:

- Opportunities to promote just, efficient and sound markets;
- Market risks which might warrant regulatory intervention;
- Regulatory failures (for example instances where regulation is not effective or where sectoral or national regulations are inconsistent or incomplete);
- IOSCO's overall programme of activities;
- Specific on-going initiatives of IOSCO.

Comments on this consultation paper will assist IOSCO in evaluating its priorities and in considering if it needs to undertake work on certain issues.

## How to Submit Comments

Comments may be submitted by one of three methods **at the latest on 8 June 2007**. To help us process and review your comments more efficiently, please use only one method.

### 1. E-mail

- Send comments to Ms. Tillie Rijk: [t.rijk@iosco.org](mailto:t.rijk@iosco.org)
- The subject line of your message should indicate "An Overview of the Work of IOSCO's Technical Committee".
- Please do not submit attachments as HTML, GIF, TIFF, PIF, or EXE files.

**OR**

### 2. Fax

Send a fax to the attention of Ms. Tillie Rijk, using the following fax number: 34 (91) 555 93 68.

**OR**

### 3. Post

Send your comment letter to:

Ms. Tillie Rijk  
IOSCO General Secretariat  
C/ Oquendo 12  
28006 Madrid  
Spain

Your letter should indicate prominently that it is a public comment on “An Overview of the Work of IOSCO’s Technical Committee”.

**Important:** All comments will be made publicly available, unless anonymity is specifically requested. Comments will be converted to PDF format and then posted on the IOSCO-website. Personal identifying information will not be edited from submissions.

## 1. INTRODUCTION

In the past years, the world has witnessed a rapid evolution of the international markets. New developments in technologies and financial products as well as the increasing interdependence of financial markets and the growing number of retail investors have posed new challenges for securities regulators when shaping their supervisory strategies.

Since 1983, the leading international standard setter in the field of securities regulation has been IOSCO. Together, its 183 members endeavour to maintain just, efficient and sound markets through the promotion of common standards of regulation and cooperation in the enforcement of these standards.<sup>1</sup> The importance of IOSCO's role in securities markets has grown significantly over the years. Its standards and recommendations are the most important benchmark for securities regulators worldwide.

IOSCO is governed by an Executive Committee. Its technical work is conducted by the Technical Committee (TC) and the Emerging Markets Committee. The TC has a leading role in developing standards within IOSCO. It proposes standards to the whole organisation, which are to be endorsed by the Presidents' Committee. Through its Standing Committees and its specialised Task Forces, the TC<sup>2</sup> monitors markets evolutions, analyses new trends in financial activities and identifies actions to be taken by regulators.

Financial markets have never been as interdependent as they are now and this interdependence is likely to increase during the coming years. While investors and service providers benefit from new opportunities worldwide, it is important that the global regulatory framework be consistent and that the benefits of orderly and fair capital markets are not unduly undermined by regulatory arbitrage. IOSCO seeks to strengthen and harmonise the global regulatory framework by adopting a full spectrum of high-level international standards and by encouraging its members to implement those standards in their respective jurisdictions. In addition, IOSCO works closely with the other international financial standard setters (Basel Committee on Banking Supervision and IAIS) to enhance the stability of the financial system worldwide.

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<sup>1</sup> The objectives of IOSCO members are:

- to cooperate to promote high standards of regulation in order to maintain just, efficient and sound markets;
- to exchange information on their respective experiences in order to promote the development of domestic markets;
- to unite their efforts to establish standards and an effective surveillance of international securities transactions;
- to provide mutual assistance to promote the integrity of the markets by a vigorous application of the standards and by effective enforcement against offences.

<sup>2</sup> The TC-member jurisdictions are: Australia, Canada (Ontario and Quebec), France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Spain, Switzerland, United Kingdom, United States of America (CFTC and SEC).

Following the adoption of its Objectives and Principles in 1998, in recent years IOSCO has responded to new issues raised by the crises and scandals of the late nineties and early new millennium. Important examples are IOSCO's principles on analysts, the Code of Conduct for Credit Rating Agencies and its report "Strengthening Capital Markets against Financial Fraud" which identified several critical issues needing to be addressed in order to be better able to prevent large scale financial fraud. In particular, this report examined areas such as corporate governance, auditor's independence, issuers' disclosure requirements, bond market regulation and transparency, the role and obligation of market intermediaries and the role of private sector information analysts. Having analysed whether any international standards or principles currently exist to remedy or address each of these issues, the report sets out a series of actions for further work. This work was timely and gave clear guidelines for both the regulatory community and the industry. While it is wary of burdening the financial markets with excessive regulations, IOSCO recognises that it is important to continue to anticipate and to react pro-actively to any issues that might occur within the financial markets and that might harm investors or the integrity of these financial markets.

IOSCO's Technical Committee is now considering its priorities for the coming years and welcomes input from the industry and other interested parties in order to identify which issues are most pressing and need to be addressed. It also wishes to identify areas of potential risk. For this purpose, IOSCO is publishing this consultation report, which is an overview of its current work. This paper does not reflect ideas or proposals for IOSCO's future work that may be under development in its Committees and Task Forces and that have not yet been presented to the Technical Committee.

In particular, the Technical Committee is interested in receiving input on:

- Opportunities to promote just, efficient and sound markets;
- Market risks which might warrant regulatory intervention;
- Regulatory failures (for example instances where regulation is not effective or where sectoral or national regulations are inconsistent or incomplete);
- IOSCO's overall programme of activities;
- Specific on-going initiatives of IOSCO.

Comments on this consultation report will assist IOSCO in evaluating its priorities and in considering if it needs to undertake work on certain issues. It should be emphasised that the identification of new issues will not automatically lead to work by IOSCO in this area. Rather, it will be used as input for discussions that IOSCO intends to have internally and with its stakeholders. IOSCO only issues new principles for securities regulations when it is of the opinion that they can contribute to improvements in global standards or that significant market or regulatory failures are present. IOSCO also plans to use this

document as a discussion paper to be used as a means to improve its dialogue with the financial services industry.

This report is structured in terms of market participants in order to facilitate their access to subjects relevant to their own domain.

The matrix only serves as a general overview. In chapter II a more elaborate explanation of current and planned work is given for each of the themes.

## OVERVIEW OF IOSCO TC WORK PROGRAM

		ISSUERS	ACCOUNTANTS AUDITORS	TRADING VENUES	INTERMEDIARIES	ASSET MANAGEMENT
<b>NEW EXPLORATORY WORK</b>				Price formation on fragmented markets	Impact of new technology	Private equity
<b>REGULATORY TRENDS IN FINANCIAL ACTIVITIES</b>		<ul style="list-style-type: none"> <li>Monitoring of accounting and standards</li> </ul>				<ul style="list-style-type: none"> <li>Hedge funds valuation</li> <li>Elements of regulations for funds of hedge funds</li> </ul>
	<b>DISCLOSURE AND TRANSPARENCY</b>	<ul style="list-style-type: none"> <li>Financial and non-financial disclosure standards</li> <li>Special purpose vehicles</li> <li>Credit rating agencies</li> </ul>	Review of audit standards	Bond market Transparency		Soft commissions and incentives
	<b>GOVERNANCE AND CONFLICTS OF INTEREST</b>	<ul style="list-style-type: none"> <li>Independence of board members</li> <li>Protection of minority shareholders</li> </ul>	Non audit services Audit Quality		Conflicts of interest in an initial public offering	
	<b>RULES OF CONDUCT</b>				Point of sale disclosure and customers suitability	
<b>ENFORCEMENT</b>			<ul style="list-style-type: none"> <li>Audit Contingency planning</li> </ul>	<ul style="list-style-type: none"> <li>Exchange of information in cross-border activities</li> <li>Boiler rooms</li> <li>Asset freezing</li> </ul>		

## **2 THE WORK OF THE TECHNICAL COMMITTEE**

### **A Issuers**

#### **A. 1. Monitoring developments and the enforcement of accounting standards**

Recent financial scandals have shown the importance of adequate transparency on financial markets. In February 2005 the IOSCO Technical Committee (“TC”) published the report *Strengthening Capital Markets against Financial Fraud* (“the Fraud Report”) which identified several critical issues needing to be addressed in order to better prevent large-scale financial fraud. The development of standards with regard to issuer transparency and the transparency of market operations has always been a priority for IOSCO. In May 2000, IOSCO adopted a resolution on IASC standards endorsing the international accounting standards for cross-border use, subject to national treatments where needed to address outstanding issues.

IOSCO closely monitors the developments in International Financial Reporting Standards (IFRSs), comments on proposed changes and routinely discusses standard-setting work with representatives of the International Accounting Standards Board (IASB). IOSCO encourages a reduction in the complexity of accounting standards and in the number of exceptions to principles. It also calls for an appropriate balance between the costs and benefits of accounting standards.

IOSCO has always stressed the importance of implementing IFRSs consistently throughout the world. In order to support this objective, the TC has developed the *IOSCO IFRS Regulatory interpretation and Enforcement Database*. Access to this database is available to securities regulators that have signed a participation agreement and is designed for sharing regulatory interpretation and enforcement decisions related to IFRSs. The IOSCO database is compatible with a similar database maintained by CESR and has been operational since January 2007.

#### **A. 2. Financial and non-financial disclosure standards**

##### ***Debt Disclosure***

As noted in the Fraud Report, IOSCO has undertaken a project to develop principles of disclosure for debt prospectuses that should provide useful guidance to securities regulators. The TC has approved and will very soon publish a report entitled *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*. This project is a follow-up to the 1998 public release of the IOSCO International Disclosure Standards for Cross-border Offerings and Initial Listings by Foreign Issuers which apply to equity securities.



## ***Periodic Disclosure***

IOSCO is developing principles for the disclosure that listed issuers provide in their periodic reports. These principles should facilitate agreement among regulators on minimum standards for disclosure in periodic reports, particularly annual reports

## ***Special purpose vehicles***

As a follow-up to the Fraud Report, IOSCO has launched a survey to ascertain the accounting and non-financial statement requirements that apply to with respect to their use of unconsolidated Special Purpose Vehicles.

### **A. 3. Corporate governance**

#### ***Board independence and minority shareholders***

In the Fraud Report, IOSCO identified board independence, related party transactions and the protection of minority shareholders as crucial elements of corporate governance. Moreover, good corporate governance plays a role in investor protection. These issues are already addressed by some international standards, in particular those published by the Organisation of Economic Cooperation and Development (OECD). However, as these are high-level standards designed to accommodate different legal and regulatory frameworks, IOSCO has decided to do additional work on how the OECD principles can be implemented in practical terms. More specifically, IOSCO has set out to undertake, in collaboration with the OECD, an additional descriptive and thematic analysis of the definition and role of independent directors on the boards of public issuers and on the additional protection required in situations where these issuers are controlled by a dominant shareholder.

In 2006, the Task Force on Corporate Governance carried out an extensive survey related to independence of the board. A consultation report was published in December 2006 and the final report was published in early March 2007. The report contains an overview of the regulatory frameworks currently existing as regards to board independence and a related comprehensive analysis.

A second mandate is being carried out by the Task Force, which deals with the protection of minority shareholders from dominant shareholders or changes in control. A report is expected to be published in 2007.

#### ***Scheduled output:***

- *Final report Board Independence of Listed Companies: February 2007*
- *Report on protection of minority shareholders from dominant shareholders or changes in control: Early 2008*

#### **A. 4. Credit Rating Agencies**

In December 2004, IOSCO published the *Code of Conduct for Credit Rating Agencies* (CRA Code). This Code offers a set of robust, practical measures that serve as a guide to and a framework for implementing the objectives of the principles on this matter which were published by IOSCO in 2003. These measures are the fundamentals which should be included in individual CRA codes of conduct, and the elements contained in the Code Fundamentals should receive the full support of CRA management and be backed by thorough compliance and enforcement mechanisms.

In order to assess the level of implementation of this code of conduct, IOSCO has set up a task force to review the codes of conduct published by CRAs. Its report was published for consultation in February 2007. It highlights that any variation from the IOSCO Code is usually noted and adequately explained by the CRA, although in specific area, there is still room for improvement.

IOSCO will continue to monitor new developments of CRAs' activities and their impact on the market.

*Scheduled output:*

*To continue to monitor progress in the adoption of the CRA Code as well as new developments in the market that may require revisiting the Code in the future.*

## **B Accountants and Auditors**

### **B. 1. Monitoring developments with respect to auditing standards**

The International Federation of Accountants (IFAC) and the International Auditing and Assurance Board (IAASB) are engaged in a major project to clarify and improve International Standards on Auditing (ISAs). IOSCO is closely monitoring this project and expects a substantive evolution of ISAs, which might justify a future IOSCO endorsement for the purpose of facilitating multinational securities offerings and cross-border listings.

### **B. 2. Non audit services**

IOSCO has begun exploring issues related to auditor independence. It focused first on the issue of non-audit services offered to publicly listed audit clients and the potential impact of these services on auditor independence. IOSCO's objective was to gather information to assist its member regulators in determining how best to deal with audit independence issues in their respective jurisdictions and to encourage related cross-border convergence, in particular by exploring convergence opportunities. A survey was published on the regulation of non audit services provided by auditors in February 2007.

IOSCO is closely monitoring the development of auditor independence standards issued by IFAC's International Ethics Standards Board for Accountants and regularly comments on proposed changes and additional changes needed.

### **B. 3. Audit Quality**

In relation to auditing, IOSCO is also exploring the possible drivers of audit quality, including the possible impact of audit firm concentration, auditor liability and other factors. IOSCO plans to hold roundtable discussions with its financial market stakeholders on topics related to the quality of audits in Paris in June 2007. IOSCO and its members are also coordinating with auditor oversight bodies to examine and address issues affecting audit quality.

### **B. 4. Audit Contingency Planning**

IOSCO is identifying the range of possible considerations by a securities regulator in the event of an audit crisis or the demise or suspension of a major audit firm.

#### Scheduled output:

- *Publication of a report describing the results of survey responses related to the regulation of non-audit services provided by auditors: January 2007*
- *Roundtable meetings on audit quality: mid-2007*
- *Recommendations for any additional work on auditor independence by IOSCO and/or others: 2007*

## **C Trading Venues**

### **C.1 Regulatory trends in financial activities**

#### **C. 1.1 Bond Market Transparency**

A key issue that was identified in the Fraud Report is the transparency and regulation of corporate bond markets. It was found that in many (though certainly not all) jurisdictions, corporate bond markets differ from equity markets in significant ways. For example, corporate bonds frequently are traded on Over-the-Counter (OTC) markets, where institutional investors may be more comfortable than retail investors. Similarly, many corporate bonds, although listed on exchanges, are frequently traded “off market,” between institutional dealers and buyers.

These factors combine to make bond markets’ price-setting mechanisms less transparent than those of equity especially to retail investors. Following this, in the Fraud Report IOSCO raised the question regarding how to improve the transparency of bond market trading, and whether, in light of recent financial scandals, additional recommendations to those contained in the IOSCO Report “Transparency of Corporate Bond Markets (May 2004) could be deemed necessary.

IOSCO, thus, analysed more recent developments in the corporate bond market taking into account those in the regulatory environment of member jurisdictions, evaluations by the industry, as well as the results of academic studies. Overall, this information indicated that the level of transparency of trades in listed and exchange-traded bonds is adequate. The majority of TC member jurisdictions, however, do not mandate transparency for corporate bonds traded OTC and some have suggested that increased post-trade transparency might be useful. Some of them argued for a regulatory initiative in this area others argued strongly in favour of a market driven approach.

IOSCO concluded that the description of the regulatory environment of corporate bond markets contained in the 2004 Report is up to date and needs no revision. Since 2004, the structure of the corporate bond markets in member jurisdictions has not changed substantially. IOSCO concluded, therefore, that no additional recommendations are necessary. However, it will continue to closely monitor developments in the corporate bond market especially in the area of post-trade transparency in the OTC market.

#### **C. 1.2 Multi-jurisdictional Information Sharing for Market Oversight**

In recent years, issuers have increasingly sought to raise capital internationally. Moreover, many investors, especially institutional investors, have been diversifying their portfolios geographically. As a result, investors from different countries now hold an increasing proportion of many issues of securities and other financial instruments. At the same time, the marketplaces for trading these instruments have also become more international.

There are different ways in which this internationalisation of the marketplace can take place. For example, markets may offer direct (electronic) access to participants in other countries. An other example is that the same and/or closely related financial instruments are listed and/or traded in parallel in different countries.

These scenarios raise a wide range of issues concerning multi-jurisdictional oversight. In order to address these issues, IOSCO has tried to identify the regulatory approach with regard to markets that operate or seek to operate in more than one jurisdiction and has identified the categories of information that could usefully be shared on an ongoing or ad hoc basis between regulators with regard to the cross border trading of securities.

*Scheduled output:*

*A report on multi jurisdictional information sharing for market oversight has been published for consultation in February 2007*

### **C. 1.3 Boiler rooms**

The internationalisation of investment services has also brought the development of new international scams. Sophisticated “boiler room” operations have been on IOSCO’s “radar screen” for some time. This type of operation is a common problem experienced by numerous regulators. IOSCO provides a forum where regulators can readily assist each other in combating this type of crime.

### **C. 1.4 Asset freezing and other enforcement related issues**

In addressing cross-border fraud, IOSCO has recognised (in its 7 June 2006 Resolution on Cross-border Cooperation to Freeze Assets Derived from Securities and Derivatives Violations) that the effective enforcement of securities laws and regulations would increase if national regulators can provide cross-border assistance to a regulator in another jurisdiction in freezing assets relating to securities violations. At this time, not all IOSCO jurisdictions have sufficient powers to freeze assets which have derived from fraudulent activities. Therefore, IOSCO has encouraged its members to examine the legal framework under which they operate and strive to develop mechanisms by which within their jurisdiction these assets could be frozen.

At the basis of IOSCO’s enforcement-related work lies the IOSCO Multilateral Memorandum of Understanding which, if signed by the respective members, allows members to exchange cross-border information. The signing of this MMOU by all IOSCO ordinary and associate members is an ongoing effort.

IOSCO has also engaged a confidential dialogue with certain jurisdictions with which specific cooperation issues have been experienced. The objective of this work is to assist each of the identified jurisdictions to make genuine improvements in the level of cooperation they are able to offer their international counterparts in relation to information sharing. Positive and constructive progress has been made with a number of the securities regulators with which dialogue has been ongoing. Cross-border

enforcement related cooperation and exchange of information has genuinely improved in these instances.

## **C.2 New exploratory work**

### **C. 2.1. Price formation on fragmented markets**

The landscape of securities exchanges has changed dramatically in recent years. Developments have included exchange demutualisation, internalisation and the creation of significant, global players through cross-border alliances of exchanges. Monitoring these developments and assessing their consequences for market integrity and investor protection continues to be one of IOSCO's priorities. One of the issues IOSCO is currently monitoring are the consequences of market fragmentation. The existence of multiple market centers through which the same securities are traded may create issues affecting the efficiency of price formation. Inefficient price formation may have an impact on market transparency and run counter to the interests of a large number of financial market stakeholders.

### **C. 2.2. 'Direct' access to exchanges and other markets**

With the advent of electronic trading, intermediaries began transmitting orders electronically and markets were able to offer "direct" electronic access to clients of the intermediaries. In this way, clients could be given access to markets through either a registered intermediary's system or via an arrangement set up by the intermediary.

Derivatives exchanges also permit intermediated access through registered intermediaries and, in addition, direct access by "non-intermediaries" may be granted. These entities are permitted to become members or participants on an exchange, if they meet certain eligibility criteria.

The question that arises for regulators with respect to direct access is: What are the regulatory regimes in place to deal with the different permutations of "direct" access? For example, for regulators it is a concern to assess what tools are in place to enable them to obtain any necessary information from the clients when needed. IOSCO intends to deal with this topic in more depth by conducting a fact-finding survey of direct access market models located in TC-member jurisdictions. It will also determine whether it is appropriate and necessary to give guidance regarding access issues.

## **D Intermediaries**

### **D.1 Regulatory trends in financial activities**

#### **D. 1.1. Conflicts of interest**

An important element of the Fraud Report was the role of intermediaries in initial public offerings (IPOs). Recent financial scandals have involved accusations of wrongdoing on the part of underwriters and investment banks. As part of a securities underwriting, market intermediaries frequently become aware of material non-public information about the issuer. Market intermediaries may be in a position to misuse this information, particularly when the intermediary is involved in the market in a number of ways (for example as an underwriter, lender, broker-dealer, market maker or proprietary trader). Therefore, in 2006 IOSCO undertook to review the role played by financial intermediaries in recent financial scandals.

This project focuses on information flows within market intermediaries as well as between them and issuers and investors in order to identify (1) potential conflicts of interest, (2) how information is managed within market intermediaries involved in securities offerings and (3) the possible inappropriate use or withholding of relevant information related to these conflicts. IOSCO is also looking at how inappropriate uses of information and possible conflicts of interest related to a securities offering could be addressed by information management arrangements within the market intermediary.

After holding a number of informal discussions with market stakeholders in early 2006, IOSCO has released a consultation paper intended to facilitate further dialogue with financial market stakeholders on regulatory principles that might be used by market intermediaries to guide their management of some of the conflicts that arise from activities related to securities offerings.

*Scheduled output:*

*Discussion paper on Market Intermediary Management of Conflicts of Interest that Arise in Securities Offerings: February 2007*

#### **D. 1.2. Point of sale disclosure and customer suitability**

As retail investors may not access the same information as market professionals, their growing role in financial markets raises issues concerning their capacity to assess the suitability of financial products and investment risks related to these products.

Many retail investors who buy investment products, particularly interests in a collective investment scheme and possibly similar products, may not clearly understand the products or the layers of costs associated with those products. Also, many retail investors may not clearly understand their intermediary's financial stake in selling those products, including so-called "revenue sharing" arrangements. Therefore, they might end up purchasing a product that they would not have

otherwise, had they understood the true costs of the product and/or their intermediary's conflicts of interest.

IOSCO is currently considering the key information that customers ought to receive at the point of sale in order to support sound investment decision-making. If appropriate, it will develop recommendations or principles relating to this issue. A consultation paper on this issue is expected to be published in 2008. If appropriate, IOSCO will later develop recommendations or principles relating to this issue, which would also be published for consultation.

Although IOSCO is now focussing on point of sale disclosure, it will also continue to monitor related issues such as miss-selling, suitability and best execution.

Scheduled output:

- *Customer suitability report (Joint Forum): end of 2007*
- *Consultation report on issues related to point of sale disclosure: mid-2008*

## **D.2 New exploratory work**

### **D. 2.1 The impact of new technology**

Developments in the use of the internet in financial markets continue to be monitored closely by IOSCO. In 2003, IOSCO organised several large scale roundtable meetings in order to discuss related developments with financial market stakeholders and to assess if related regulatory initiatives were necessary. IOSCO will continue to monitor new technical developments and intends to periodically discuss them with financial market stakeholders.

In addition, IOSCO is reviewing the technological issues raised by the retention of electronic records, and the ability of firms to organise and retrieve specific types of electronic records, particularly in response to a request from regulators. In recent years the use of electronic trading, e-mail and instant messaging for securities related transactions has increased dramatically. The increased use of new communication technologies raises challenges with regard to recordkeeping, particularly the retention, retrieval and form of electronic records, privacy concerns and how easily and cost-efficiently market intermediaries can make electronic records available to regulators.

It is important for regulators to have a clear understanding of the technological resources available to market intermediaries, and the cost of those resources, when seeking to gain access to electronic records that a regulator requires to be maintained. For this reason, in 2007 IOSCO intends to meet with representatives from both intermediaries and technology service providers who sell software and other technology to those intermediaries.

Scheduled output:

*Discussions with technology service providers and intermediaries as part of regular standing committee meetings during 2007, in Europe, Asia and North America.*



## **E Asset Management**

### **E.1 Regulatory trends in financial activities**

#### **E. 1.1. Asset pricing, fund valuation and Risk management aspects linked to the use of derivatives and complex strategies within CIS products**

Due to the sheer size of hedge funds, regulatory or market failures in this field could potentially have an effect on the stability of the global financial markets. With hedge funds having an unprecedented influence on global financial markets and an ever-increasing participation by retail investors in certain jurisdictions, IOSCO has prioritised its work on hedge funds and alternative investments. In 2006 it published “Regulatory Environment for Hedge Funds: a Survey and Comparison” which was an exploration of issues related to hedge funds.

IOSCO is now working on “Principles for the Valuation of Hedge Fund Portfolios”. The chief aim of these principles is to ensure that the value of a hedge fund’s financial instruments is accurate and, in particular, is not distorted to the disadvantage of fund investors. It is expected that this paper will be published for consultation in the beginning of 2007.

#### **E. 1.2. Elements of regulation for hedge**

A further project under consideration by IOSCO is the examination of existing regulations on funds of hedge funds (or proposed regulations) and to identify the issues of potential concern in this area. The goal is to update the existing report produced by IOSCO in 2003 with regard to recent trends and evolutions and to develop a report on “Elements of International Regulatory Standards on Funds of Hedge Funds” based on best market practices. This review will more particularly address the due diligence process conducted by the manager of a fund of hedge funds when underlying funds are selected, the valuation process that is conducted on these underlying funds on an on-going basis and the possibility of disclosure of outstanding market positions by the underlying funds to the fund of hedge funds’ manager allowing the manager of the fund of hedge funds to assess their liquidity and their value.

##### Scheduled output:

- *Principles for the Valuation of Hedge Fund Portfolios: Consultation March 2007*
- *Call for views on issues to be addressed by IOSCO on funds of hedge funds April 2007, consultation mid-2008*

#### **E. 1.3. Soft commissions and incentives**

As soft commissions could lead to conflicts of interest as regards the provision of services to investors and the allocation across funds, IOSCO has published an examination of existing regulations of soft commissions. As a result of this report, the TC

is considering the issue of assessing investment managers' duties of care and incentives to comply with their fiduciary duties.

The use of incentives could also be an issue with respect to exchanges and other market venues who want to attract business. As market venues become more competitive, many of them are offering incentives to intermediaries. There may be some risk that these schemes undermine the integrity of price formation or create conflicts of interest to the detriment of investors. IOSCO will continue to monitor developments in this area.

Scheduled output:

*Consultation report on soft commissions: November 2006 (comments by March 2007)*

**E. 2. *New exploratory work***

**E. 2.1 Private equity**

Increasing levels of debt taken on by private firms can prompt such widespread disruption in case of large scale defaults that they could have a significant impact on global financial market stability. While part of the private equity falls outside the limits of regulated markets, linkages are developing between private equity and the public markets. IOSCO is monitoring potential impacts on the capital markets from the plans of some buy-out firms to sell shares to retail investors, and the private equity investments of hedge funds. IOSCO is conducting a preliminary review to assess whether private equity is subject to sufficient overview by regulatory authorities.