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This Detailed Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation for the United States was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in May 7, 2010. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the United States or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

UNITED STATES OF AMERICA

THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

DETAILED ASSESSMENT OF IMPLEMENTATION

MAY 2010

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

Advisers Act	Investment Advisers Act of 1940
ALJ	Administrative Law Judge
AML	Anti-Money Laundering
APA	Administrative Procedures Act
ATS	Alternative Trading System
AUM	Assets under Management
BD	Broker Dealer
BSA	Bank Secrecy Act
CBOE	Chicago Board Options Exchange
CCO	Chief Compliance Officer
CCP	Central Counterparty
CDS	Credit Default Swaps
CEA	Commodity Exchange Act
CFMA	Commodity Futures Modernization Act of 2000
CFTC	Commodity Futures Trading Commission
CIS	Collective Investment Schemes
CPSS	Committee on Payment and Settlement Systems
CME	Chicago Mercantile Exchange
CPO	Commodity Pool Operator
CP&P	Compliance Policies and Procedures
CTA	Commodity Trading Advisor
CTR	Complaints, Tips and Referrals
COT Report	Commitment of Traders Report
CSE	Consolidated Supervised Entities
DCM	Designated Contract Market
DCO	Derivatives Clearing Organization
DOJ	Department of Justice
DSRO	Designated Self-regulatory Organization
DTEF	Derivatives Transaction Execution Facility
EBOT	Exempt Board of Trade
ECM	Exempt Commercial Market
ECN	Electronic Communications Network
ECP	Eligible Contract Participant
EDGAR	Electronic Data Gathering, Analysis and Retrieval System
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FCM	Futures Commission Merchant
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FINRA	Financial Industry Regulatory Authority
FOIA	Freedom of Information Act
GAAP	Generally Accepted Accounting Principles

GAAS	Generally Accepted Auditing Standards
GLBA	Gramm-Leach-Bliley Act
IA	Investment Adviser
IASB	International Accounting Standards Board
IB	Introducing Broker
ICA	Investment Company Act of 1940
ICE	Intercontinental Exchange
IG	Inspector General
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IOSCO MMOU	IOSCO Multilateral Memorandum of Understanding
ISG	Inter-market Surveillance Group
Joint Report	Joint Report of the SEC and CFTC on Harmonization of Regulation issued October 16, 2009
LLC	Limited Liability Company
MSRB	Municipal Securities Rulemaking Board
MOU	Memorandum of Understanding
NASD	National Association of Securities Dealers
NASDAQ	National Association of Securities Dealers Automated Quotations
NAV	Net Asset Value
NFA	National Futures Association
NMS	National Market System
NYSE	New York Stock Exchange
OCIE	Office of Compliance, Inspections, and Examinations (SEC)
OTC	Over-the-Counter
PCAOB	Public Company Accounting Oversight Board
RFA	Registered Futures Association
RSA	Registered Securities Association
PWG	President's Working Group
RER	Rule Enforcement Review
RFPA	Right to Financial Privacy Act
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933
SFP	Securities Futures Product
SIPA	Securities Investor Protection Act of 1970
SIPC	Securities Investor Protection Corporation
SOX	Sarbanes-Oxley Act of 2002
SPDC	Significant Price Discovery Contracts
SRO	Self-regulatory Organization
Treasury	Department of the Treasury
UIT	Unit Investment Trust
White Paper	Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure

I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

Introduction

1. **An assessment of the United States securities and futures market regulatory system was conducted by Susanne Bergsträsser, Richard Britton, and Tanis MacLaren from October 7 to November 3, 2009 as part of the Financial Sector Assessment Program (FSAP).**

Information and methodology used for assessment

2. **The assessment was conducted based on the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation and the associated methodology adopted in 2003, as updated in 2008.**[1] An assessment of the securities settlement systems under the Committee on Payment and Settlement Systems (CPSS)/IOSCO Recommendations was conducted separately; thus Principle 30 was not assessed here.

3. **The conclusions below are based on information and findings as of November of 2009.** As noted below, important reforms have been introduced in the past year, some of which have already been implemented and are beginning to take effect. However, while these promise to address many of the issues identified in this assessment, it would still be important to establish a consistent track record before their efficacy could be judged.

4. **The assessment team relied on number of sources in carrying out this assessment.** The assessment was based on a review of the relevant legislation, self-assessment questionnaires prepared by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) prior to the mission, detailed discussions with CFTC and SEC staff, with staff of the various self-regulatory organizations, securities and futures exchanges, law enforcement agencies and representatives of industry, and the law and accounting professions. We also reviewed the Joint Report of the SEC and CFTC on Harmonization of Regulation issued October 16, 2009 (Joint Report) and the Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure (White Paper). Staff of the regulators was generous in making themselves available for discussions which were helpful, frank, and forthcoming. Assistance from market representatives was also extremely helpful.

5. **The assessment did not address the securities regulatory regime that is imposed at the state level to any significant degree.** State regulation plays a more minor role, mostly aimed at consumer protection. In certain areas, such as new issues of securities, state blue sky

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[1] The IOSCO methodology was amended in 2008 to update footnotes to reflect recent IOSCO publications. Currently IOSCO is undergoing a substantive review of the Principles, which will be followed by a review of the methodology.

laws have largely been preempted by legislative amendments at the federal level. In others, the state regulatory activities run parallel to federal ones, such as in the area of enforcement and registration of intermediaries and their representatives.

6. **The assessment has been challenging given the complexity of the U.S. system and the task of the regulators in this jurisdiction.** The methodology notes that "markets with a single or a few issuers, that are totally domestic in nature, or that are predominantly institutional, will pose different questions and issues as to the sufficiency of application of the Principles and as to the potential vulnerabilities likely to arise from their non-application, than jurisdictions where there are substantial numbers of retail participants, intermediaries frequently are part of complex groups, issuers are established in other jurisdictions, or the markets have other international or cross-border components." The methodology was therefore applied taking into account that a higher quality of supervisory and regulatory oversight is needed where financial systems are large and complex, as is the case in this jurisdiction. While the assessment has been done against internationally agreed standards, care is needed in comparing the results with those for other countries because of this level of complexity. Further, the methodology has undergone changes (in 2003 and in 2008) and finally the application of the standards in this and other recent cases has necessarily also taken into account the lessons of the recent financial crisis.

7. **The assessment was carried out in a post-crisis environment, which had a clear impact on the findings.** The financial crisis of 2008 exposed a number of underlying issues in the U.S. financial markets, some of which were causally related to the crisis—such as the lack of ability of U.S. investment banks to withstand shocks to liquidity—while others arose as a result of secondary effects of the crisis—such as the exposure of a giant fraud because of the precipitous contraction of investment in-flow during the crisis. The system was tested in a way that most systems are not and this testing has revealed weaknesses that might otherwise have gone undetected. The authorities have been under extraordinary pressure; first to respond to the crisis and then to undertake reforms. An assessment is rarely carried out in such circumstances—a reading of the findings must give this due consideration.

8. **The uncommon level of transparency in the jurisdiction has also affected the assessment findings.** The mission had access to a range of official reports, internal evaluations of the regulatory framework, and regulatory practice. Given the size and importance of the markets, there are many sources of analysis available from the private sphere as well. The information made available through this unusual level of transparency and 'self-criticism' was taken into consideration by mission, and this context is also important to understanding the findings.

Institutional and market structure—overview

9. **The legislative framework in place in the jurisdiction provides a comprehensive, but complex, framework for the types of activities undertaken in the public markets**. The responsibility for regulation of the markets at a federal level is split between two agencies created under separate statutes. The CFTC is responsible for the supervision of

commodity futures market—the commodity exchanges, the intermediaries and the futures products offered in the public markets—under the Commodity Exchange Act (CEA) as modified by the Commodity Futures Modernization Act (CFMA). The SEC regulates securities markets, issuers, and participants. Its authority flows from several statutes including the Securities Act of 1933 (Securities Act), Securities Exchange Act of 1934 (Exchange Act), Trust Indenture Act of 1939, Investment Company Act of 1940 (ICA), Investment Advisers Act of 1940 (Advisers Act), and Sarbanes-Oxley Act of 2002 (SOX). All of these federal statutes are supplemented by an extensive body of regulations, rules, guidance, court decisions, and regulatory no-action letters. In addition, there are state securities regulators involved in both licensing and enforcement activities. Further, other law enforcement agencies, such as the Department of Justice (DOJ) and state Attorneys General, participate in enforcement activities.

10. **The CFTC and SEC rely to a significant degree on self-regulatory organizations (SROs) for the regulation of the markets and their participants**. These entities include exchanges, clearing organizations, and securities or futures associations, each of which has authority over their members' activities. The Financial Industry Regulatory Authority (FINRA) is the registered securities association with authority over broker-dealers (BDs), and the National Futures Association (NFA) is the registered futures association for commodity futures intermediaries and commodity pool operators.

Market data

11. **The number of futures and options contracts, and the volume of trading in these contracts have increased dramatically since the CFMA was passed in 2000 (by 570 percent and 594 percent respectively)**. Over the same time period, client funds held by futures commission merchants (FCMs)—one measure of risk in the system—rose by 354 percent. The number of exchanges has been roughly stable which reflects both consolidations among existing exchanges and the creation of new exchanges. The four exchanges in the Chicago Mercantile Exchange (CME) group now account for over 90 percent of total volume. There has been substantial growth in exempt marketplaces that are not subject to formal designation or licensing and are subject to more limited ongoing regulation once operational. During this period, the number of full time equivalent staff at the CFTC has declined by 18 percent.

12. **In comparison, the equity market showed more modest growth until 2008.** Between 2000 and 2007, daily volumes increased by only 62 percent. During the market crisis of 2008, volumes increased by 52 percent over 2007, taking the 10-year growth to 255 percent. This was still only 44 percent of the growth rate of the volume of trading of on-exchange futures markets. Not included in these statistics was the 780 percent increase in the number of shares of "pink sheet" OTC stocks traded on a daily basis between 2001 and 2008. Although compared to the main markets the values are small (US$200 million in 2001 and US$540 million in 2008), pink sheet stocks are a major source of securities fraud. In the securities markets, as of March 2010, there were 11 registered national securities exchanges,

79 registered alternative trading systems (ATS), and 4 electronic communications networks (ECNs).[2]

Futures Statistics

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Volume of contracts traded (millions)	580	723	1,004	1,225	1,518	1,920	2,421	3,085	3,446
Number of contracts	266	250	278	538	662	906	1,135	1,365	1,521
Client funds held by FCMs (in US$ billions)	56.7	59.7	64.3	75.6	94.5	116.7	138.0	155.4	201
Commodity exchanges				15	18	13	12	12	13
Exempt markets									
ECMs				11	11	12	17	19	19
EBOTs				2	3	5	8	8	10
CFTC full time equivalent staff	546	514	521	497	517	491	493	437	448

Source: CTFC.

Daily Average Volume of Shares Traded
(In millions of shares)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
Vol.	2,851	3,206	3,257	3,217	3,323	3,458	4,004	4,769	7,282

Source: SIFMA.

13. **SEC staff numbers, although 24 percent up in this period peaked in 2005 and fell back subsequently; they increased somewhat in 2008/9.**

SEC Staffing

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
SEC full time equivalent staff	2,840	2,936	3,009	3,060	3,550	3,851	3,695	3,465	3,511	3,656

Source: SEC.

[2] One ECN (Direct Edge) is in the process of converting from an ECN into two separate registered exchanges. The SEC has granted exchange status to those two exchanges, though they are not yet operational. The SEC has recently approved the registration of a third new exchange (C2) which also is not yet operational. This will bring the total number of exchanges from 11 to 14.

14. **The United States has a system of specialized intermediaries with separate categories across the futures and securities regimes.** Intermediaries trading as principals or agents are registered as BDs under the Exchange Act or FCMs and introducing brokers (IBs) under the CEA. Advisers are registered as IAs or commodity trading advisers (CTAs) under the securities or futures legislation, respectively. The operators of Collective Investment Schemes (CIS) are registered as IAs under the Advisers Act or commodity pool operators (CPOs) under the CEA.

15. **The number of registered intermediaries participating in the market has grown only slightly over the past five years.** The number of registered commodity futures firms and BDs has declined, with more marked drops in the number of CFTC registrants. This reflects both consolidation in and departures from the industry. The data for CFTC registrations also reflects a migration of CPOs to providing services that do not require registration. The number of BDs has declined 6 percent over the 5-year period, while the total net capital of these firms has increased nearly 80 percent and the total number of registered persons at FINRA member firms has remained relatively constant. Substantial growth has been seen in the number of registered IAs and the assets these firms have under management (32 percent and 79 percent). If unregistered firms—such as hedge fund and ones that are only registered at the state level—are added in, the growth rate in assets under management over the period likely would be much higher.

16. **The U.S. CIS market is the largest in the world with nearly US$10 trillion in assets under management in the funds that are registered with the SEC.** There was a sharp drop in assets under management in 2008 (-20 percent) reflecting substantial declines in equity markets. However, by the end of September of this year, the total assets under management had recovered somewhat. During 2008, assets in funds moved from long-term funds (equity and bond funds) to money market funds with portfolios consisting only of short-term government paper and cash. Since the beginning of 2009, that trend has reversed and the growth is in equity and bond funds.

17. **In contrast, commodity pools operated by registered CPOs have experienced steady declines over the past five years.** The number of commodity pools reporting to the CFTC is down 52 percent with their aggregate assets under management down 77 percent over the 5-year period. This reflects both responses to adverse market conditions (trading losses, decreased new contributions, and ceasing business) and conversions of funds to ones exempt from reporting to the CFTC.

Futures and Securities Intermediaries

Year (As at September 30)

Intermediary Category[1]	2004	2005	2006	2007	2008
CFTC[2]					
FCMs	211	211	210	197	179
IBs	1,664	1,711	1,740	1,699	1,647
CTAs	2,640	2,635	2,589	2,601	2,534
CPOs	1,810	1,782	1,570	1,416	1,353
SEC					
BDs	5,219	5,134	5,052	4,969	4,923
IAs	8,535	9,017	10,662	10,817	11,292
Total Net Capital of BDs (in US$ millions)	87,127	101,334	102,969	128,244	155,468
Total AUM by Reg'd IAs (in US$ trillions)	24	27	32	38	43
Median AUM of Reg'd IAs (in US$ millions)	99	108	116	123	125

Sources: CTFC, SEC, and SIFMA.

[1] Only includes firms registered with one of the two agencies, not firms exempt from registration or only registered at a state level.

[2] A firm registered in more than one category is counted in each category.

Mutual Fund Assets

(US$ billions)

	Equity	Hybrid	Bond	Money Market	Total Assets
2004	4,384.0	519.3	1,290.4	1,913.2	8,106.9
2005	4,940.0	567.3	1,357.4	2,040.5	8,905.2
2006	5,911.4	653.1	1,494.3	2,354.8	10,413.6
2007	6,521.4	713.4	1,678.9	3,085.8	11,999.5
2008	3,708.1	494.2	1,567.2	3,832.3	9,601.8
Sept '09	4,511.2	576.6	1,973.1	3,551.8	10,612.7
%Change Sept '08 –Sept'09	-20.0%	-13.1%	12.7%	1.8%	-8. 4%

Mutual Fund Net New Cash Flow[1]

(US$ billions)

	Equity	Hybrid	Bond	Money Market	Total	Total Long-Term Funds
2004	177.9	42.7	-10.8	-156.6	53.2	209.8
2005	135.5	25.2	31.3	63.1	255.2	192.0
2006	160.1	7.1	60.6	247.5	475.2	227.8
2007	95.6	22.2	108.6	661.5	887.9	226.4
2008	-237.7	-21.7	33.0	631.7	405.2	-226.4
Sept '09	12.4	3.1	220.1	-291.3	-55.7	235.6
%Change Sept '08 –Sept'09	118.1%	-49.24%	128.6%	-184.7%	-114.7%	595.0%

Source: Investment Company Institute.

[1] New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges.

Commodity Pools

	Number of pools (to nearest hundred)	Aggregate net asset value reported for all pools (US$ billions)
2004	3,100	$1,348
2005	2,600	$564
2006	2,100	$513
2007	1,700	$573
2008	1,500	$316

Source: CFTC.

Preconditions for effective securities regulation

18. **The general preconditions for effective securities regulation in the United States are present.** There are no significant barriers to entry and exit for market participants. Competition is encouraged and foreign participation is welcomed. The legal and accounting system supports the implementation of requirements and effective regulation of market participants. The commercial law is up-to-date and is capable of supporting the demands posed by cross-border trade, modern financial instruments, and current corporate governance standards. The legislation regarding bankruptcy, insolvency, and winding up in the jurisdiction and the professionals associated with those matters are sophisticated. The regulators have legally enforceable powers of decision and action, the limits of which have been tested frequently by the courts. The taxation framework is supportive to the operations of the industry in the jurisdiction.

Main findings

19. **Complexity is a key challenge.** The U.S. securities and futures markets are very complex. The regulatory framework and system that has developed equally complex. This is evident in the division of responsibility between the agencies and in the way that each is structured. There is a high degree of specialization evident at each agency. Although specialization may have benefits in a complex environment, regulators may be challenged to appropriately assess overall issues that cross specialization lines—both within an agency and between agencies. A greater focus on systemic issues relating to both securities and futures markets would make the overall regulatory system more robust.

20. **The chairmen of the CFTC and SEC have both recognized the need for change and have taken steps toward strengthening their institutions.** However, institutional culture is not easy to transform. Moreover, the agencies are under strong and continuous pressure, including from industry, and the agencies' challenge will be to respond to market developments and develop a reform agenda in an independent manner.

21. **These issues manifest themselves in some key areas** (such as in the enforcement function or in regulation of over-the-counter derivatives markets) but the problems affect the entire system.

22. **As a matter of priority, the system should work toward simplification of internal and institutional structures.** Within the agencies, better internal management structures and improved communication between departments should be established to facilitate a regulatory culture of continuous learning and response.

23. **Principles relating to the regulator (Principles 1–5):** The responsibilities of the CFTC and SEC are clearly stated in law. There are gaps in coverage of the wide range of activity in the U.S. markets and in the scope of authority of both agencies. There are also differences between the futures and securities regimes in how similar instruments are regulated. There are also gaps between the authority of the SEC and the Federal Reserve with respect to the regulation and oversight of investment bank holding companies which added to the fragility of the overall system in the recent crisis. These gaps should be reduced as much as possible. The legal system grants the CFTC and SEC sufficient protection for their independence and the agencies operate independently on a day to day basis. There is a strong system of accountability to Congress. Neither agency has sufficient funding nor does the method of funding provide sufficient assurance of continuing funding levels to be able to commit to long-term capital projects, such as building new market surveillance systems, which are necessary to keep pace with changes in the industry. The CFTC and SEC activities and processes are transparent and there is public consultation regarding their regulations. They are active in investor education. CFTC and SEC staff and commissioners are subject to codes of ethics and other requirements to ensure a high standard of conduct.

24. **Principles relating to self-regulation (Principles 6–7):** SROs play a very significant role in the supervision of markets and their participants. Exchanges and clearing organizations perform important self-regulatory functions, as do registered associations. SROs are subject to an authorization regime based on eligibility criteria that address issues of integrity, financial viability, capacity, governance, and fair access—although the regimes are different for exchanges in the securities and futures markets. The CFTC has insufficient authority regarding exchanges following the coming into force of the CFMA. The CFTC has limited ability to intervene in the introductions of a new product or changes in rules, such as those governing trading. There is also no opportunity for stakeholders whose interests may be negatively affected to have their views taken into account in advance of a new product listing or rule change. These deficiencies have been recognized and are now being addressed via recommendations for legislative change set out in the Joint Report. Unlike securities exchanges, some demutualized futures exchanges have retained full member regulation powers. Some in the industry are concerned this may be used to restrain member dissent in the pursuit of shareholder interests. The CFTC publicly examined this issue from 2003 through 2009, which resulted in the adoption of acceptable practices for exchanges to follow in addressing conflicts of interest.

25. **Principles relating to enforcement of securities regulation (Principles 8–10):** The anti-fraud provisions under the U.S. federal securities laws, as enforced by the SEC via Rule 10b–5[3] and supported by the courts, have proved to be a very effective tool for prosecuting offences under the securities laws. Private litigation is also an unusually powerful tool for securing compliance and obtaining redress in case of breach. The CFTC and SEC have broad investigative and surveillance powers over regulated entities, exchanges, and regulated trading systems. They can conduct on-site inspections without prior notice and can obtain information of all types without the need for a court order. The CFTC and SEC have broad enforcement powers, including the power to seek injunctions, bring an application for civil proceedings, and compel information and testimony from third parties. They also can impose administrative sanctions and refer matters to criminal authorities. The CFTC and SEC have implemented a system of supervision of markets and market participants including conducting on-site examinations. Significant shortcomings were identified in the SEC enforcement program. However, the SEC's extensive and wide-ranging program to implement the IG's recommendations and other changes is beginning to generate improvements and such efforts should be brought to a conclusion as a matter of high priority. Resources dedicated to the examination of SEC-registered IAs (a program currently conducted solely by the SEC) are insufficient, thus reducing the effectiveness of the program. Therefore, resources should be increased to at least enable the SEC to match the frequency and scope of the periodic examination of BDs where the responsibility is shared between the SEC and FINRA. Resources for criminal prosecution of securities fraud are too limited.

26. **Principles for cooperation in regulation (Principles 11–13):** The CFTC and SEC have broad authority to share information with both domestic and foreign regulators, even without having memoranda of understanding (MOUs) in place. Both agencies are signatories of the IOSCO MOU and also have many bilateral MOUs in place with other regulators. The CFTC and SEC have the authority to assist foreign regulators in obtaining information that is not in their files, using the powers that are available for their own investigative activities.

27. **Principles for issuers (Principles 14–16):** Companies that issue securities in the public market must provide extensive financial and other disclosure on initial offerings and most are subject to detailed continuing disclosure obligations in line with IOSCO standards. Liability provisions are in place to ensure that issuers are held responsible for all disclosure provided. This responsibility is enforced by the SEC, the exchanges and by civil suits by investors. However, there is limited authority over municipal government issuers. Holders of voting securities of a public issuer are generally treated fairly.

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[3] Rule 10b–5 under the Exchange Act makes it unlawful for any person, directly or indirectly, to use any device, scheme or artifice to defraud, to make any untrue statements of material fact or to omit to state a material fact necessary in order to make the statements made not misleading, and to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

28. **Principles for collective investment schemes (Principles 17–20):** Operators and marketers of CIS offered to the public are subject to registration requirements. Initial eligibility criteria for CIS and their operators should be more extensive, and should be demonstrated prior to registration. The initial and ongoing disclosure requirements for CIS are extensive, however, the update requirements under the CEA are not timely. Assets of CIS are valued in accordance with U.S. generally acceptable accounting principles (GAAP) and verified by an independent auditor at least annually. The custodian of CIS assets is not required to be an arm's length party.

29. **Principles for market intermediaries (Principles 21–24):** There are minimum entry standards for all market intermediaries that include criteria relating to integrity. Capital and internal control requirements apply to FCMs, IBs that are not fully guaranteed by an FCM, and BDs; these are assessed prior to licensing by the SROs. Advisers are not subject to capital requirements or to operational capacity assessments prior to licensing. The applicable capital requirements vary by the chief risks undertaken by the FCMs, IBs, and BDs (largely market and credit risk). The ability of the prudential requirements (capital formulae and risk management requirements) to address the full range of risks (funding, liquidity, reputational, and affiliate risks) appears to need improvement. The regulators should strive to ensure that both capital and risk management requirements adequately address risks under stress. The crisis brought to light weaknesses in the framework governing investment bank holding companies, but the conversion of the remaining entities into bank holding companies has eliminated the practical need for the securities regulators to address these problems immediately. There are procedures in place at both agencies to address failures of intermediaries, and these have been tested in practice.

30. **Principles for the secondary market (Principles 25–30):** Securities and futures exchanges are subject to authorization and oversight. ATSs are authorized and regulated as BDs. Under the CEA, there are categories of futures trading systems which are exempt from authorization (exempt commercial markets or ECMs), although recent legislative amendments have enabled the CFTC to strengthen oversight of operational ECMs where appropriate. The SEC should join the CFTC in considering the introduction of explicit and comprehensive financial resources requirements for exchanges. In the securities markets, post trade transparency (details of completed transactions) is comprehensive as is publicly displayed liquidity or pre-trade transparency (best bids and offers). However, 25 percent of liquidity is not publicly displayed (i.e., dark pool ATSs and broker dealer internalization of trading on behalf of clients). The SEC's concern that a two-tier market may be emerging—that provides valuable order information on the best prices for NMS stocks only to selected market participants—is justified. Its current broad review of and public consultation on equity market structure is therefore timely. It should accurately establish the needs of investors of all classes. It also needs to reach actionable conclusions promptly. Analysing these issues and those related to advanced trading technologies requires the SEC to be better informed. Any proposed rule changes should be supported by independent factual evidence. Market surveillance by the securities and futures exchanges and FINRA is effective and has kept pace with technological developments in markets. A comprehensive surveillance system for securities trading to be used by the exchanges, ATS, and the SEC

(such as exists in the futures markets) would be beneficial for the detection of market abuse and also for identifying indicators of developing stress points. The CFTC and the futures exchanges have been able to construct such a system despite the CFTC's serious budget constraints. Market manipulation is generally well policed in both markets. For insider trading, the legislation should be more comprehensive in futures markets. The approach to insider trading for securities and futures should be different given the differences in the nature of the markets. Implementing the recommendations in the Joint Report for expanding the insider trading provisions of the CEA will be an important step. Whether additional expansion of coverage is warranted, should be studied. While the IOSCO Principles do not require all markets in financial products to be transparent, the opacity of the OTC derivatives market contrasts with the relative transparency of OTC securities markets for equities and bonds.

Table 1. Summary Implementation of the IOSCO Principles—Detailed Assessments

Principle	Grading	Findings
Principle 1. The responsibilities of the regulator should be clearly and objectively stated.	**PI**	The responsibilities of the CFTC and SEC are clearly stated in the laws. However, there are gaps in coverage of products and services in the market, differences in treatment of similar products, and gaps in the scope of each agency's authority. They should be reduced as much and as soon as possible.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.	**BI**	The CFTC and SEC are operationally independent. There is a strong system of accountability to Congress. The funding method for the authorities does not provide funding sufficient to meet their regulatory and operational needs on a long-term basis.
Principle 3. The regulator should have adequate powers, proper resources, and the capacity to perform its functions and exercise its powers.	**PI**	Both authorities have extensive powers over their areas of responsibility, but there are gaps. The CFTC and SEC need additional resources in order supervise the very large and complex U.S. securities and futures markets. For example, neither agency has the resources to make full use of electronic systems to oversee the market or upgrade their market surveillance systems.
Principle 4. The regulator should adopt clear and consistent regulatory processes.	**FI**	The CFTC and SEC are subject to a high degree of transparency including public consultation regarding their regulations. They are active on investor education.
Principle 5. The staff of the regulator should observe the highest professional standards.	**FI**	The CFTC and SEC have developed codes of ethics. These include investment limitations on staff and, in the case of the SEC, reporting obligations. There are mechanisms to monitor compliance.
Principle 6 The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.	**FI**	The effectiveness of the regulatory regime is to a large degree dependent on the skills and resources of the SROs. They play a very significant role in the supervision of markets and their participants. Exchanges and clearing agencies perform important self-regulatory functions as do registered associations.
Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	**BI**	SROs are subject to an authorization regime based on eligibility criteria that address issues of integrity, financial viability, capacity, governance, and fair access—although the

Principle	Grading	Findings
		regimes are different for exchanges in the securities and futures markets. Following the coming into force of the CFMA, the CFTC has had insufficient authority over exchanges. This deficiency is now being addressed via recommendations for legislative change set out in the Joint Report. However, corrective measures should balance prior product or rule approval with the exchanges' ability to quickly bring innovative products and rules to the marketplace. Unlike demutualized securities exchanges, the dominant futures exchange group (also demutualized) has retained member regulation responsibility. The CFTC should remain aware of industry concerns that this power may be used to restrain member dissent in the pursuit of shareholder interests.
Principle 8. The regulator should have comprehensive inspection, investigation, and surveillance powers.	**FI**	The CFTC and SEC have broad investigative and surveillance powers over regulated entities, exchanges, and regulated trading systems. They can conduct on-site inspections without prior notice. They can obtain books and records and request data or information without a court order.
Principle 9. The regulator should have comprehensive enforcement powers.	**FI**	The CFTC and SEC have broad enforcement powers. These include the power to seek injunctions, bring an application for civil proceedings, and compel information, documents, records, and testimony from third parties in the course of their investigations. They can impose administrative sanctions and refer matters to criminal authorities.
Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance, and enforcement powers and implementation of an effective compliance program.	**PI**	Significant shortcomings were identified in the SEC enforcement program. However the current extensive and wide-ranging program of change—including measures to implement the recommendations made in the report by the SEC's Office of Inspector General (OIG)—is beginning to generate improvements. Important elements, such as the restructuring of complaints handling processes remain "work in progress." The CFTC and SEC have implemented a system of supervision of markets and market participants including conducting on-site inspections/examinations. However, resources for the examination of registered

Principle	Grading	Findings
		IAs by the SEC are insufficient, thus reducing the effectiveness of these efforts. Resources for criminal prosecution of securities fraud are too limited.
Principle 11. The regulator should have the authority to share both public and non-public information with domestic and foreign counterparts.	**FI**	The CFTC and SEC have broad authority to share information with both domestic and foreign regulators. They can do so without having MOUs in place. Both agencies have shared information extensively with international counterparties.
Principle 12. Regulators should establish information-sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	**FI**	The CFTC and SEC are signatories of the IOSCO MMOU. They also have bilateral MOUs with other regulators.
Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	**FI**	The CFTC and SEC have authority to assist foreign regulators in obtaining information that is not in their files.
Principle 14. There should be full, timely, and accurate disclosure of financial results and other information that is material to investors' decisions.	**BI**	There is extensive initial and ongoing disclosure for most public issuers. However, there is limited direct authority over municipal government. On-going disclosure requirements do not apply to all public issuers.
Principle 15. Holders of securities in a company should be treated in a fair and equitable manner.	**FI**	Holders of voting securities of a public issuer generally are treated fairly.
Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality.	**FI**	U.S. GAAP is widely recognized as an acceptable accounting standard for use by public issuers and the generally accepted auditing standards (GAAS) of the U.S. Public Company Accounting Oversight Board (PCAOB) also are widely accepted globally.
Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.	**PI**	Operators and marketers of CIS are subject to registration requirements. Eligibility criteria are not comprehensive. In addition, at present the resources and internal controls of a CIS would be subject to an examination by the regulator only sometime after the fund began operation, but are not preconditions to the original approval. Resources at the SEC, CFTC, and NFA do not allow routine examination of the operators to take place with sufficient frequency.

Principle	Grading	Findings
Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	**BI**	There are requirements governing the legal form of CIS and addressing protection of client assets. Notice of changes that affect investor rights should be given prior to the effective date of the change, whether or not investor approval is required. The material change requirements set out in CEA are not timely. The custodian of a CIS's assets is not required to be an arm's length party.
Principle 19. Regulation should require disclosure, as set out under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	**FI**	The disclosure required for public commodity pools and securities CIS is extensive and is updated throughout the period when the CIS is offering its securities to the public. However, the CEA requirements regarding updating the Disclosure Documents are not timely. The information disclosed is sufficient for investors to assess suitability and the value of their investments in the CIS.
Principle 20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme.	**FI**	Assets of CIS are valued in accordance with U.S. GAAP and verified by an independent auditor at least annually. The prices of the instruments are made available to the investors periodically. No guidance is provided on how pricing errors in commodity pools should be addressed.
Principle 21. Regulation should provide for minimum entry standards for market intermediaries.	**BI**	There are minimum entry standards for market intermediaries but only some types of intermediaries are subject to standards relating to financial capacity or assessed with respect to their internal controls, risk management, and supervisory systems in place before licensing.
Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	**PI**	Capital requirements apply to FCMs, non-guaranteed IBs, and BDs that vary by certain of the risks undertaken by the firm. The capital formulae and other prudential requirements do not address fully the complete range of risks to which a firm may be exposed. The regulators should strive to ensure that both capital and risk management requirements adequately address risks posed when firms are under stress.
Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper	**BI**	There are standards of conduct and internal control requirements for the protection of clients of intermediaries. Management must supervise the business of the intermediary

Principle	Grading	Findings
management of risk, and under which management of the intermediary accepts primary responsibility for these matters.		appropriately. The risk management expectations for BDs and FCMs should be reexamined, particularly with regard to management of liquidity, funding and reputational risks under stress.
Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	**FI**	There are procedures in place at both the CFTC and SEC to address failures and these have been put to the test.
Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	**BI**	Securities and futures exchanges and trading system operators are subject to authorization and oversight. However, under the CEA, there are categories of trading systems, ECMs, and EBOTs, which are exempt from authorization. Exempt markets are not registered with, or designated, recognized, licensed, or approved by the CFTC. Under the Exchange Act, operators of securities market trading systems can elect to be regulated as exchanges or as ATSs (which must, among other things, register as BDs). The authorization of so called "dark pool" ATSs under Regulation ATS whereby they are not required to publicly display their best-priced orders in NMS stocks, does not provide for adequate pre-trade transparency of trading interests. Thus, the consultation currently being conducted by the SEC on equity market structure, including issues related to "dark pools," is timely. See also Principle 27.
Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	**FI**	The ongoing supervision of ECMs was an excessively light-touch regime, although the CFTC has recently sought and obtained regulatory change which has enabled it to strengthen oversight where appropriate. As to futures exchanges, CFTC staff is working with Congress to get explicit statutory authority to impose financial resource requirements on designated contract markets (DCMs). The SEC's focus on two elements of an exchange's financial resources risk, namely information technology (IT) and the self-regulatory functions, while necessary risks missing evaluating other exposures such as affiliate risk. A more holistic approach to

Principle	Grading	Findings
		capital adequacy would be preferable.
Principle 27. Regulation should promote transparency of trading.	**FI**	The CEA and CFTC regulations have not been updated to reflect modern concepts of transparency. However, the practice in futures markets, consistent with the Principle, is real time publication. In the securities markets, post trade transparency (details of completed transactions) is comprehensive as is publicly displayed liquidity or pre-trade transparency (best bids and offers). However, 25 percent of liquidity is not publicly displayed (i.e., dark pool ATSs and broker dealer internalization of trading on behalf of clients). The Principle has been assessed as fully implemented but the judgment was finely balanced. The SEC's concern that a two-tier market may be emerging (that provides valuable order information on the best prices for NMS stocks only to selected market participants) is justified. Its current public consultation on these issues is therefore timely. Analyzing these issues and those related to advanced trading technologies requires the SEC to be better informed. Any proposed rule changes should be supported by independent factual evidence. See also Principle 25.
Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	**BI**	Insider dealing law is too narrowly focused in the derivatives markets. If accepted, the recommendations in the Joint Report will be an important advance. Additional study is recommended to consider whether further restrictions would be appropriate. Market surveillance is carried out to a high standard by the exchanges and FINRA, and is particularly comprehensive in the futures markets. The SEC and CFTC are constrained by technology limitations.
Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	**FI**	The timely and comprehensive information flows available in futures markets provide for effective early warnings. In securities markets, tracking large exposures and other potential sources of market disruption is more difficult and should be improved.

Principle	Grading	Findings
Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and designed to ensure that they are fair, effective, and efficient and that they reduce systemic risk.	**N/A**	A separate CPSS-IOSCO assessment was conducted for the securities markets. Arrangements in the futures markets were not assessed.
Aggregate: Fully implemented (FI) – 16, Broadly implemented (BI) –8, Partly implemented (PI) – 5, Not implemented (NI) – 0, Not applicable (N/A) – 1		

Recommended action plan and authorities' response

Recommended action plan

Table 2. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principles relating to the regulator (Principles 1–5)	Decisions should be taken promptly on the recommendations of the Joint Report to enhance investor protection and improve cooperation between the CFTC and SEC. Legislative and regulatory gaps identified in the Joint Report should be closed. Funding of both authorities needs to be increased and the method of funding should be reviewed. The annual appropriations process seems inadequate to meet the needs for funding necessary long term projects. Annual funding makes it difficult to commit to major investments in software development which takes place over several years. Consideration should be given to moving to direct self-funding (i.e., ability to capture fee income for own funding rather than remitting it to general government revenue and relying on a government budget). The total fee income at the SEC presently generated from its activities far exceeds the combined budgets of the SEC and the CFTC. Taking into account the size and complexity of the markets and the number of registrants they oversee, both agencies need more resources—human, informational and technological—to fulfill their regulatory functions efficiently and effectively.
Principles relating to self-regulation (Principles 6–7)	As recommended in the Joint Report, the CEA should be amended to provide the CFTC with greater powers over product and rules approval of the futures exchanges and to provide greater scope for public consultation prior to their introduction. Corrective measures should recognize the need to balance prior product or rule approval with the exchanges' ability to benefit from their innovative endeavors in a competitive market. The CFTC should remain aware of industry concerns regarding the retention of member regulation by demutualized DCMs.

Principle	Recommended Action
	The SEC should consider delegating sole registration authority for BDs to FINRA.
Principles relating to enforcement of securities regulation (Principles 8–10)	Although many improvements have been made or are under way within the SEC, the current program in the Enforcement Division and Office of Compliance, Inspections and Examinations (OCIE) to implement the 21 recommendations set out in the 2009 report of the OIG and other improvements should be completed as a matter of high priority. The SEC also may want to consider adding enforcement staff with more accounting and economics backgrounds. Mixed teams with different skill sets and experience in the Enforcement Division could enhance its performance. The number of staff dedicated to the periodic examination of registered IAs (whether at the SEC alone, or in combination with FINRA and/or state regulators) should be increased at least to a level where the percentage of IAs examined annually matches the percentage of BDs examined by the SEC and FINRA. The enforcement division of the CFTC would benefit from more resources. Given the current limited scope of its remit and the integrated market surveillance systems it operates in close cooperation with the DCMs this is not a pressing problem though it will become one if its remit is expanded (e.g., to include OTC derivatives). The securities unit of the fraud section in the criminal division of the DOJ should be given additional resources to prosecute securities fraud.
Principles for issuers (Principles 14–16)	Continuous disclosure requirements should apply to all public issuers. The SEC should have the power to mandate both initial disclosure requirements and on-going obligations directly on municipal government issuers.
Principles for collective investment schemes (Principles 17–20)	The eligibility criteria for CIS and their operators should include the human and technical resources to carry out the required functions, the appropriate financial capacity and adequate internal management and controls. These should be assessed before a CIS or its operator is permitted to begin operations. The resources at the relevant regulators (statutory or SRO) for routine examinations of operators and CIS should be increased. CPOs should be required to have policies in place to avoid or mitigate conflicts. Notice of changes that affects investor or participant rights should be given prior to the effective date of that change, whether or not prior approval is required. Prompt changes to commodity pool disclosure documents should be required when material changes occur. Consideration should be given to requiring the custodian of a CIS's assets to be an arm's length party. Requiring an auditor of a CIS to have relevant prior experience might also be considered. The CFTC should provide guidance to the industry on how to address pricing errors in the valuation of commodity pools.

Principle	Recommended Action
Principles for market intermediaries (Principles 21–24)	The threshold for review of the fitness of control persons of an intermediary should be the same under the CEA and Exchange Act; the lower 10 percent threshold should be adopted. There should be an assessment of the back-office capabilities, internal controls and policies and procedures of all futures intermediaries and IAs prior to the grant of registration. FINRA should have clear authority to examine and address all securities-related activities of members, including their registered IA activities. Consideration should be given to requiring that custodian be at arm's length to the IA. The proposed changes to the futures capital rules to address gaps relating to cleared OTC derivatives and improve the sensitivity of the formula to the actual risks undertaken by the firm should be implemented promptly. The capital rules and other prudential requirements, such as risk management standards, should be reexamined to ensure all risks, including funding, reputational, liquidity and affiliate risks are addressed fully. The regulators should strive to ensure that both capital and risk management requirements adequately address risks posed when firms are under stress. Consideration should be given to reviewing the rules governing BD custody of client assets. The CFTC should have authority to review and approve/disapprove margin requirements set by the DCMs.
Principles for the secondary market (Principles 25–30)	In addition to pursuing legislative change to secure the enhanced powers as set out in the Joint Report the CFTC should consider seeking an authorization power over entities seeking to set up ECMs and Exempt Boards of Trade (EBOTs). However ongoing legislative initiatives are considering the abolition of the ECM and EBOT market categories. The SEC's current broad review of equity market structure to determine whether the rules have kept pace with changes in trading technology and practices should be prioritized with a view to encouraging the broadest public debate while reaching actionable conclusions promptly. It will be essential that the review be conducted on the basis of comprehensive and independent evidence in order to establish accurately the needs of investors of all classes. The recommendations in the Joint Report regarding insider dealing and Chinese Walls in derivatives markets should be implemented. The CFTC should undertake a study to consider whether expansion of the insider trading prohibition in the futures markets beyond the recommendation in the Joint Report is warranted given the current state of the markets, contracts and investors. Such a study would complement the current debate in Europe as to the appropriate coverage of insider trading laws in derivatives markets. The SEC should review the extent to which the absence of additional offences of insider trading is a limiting factor in the SEC's enforcement effort

Principle	Recommended Action
	in this area. Current discussions among the securities exchanges and FINRA on creating a consolidated surveillance structure to oversee the consolidated market should be given greater priority with a view to reaching a positive conclusion in a timely manner. Consideration should be given to amending the regulations to provide the SEC and the securities exchanges with accurate and timely information on large holders of and traders in securities as the CFTC and the futures exchanges have in their markets. This would support surveillance and identify emerging market stress points in a timely fashion. The SEC should join the CFTC in considering the introduction of an explicit and comprehensive financial resource requirement for exchanges.

Authorities' response to the assessment

31. The U.S. authorities appreciate the effort, time, and resources committed by the IMF to prepare the FSAP. The FSAP is intended to promote the soundness of financial systems in member countries and to contribute to improving supervisory practices around the world. The U.S. assessment has presented a challenging and complex task. In light of the financial crisis as well as the maturity, complexity and significance of the U.S. financial system, we understand that the U.S. regulatory system was subject to a more stringent standard than in previous IMF assessments. Nevertheless, it is essential that regulators hear from third parties to gauge their effectiveness. We are grateful for the opportunity to provide the following comments regarding the IMF's Report, although as discussed below we take exception to a number of the findings.

32. As recognized in this Report, the U.S. FSAP is occurring at a critical and extraordinary time. According to the G20 leaders in April 2009, major failures in the financial system, including in regulation and supervision, were fundamental causes of the crisis. The last 18 months have taught regulators around the world much about the new realities of our financial markets. We have learned the limits of foresight and the need for candor about the risks we face. We were reminded that transparency and accountability are essential. Only through strong, intelligent regulation—coupled with aggressive enforcement mechanisms—can we fully protect the American public and keep our economy strong. Given the global nature of markets, we recognize that U.S. leadership remains critical to the stability of markets worldwide.

33. The financial crisis left regulators with enormous challenges and a heightened interest in strengthening regulation. Perhaps most importantly, as the Report recommends, comprehensive regulatory reform of the OTC derivatives marketplace is essential. The financial crisis highlighted how opaque markets can threaten the financial system and the

broader public. The U.S. authorities agree with the Report's strong recommendation for increased resources for the CFTC and the SEC should the U.S. Congress expand the agencies' missions to include the regulation of OTC derivatives. The CFTC and SEC additionally need greater resources to keep up with the growth of securities and futures markets in the United States. The U.S. authorities also agree with the assessment that the CFTC and SEC should enhance cooperation and coordination and already have taken steps to do so.

34. While change is needed, the U.S. regulatory system nevertheless helped ensure that the world's largest and most complex exchange-listed equity, commodity futures, and options markets continued to function properly and withstood the ultimate stress test during the financial crisis. The system has served as a model for regulatory authorities worldwide. Moreover, some of the proposed reforms to address risk in OTC derivatives—for example, requiring standardized products to trade on regulated trading platforms and to be cleared by central counterparties—reflect long-standing elements in the U.S. approach to regulating financial markets.

35. In addition to supporting reform, U.S. regulators have taken action under existing authority to remedy problems and to make improvements. For example, in the area of disclosure, the SEC proposed new rules that would improve the quality and timeliness of disclosure in municipal markets. In the area of investment management, the SEC sought to provide greater protections to investors by adopting new custody control rules that include surprise inspections to verify assets held by money managers. Finally, in the past year, the SEC launched a robust and vigorous review of equity market structure, including issues such as dark pools. The CFTC is continuing to improve and extend its world-class system of risk surveillance by requiring large trader reporting in the cleared OTC markets. This effort will allow the CFTC to conduct financial surveillance in this area consistent with its existing risk program for on-exchange trading.

36. The overall ratings in the Report, however, do not reflect the CFTC's and SEC's regulatory successes and, in some cases, suggest a misunderstanding of the U.S. regulatory system. Thus, the Commissions strongly disagree with many of the ratings in the Report. By way of example, while the IOSCO Principles recognize that regulators may use different approaches to accomplish the same objectives, the Report's rating on market intermediaries is based on the assumption that every intermediary must be regulated the same way. That is, they must undergo an extensive review prior to registration. This requirement, however, cannot be found in the Principles or the assessment Methodology. The Report rejects a legitimate risk-based approach to a registration requirement and oversight of futures and securities intermediaries without evidence that the approach is ineffective. The Report also states that capital requirements for futures and securities firms do not fully address risk, yet provides no evidence that the CFTC's and SEC's current requirements do not already exceed recognized international best practice as reflected in the Principles.

37. In particular, the Report suggests that only systems that call for review of the "fitness and properness" of CIS operators are acceptable. The Report finds that the regulatory framework in the United States does not address the adequacy of the CIS operators' human and technical resources, financial capacity and internal management and controls. However, this finding does not take into account key and unique features of the U.S. system. The U.S. system mandates disclosure by CIS operators and also relies on oversight by a separate entity, a CIS board, which generally consists of a majority of independent directors. The CIS board serves as an initial check on the fitness, resources, and internal controls of the CIS operator. Moreover, both the CIS operators and CIS boards are subject to fiduciary duties, which are enforced by the SEC and by private litigants. This system offers an ongoing review of the fitness, resources, and internal controls of a CIS operator instead of a one-time "fit and proper" check. The Report disregards these important features of U.S. market regulation, and the effects they have on how regulated entities operate.

38. As a related matter, the IOSCO Principles make clear that they apply to futures markets "where the context permits." For instance, the Principles relating to CIS were written for publicly offered funds, such as mutual funds. The CIS Principles were not intended to cover privately-offered funds, such as the vast majority of CFTC-regulated commodity pools. The pools that are publicly offered represent a small percentage of total pools regulated by the CFTC. The ratings in this area are misplaced given the de minimis number of publicly offered funds.

39. In addition, some of the Report's adverse conclusions about the U.S. regulatory system are not based on objective criteria. For example, the Report finds that per Principle 10 the U.S. system fails to "ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers." This conclusion appears to be based solely on an SEC Office of Inspector General (OIG) Report issued in August 2009 that reviewed the failings of a specific high-profile investigation, and then extrapolates those failings to all SEC enforcement activities. In so doing, the Report overlooks the SEC's overall success in the area of enforcement. In fiscal year 2009, SEC enforcement actions yielded: (1) orders that required wrongdoers to disgorge ill-gotten gains in the amount of approximately US$2.09 billion; (2) orders that imposed money penalties on wrongdoers in the amount of approximately US$345 million, a 35 percent increase over the previous fiscal year; and (3) the filing of 664 cases against 1,787 persons. SEC enforcement actions also have resulted in the return of billions of dollars to injured investors since the agency received "Fair Fund" authority in 2002. During fiscal year 2009 alone, the SEC distributed approximately US$2.1 billion to harmed investors from both disgorgement funds and Fair Funds.

40. These performance measures are a testament to the credibility and effectiveness of the SEC enforcement program in relation to the U.S. securities markets—a level of enforcement activity and investigative aggressiveness that far exceeds that of any other securities regulator in the world. These facts are inconsistent with a conclusion that the SEC enforcement program broadly fails to satisfy Principle 10. Granted, the metrics set forth above may not be the only objective measures by which to judge the effectiveness of the SEC's enforcement program. But, the Report fails to articulate any objective metrics on which to base the rating.

41. To be sure, the OIG Report highlights a major failure. The SEC, however, has taken action in response. In the past year, the SEC, among other things, restructured the Enforcement Division and streamlined its procedures. The SEC also took steps to improve its inspection program and place greater reliance on risk assessment. The SEC is actively working to improve its technology and modernize the way it handles the massive number of tips and complaints it receives each year. The Report's rating fails to give full credit for these improvements. In short, the effectiveness of an enforcement program should not be measured by zero tolerance for failure. There are many effective criminal justice systems around the world that are held in high esteem, not because of an absence of crime or a perfect record, but because, among other things, they apply considerable resources and visible effort to prevent, investigate, and prosecute crime.

42. In conclusion, the SEC and CFTC recognize a number of the areas that the IMF identified for improvement. Much is already underway to address these concerns. However, these types of suggestions in the Report are the exception rather than the rule.

43. Further, the SEC believes that the Report's conclusions are seemingly at odds with those of investors from around the world, both large and small. Capital markets essentially function to allocate capital. In making decisions about capital allocation and the premiums charged for such investments, investors make judgments about the quality of the regulator, the breadth and depth of disclosure, the efficacy of the enforcement regime and the fairness of the marketplace, among other things. Judging by the degree of global investment in the U.S. market and taking into account the cost of capital in the United States, it would appear that those whose money is at stake view the U.S. regulatory system in a different, more positive light—even in light of recent regulatory failings.

44. In sum, the U.S. authorities firmly believe that the overall ratings are not reflective of the U.S. system for the regulated marketplace. Nonetheless, the U.S authorities will continue to evaluate and, as appropriate, enhance their regulatory programs. The CFTC and SEC look forward to a continuing dialogue with the IMF to advance our shared goal of strengthening financial regulation and enhancing supervision of the global financial services sector.

II. Detailed Assessment

Table 3. Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	Since the 1930s, securities and futures have been subject to separate federal regulatory regimes in the United States; the U.S. CFTC has exclusive jurisdiction over futures and commodity option transactions, whereas the U.S. SEC has oversight of the securities market. Both authorities make use of SROs for supervision of trading systems (including exchanges) and intermediaries. There also is regulation at the state level for securities, primarily with a consumer protection focus. **CFTC** The CFTC is an operationally independent federal agency established under the CEA. The responsibilities, powers, and authority assigned by law to the CFTC are clearly defined and transparently set out in the CEA and CFTC regulations. It is the mission of the CFTC to protect the public interest by providing a means for managing and assuming price risks, discovering prices, and/or disseminating pricing information through trading in liquid, fair, and financially secure trading facilities for commodities. In order to foster the public interest, the CFTC endeavours to detect and prevent price manipulation or any other disruptions to market integrity; to protect all commodity market participants from fraudulent or abusive sales practices and misuses of customer assets; and to promote responsible innovation. The CFTC, which has about 500 staff members, is divided into three divisions and across several offices. The CFTC´s headquarters is in Washington, D.C., with three regional offices in Chicago, Kansas City, and New York. The CFTC can interpret how to apply the authority granted to it by the CEA and is engaged in rulemaking. The criteria for interpreting the CFTC's authority are clear and transparent. The CFTC largely interprets the CEA based on the plain meaning of the statute and available legislative history as it relates to relevant markets and market participants. CFTC staff may also provide guidance to market participants and practitioners on a variety of legal and regulatory matters. Although not legally binding on the CFTC, these staff interpretations provide useful direction to market participants on the CEA and related issues. Domestically, the CFTC participates in a variety of committees, working groups, and intergovernmental partnerships with other regulators, governmental agencies, and federal law enforcement entities on matters of common interest. The CFTC is, for example, a member in the President's Working Group (PWG)—a key forum for the coordination of regulation across financial markets with participants from the Secretary of the Treasury, Federal Reserve, SEC, National Economic Council, Council of Economic Advisors, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve Bank of New York. The CFTC has established several MOUs with national authorities (see Principle 12). **SEC** The responsibilities, powers, and authority assigned by law to the SEC are clearly defined and transparently set out in several federal securities statutes (Securities Act; Exchange Act; Trust Indenture Act of 1939; ICA, Advisers Act, and SOX), and in the rules and regulations that the SEC has adopted under these statutes. Generally, these statutes are broadly drafted, establishing basic principles and objectives. To ensure that the intent of Congress is carried out in specific circumstances and to address technological, market, product, and service developments, the SEC engages in rulemaking. The mission of the SEC is to protect investors; maintain fair, orderly and

	efficient markets; and facilitate capital formation. The agency's functional responsibilities are organized into four divisions and 19 offices, each of which is headquartered in Washington, DC. The SEC's approximately 3,500 staff is located in Washington, DC and across 11 regional offices located in New York, Boston, Philadelphia, Atlanta, Chicago, Miami, Fort Worth, Denver, Salt Lake City, Los Angeles, and San Francisco. The SEC participates in a variety of committees, working groups, intergovernmental partnerships with other regulators, governmental agencies, and federal law enforcement entities on matters of common interest. The SEC is also a member, for example, in the PWG, as described above. The SEC has entered into several MOUs with national authorities (see also Principle 12). **Multi-authority issues** There are many aspect of securities market regulation for which more than one regulator has responsibility. In some cases, the responsibilities are clearly defined and there do not appear to be cooperation deficits, for example in the division of responsibility between federal and state regulation of securities activities. In particular, investment advisers with less than US$25 million in assets under management are prohibited from registering with the SEC as investment advisers and must register under state law. Securities offerings made solely within a single state, where the issuer of such security is a person resident in (or, if a corporation, incorporated in) and doing business within that state are not required to be registered under the Securities Act. However, in some areas, where more than one regulator is assigned responsibility, gaps and cooperation deficits exist. The CFTC and the SEC self-assessments as well as the Joint Report, identified several differences with respect to powers and disparate regulation of similar types of financial instruments. These differences exist, not only between the futures and securities regulators, but between the securities regulators and the Federal Reserve, as detailed below. Aiding and Abetting: The Joint Report identified a gap between the enforcement powers of the CFTC and SEC in the context of civil actions, and recommended legislation to close the gap. Specifically, it recommends that the SEC should be granted specific statutory authority to pursue persons for aiding and abetting offences in civil actions under the Securities Act and the ICA. This would match the specific statutory enforcement authority for civil actions of the CFTC regarding aiding and abetting all violations of the CEA and CFTC rules and regulations. Municipal Securities: There is a regulatory gap with respect to the regulation of municipal securities. Currently, the Municipal Securities Rulemaking Board (MSRB), an SRO, writes the rules regulating securities firms and banks involved in underwriting, trading, and selling municipal securities, but does not have the authority to apply these rules to other professionals and intermediaries in the municipal finance market. Moreover, under a provision of the federal securities laws known as the "Tower Amendment," the SEC and the MSRB are prohibited from directly requiring state and local government issuers of municipal securities to comply with disclosure requirements or file any document prior to the initial sale of securities. Economically-Similar Products and Services: Under the current regulatory structure, the rights and remedies applicable to the sale of the same or economically-similar products depend on, among other things, the type of intermediary selling the product. In a few instances, this has resulted in the imposition of different regulatory regimes on similar products. For example: Foreign Currency (forex) Transactions: The regulation of off-exchange retail forex transactions depends upon the entity offering the product. The CFTC has jurisdiction over such transactions where the entity is an FCM or retail foreign exchange dealer, but transactions with "otherwise regulated" entities such as banks, BDs, and insurance companies are overseen by their respective regulators. The CFTC is currently consulting on measures intended to increase the level of client protection when these products are offered by entities subject to CFTC registration. There are no unifying standards for forex trading activities across regulators, leading to possible inconsistencies

in the regulation of the participants and different levels of protection afforded to clients.

Gramm-Leach-Bliley Act (GLBA) and Bank "Broker" Activity: The GLBA amended several federal statutes governing the activities and supervision of banks, bank holding companies, and their affiliates. Among other things, it lowered barriers between the banking and securities industries erected by the Glass-Steagall Act. With respect to the definition of "broker," the GLBA amended the Exchange Act to provide 11 specific exceptions for banks. Each of these exceptions permits a bank to act as a broker or agent in securities transactions that meet specific statutory conditions. In particular, there are conditional exceptions from the definition of broker for banks that engage in certain securities activities such as third-party brokerage arrangements; trust and fiduciary activities; permissible securities transactions; certain stock purchase plans; sweep accounts; affiliate transactions; private securities offerings; safekeeping and custody activities; identified banking products; municipal securities; and a *de minimis* number of other securities transactions. The same activity carried on by a bank and the BD may be subject to very different regimes, such as consumer protection requirements and compensation schemes in the event of the failure of the intermediary.

Regulation of Derivatives and Securities: Certain economically-identical investment products are regulated differently depending on their classification as securities (SEC-regulated) or commodities derivatives (CFTC-regulated). As trading in commodity futures has evolved to include derivatives on financial instruments and as the SEC has maintained jurisdiction over security options (which can be economically equivalent to certain commodity derivative products), the lines between securities and commodities regulation have blurred. This has also led to jurisdictional disagreements between the SEC and CFTC.

SEC – Federal Reserve: The GLBA divided responsibility for the supervision of financial holding companies that were primarily investment banks between the Federal Reserve and the SEC. The recent crisis and the evident lack of financial resilience of the investment bank holding companies highlighted gaps in the efficacy of both the regulatory regime and resolution framework for these entities.

Additionally, other products resembling securities and commodities derivatives are generally unregulated. For example, certain qualifying transactions among "eligible contract participants" or "eligible commercial entities" for contracts subject to individual negotiation fall within a broad definition of "swaps" and are traded in the OTC market. These swaps, as defined in the CEA and the securities laws, are largely excluded or exempted from regulation by the SEC or CFTC. The anti-fraud and anti-manipulation provisions of the federal securities laws only apply to a subset of swap agreements, known as security-based swaps. The CFTC also has anti-fraud and anti-manipulation authority over some markets.

Inter-agency cooperation

Joint Advisory Committee

The CFTC and SEC have, for many years, attempted to work together on a cooperative basis to the extent permitted by the evolving formulations of the CEA and Exchange Act. This has not always been an easy task to carry out in practice. The CFTC and the SEC have entered into several MOUs and initiatives to enhance coordination and cooperation between the two authorities. The most recent initiative took place in November 2008, when the SEC, Federal Reserve, and CFTC entered into an MOU related to credit default swaps (CDS) and central counterparties (CCPs). There is an MOU between the CFTC and SEC, dated March 11, 2008, addressing "novel" derivative products to enhance legal certainty, share information permit the trading of these products—in either or both a CFTC- or SEC-regulated environment—and to provide for regular meetings of staffs to discuss particular issues and products.

There also is an MOU in place between the two agencies regarding the oversight of security futures product ("SFP") trading and the sharing of SFP information. The MOU provides for notice of any

	planned examinations and the reasons for that examination, sharing of examination-related information, and the conduct of joint examinations, if feasible. The MOU also provides for notice of significant issues arising from these markets and the sharing of trading data and related information for SFP activity. The Joint Report recommends legislation to authorize the SEC and the CFTC to jointly form, fund, and operate a Joint Advisory Committee. According to the Joint Report, this committee would identify emerging regulatory risks and assess and quantify their implications for investors and other market participants, and provide recommendations for solutions. The committee would serve as a vehicle for discussion and communication on regulatory issues of mutual concern affecting CFTC- and SEC-regulated markets; the industry generally; and their effect on the SEC's and CFTC's statutory responsibilities. The SEC and CFTC already have requested and received statutory authority to jointly form, fund, and operate a Joint Advisory Committee as recommended by the Joint Report. (See also the discussion of cooperation with other domestic regulators under Principles 11 and 12.)
Assessment	Partly implemented.
Comments	No single issue was determinative of the grade under this Principle; rather, when considered together, the totality of the matters identified raised significant concerns. The regulatory infrastructure described briefly above is highly complex. In many areas, this complexity does not produce gaps or inequity. However, in some of the instances of legislative and institutional divisions of responsibility set out above, that is not the case. As detailed above, there are gaps in the authority of agencies to cooperate, such as on aiding and abetting, and on the supervision of financial holding companies operating primarily as investment banks. There are also differences in the regulation of economically similar products and services such as foreign exchange transactions, the treatment of banks vis-à-vis brokers when carrying out the same activity, and the regulation of securities and derivatives. The gaps and differences in treatment should be reduced as much as and as soon as possible. In addition, the rapid development of the market in complex derivatives, such as CDS, large parts of which neither agency has had the authority to regulate, has created significant regulatory gaps as discussed at length in the Treasury White Paper and noted in the Joint Report. This issue is currently the subject of deliberation in Congress. Regarding effective management of the division of responsibilities between CFTC and SEC, the Joint Report has laid out a way forward and both agencies' staff appears to be fully supportive of change. In addition to seeking legislative authority to establish a Joint Advisory Committee, the Joint Report makes recommendations on how to improve coordination and cooperation between the agencies, in ways which do not require new legislation and could therefore be achieved quickly. They include establishing: • A Joint Agency Enforcement Task Force to harness synergies from shared market surveillance data to improves market oversight, enhance enforcement, and relieve duplicative regulatory burdens. • Cross-agency training programs for enforcement personnel. • A program for regular sharing of staff. • A Joint Information Technology Task Force to pursue linking information on CFTC and SEC regulated persons and entities. Historically, legislation lacked clarity as to the scope of the powers of the SEC and CFTC over particular types of derivative instruments and markets. Consequently, the commissions found it difficult to work in a cooperative and coordinated fashion. The recommendations in the Joint Report mark a strong commitment to establish a new, more effective way of working together.
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.

Description	**CFTC** The CFTC is an operationally independent regulatory commission of the U.S. government, accountable to, and subject to the oversight of, U.S. Congress. By law, the five commissioners are appointed by the President with the consent of the Senate. Each CFTC Commissioner holds office for a term of five years. Not more than three commissioners may be members of the same political party. The President also appoints one of the commissioners as chairman, with the consent of the Senate. The President may replace the chairman at any time and the former chairman may complete his or her term as a CFTC Commissioner should he/she choose to do so—which seems unlikely. The criteria for removal of a commissioner are not set out in statute. However, case law regarding independent regulatory agencies suggests that the President has the power to remove a commissioner for "cause" such as neglect of duty or malfeasance in office. The CEA prohibits any CFTC Commissioner or employee from accepting employment or compensation from any person, exchange, or clearinghouse subject to regulation by the CFTC and from participating, directly or indirectly, in any contract market operations or transactions subject to CFTC regulation. The CFTC may consult with any department or agency of the government. In specific instances, the consultation process is established by law. For example, the CFTC may not designate a board of trade as a DCM or register a derivatives transaction execution facility (DTEF) in U.S. government-issued or guaranteed securities until the shorter of 45 days after the CFTC provides a copy of the application to Treasury, and the Federal Reserve or the CFTC receives comments from those agencies. The CFTC's budget is part of the federal budget that is prepared by the President and submitted to Congress. The budget is subject to review and recommendation at several levels, including House and Senate committees, and must be adopted by Congress annually. The budget has not kept pace with the growth in the futures market. The CFTC Chairman has testified about the commission's need for more resources and the Administration and U.S. Congress are considering the agency's need for more resources. Federal law provides federal employees with immunity from individual liability for torts committed in the scope of their employment. In order to insulate CFTC staff from individual liability for possible violation of constitutional or statutory duties that are not shielded by statute, the CFTC has adopted indemnification rules. The CFTC is accountable for its conduct to U.S. Congress primarily through reporting to House and Senate committees. In general, these committees handle, in the first instance, the reauthorization, budget, and funding decisions for the CFTC, as well as bills affecting the CEA. By law, the CFTC is subject to reviews and audits by the government. The CFTC is also required to deliver a written report to Congress within 120 days after the end of each fiscal year detailing CFTC operations of that fiscal year. In addition, CFTC operations are subject to ongoing review by an independent OIG with offices in the CFTC headquarters. It has four staff members. OIG conducts and supervises audits and investigations of programs and operations of the CFTC and reviews existing and proposed legislation and regulations. OIG recommends policies to promote economy, efficiency and effectiveness in CFTC programs and operations and to prevent and detect fraud and abuse. OIG keeps the Chairman of the CFTC and Congress informed about any problems, deficiencies and the progress of corrective action in programs and operations. The CFTC must comply with the Administrative Procedures Act (APA), which requires administrative agencies to give affected parties notice of proposed actions, and an opportunity to make submissions prior to a decision being made and provide written decisions setting out its findings of fact, conclusions of law, and the reasons for its decisions. Additionally, the APA creates the right of judicial review over agency actions. A person suffering legal wrong because of

	an administrative agency's action, or adversely affected by its decision, is entitled to a judicial review of the action. The CFTC also has extensive rules of procedure to ensure fairness in the conduct of hearings and other administrative activities. **SEC** The SEC is an operationally independent federal agency headed by a bipartisan five-member commission, comprised of the chairman and four commissioners, who are appointed by the President and confirmed by the Senate for staggered five-year terms. By law, no more than three of the commissioners may belong to the same political party. All SEC Commissioners and staff are subject to the federal criminal law conflict of interest statutes including a specific prohibition from participating personally and substantially in particular matters that would have a direct and predictable effect on their financial interests or one that is imputed to them. The Exchange Act also expressly prohibits any commissioner from engaging in any other business, vocation, or employment than that of a commissioner. There are matters of regulatory policy which require consultation with or approval by other authorities, such as the requirement for joint rule-making with the Federal Reserve in connection with the implementation of the GLBA. Where consultation is required, the process is clear and the criteria are transparent. Despite these requirements to consult, the SEC has the authority to make day-to-day decisions on technical matters without the need to consult with other government authorities. The SEC's budget is part of the federal budget that is prepared by the President and submitted to Congress annually. The budget estimate is subject to review and approval by OMB before it is forwarded to Congress as part of the overall budget request of the President. The budget is subject to review and recommendation at several levels, including House and Senate committees and must be adopted by Congress annually. The budget has not kept pace with the growth in the securities market. Presently, in light of the events in the financial markets over the past year, the SEC, the Administration, and U.S. Congress are reexamining the SEC's need for more resources. The SEC chairman, in her recent appropriations testimony, presented the SEC's fiscal 2010 budget request with specific reference to the need for additional resources to match significant growth in the size and complexity of the securities industry, including the BD and IA industries. Statute law and various principles of sovereign and qualified immunity provide significant protection to the SEC, commissioners, and staff. All commissioners, including the chairman are appointed by the President and confirmed by the Senate. The chairman is designated by the President and can be replaced as chairman at any time, but would then complete the remainder of his/her term as a commissioner should he/she choose to do —which seems unlikely. There are no statutory provisions governing removal of a commissioner. However, there is case law regarding independent regulatory agencies that says a commissioner may only be removed for cause. The SEC is subject to the oversight by committees of Congress and the Senate. It also provides information to Congress and the President, including information on pending enforcement matters of interest to Congress or the Executive. The SEC's receipt and use of funds are subject to regular audit by the Government Accountability Office (GAO) and the SEC's OIG. The OIG is an independent office inside the SEC; the Inspector General is appointed by the SEC chair, but can only be removed by Congress. There are 19 staff members. The OIG has investigative powers and staff members are required to cooperate with investigations. The results of these audits are reported to agency management, made available to Congress and the Office of Management and Budget (OMB) and generally are made public on the Internet. The SEC must comply with the APA (see the description above under the CFTC). The securities laws themselves also require the SEC to issue orders in its administrative proceedings. Final orders of the SEC may be appealed to the courts. The agency also has extensive rules of procedure to

	ensure fairness in the conduct of hearings and other administrative activities.
Assessment	Broadly implemented.
Comments	Both agencies are subject to an annual appropriations process at the legislature. The experience has been that the funding provided to the CFTC and SEC by this process has not been subject to wide fluctuations year to year. However, the funding has not kept pace with the growth in the markets, let alone their increasing complexity. The annual process and resulting lack of assurance of continuing funding prevent the agencies from committing to necessary long-term capital projects, such as building new market surveillance systems to replace the existing outdated systems at the agencies. Both chairmen are on record saying their agencies are underfunded and need more resources to increase staff levels. Each agency is tasked with regulating markets where the technology used by market participants is cutting edge; and products, markets, and trading techniques are changing at an accelerating rate. In this environment, regulators need to have sufficient resources in order to develop and maintain highly sophisticated electronic tools to support their supervisory tasks. One alternative to provide more assurance of longer-term funding would be to consider moving to direct self-funding. It is clear that the revenue generated by SEC routine activities would be sufficient to meet its funding needs. The total fees presently generated from activities such as filings, registrations, etc., at the SEC far exceed the budgets of both agencies.
Principle 3.	The regulator should have adequate powers, proper resources, the capacity to perform its functions, and exercise its powers.
Description	**CFTC** The legal framework for the CFTC provides it with sufficient powers to regulate and supervise the futures market and its participants within the parameters of the CEA as presently written. The CFTC has the power to obtain information regarding regulated markets, institutions, financial products, customers, and parties to transactions. In addition, it has the power to conduct investigations and to sanction violations of the CEA. Administrative sanctions may include orders suspending, denying, revoking, or restricting registration and exchange trading privileges, and imposing civil monetary penalties and orders of restitution. The CFTC has the power to conduct direct surveillance of those markets and financial institutions that fall within its regulatory jurisdiction. The CFTC also can obtain certain information on the affiliates of FCMs, whether those entities are unregulated or subject to regulation by other authorities such as the SEC, the banking regulators, or foreign authorities. The CFTC has the power to direct “registered entities“ such as DCMs to alter or supplement their rules and to take such action as it deems to be necessary to maintain or restore orderly trading. The CEA authorizes the CFTC to suspend or revoke the designation of a DCM, DTEF, or derivatives clearing organization (DCO) based on non-compliance with any of the provisions of the CEA, CFTC regulations, or CFTC orders. The CFTC states in its self-assessment that the recent financial crisis has illustrated the need to modernize consumer and investor protection requirements; to expand those requirements to previously unregulated areas; and establish structural mechanisms to ensure that gaps are addressed as soon as new products are developed. Recent draft legislation, such as the “Over the Counter Derivatives Markets Act of 2009” that is based on the White Paper, seeks to close some of those gaps. <u>OTC Derivatives</u>. Under the CEA as presently drafted, the CFTC has no jurisdiction over contracts or transactions in an “excluded commodity” entered into by ECPs (“OTC derivatives”). Excluded commodities consist of interest rates, exchange rates, currencies, securities, security indices, credit risks or measures, and other indices based solely on commodities that have no cash market or on prices, rates, values, or levels that are not within the control of any party to the relevant transaction.

	In addition, the CEA provides an exclusion from CFTC jurisdiction for electronic trading facilities that execute OTC Derivatives traded on a principal-to-principal basis between ECPs. OTC derivatives based on exempt commodities (e.g., energy, metals, chemicals) are subject to basic anti-fraud and anti-manipulation prohibitions when executed off organized trading facilities, but are not otherwise subject to regulatory oversight. OTC derivatives in exempt commodities that are executed on trading facilities are subject to various CFTC filing and reporting requirements and, when they become significant price discovery contracts (SPDC) as determined by the CFTC following public consultation, are subject to both CFTC regulatory oversight and self-regulatory responsibilities. Strengthening Requirements for Clearing Organizations. The CFTC is pursuing the adoption of stronger and more detailed core principles for DCOs to enhance the CEA regulatory regime for CCPs, and to ensure that U.S. law is consistent with international standards for CCPs. Ensuring Greater Transparency of the Marketplace. The CFTC recently announced several initiatives designed to bring greater transparency to the market regarding participation by non-commercial participants (such as commodity index funds, swaps dealers, and others); positions of traders of contracts determined to perform a significant price discovery function; and positions for contracts listed by foreign boards of trade (FBOTs) that are linked to the settlement price of domestic contracts. Applying Consistent Position Limits. The CFTC recently held public hearings on whether federal speculative limits should be set by the CFTC for commodities of finite supply, particularly energy commodities. The CFTC also recently requested public comment on whether a "bona fide hedge exemption" should continue to apply to persons using the futures markets to hedge risks other than risks arising from the actual use of a commodity and CFTC staff is considering the extent to which swap dealers should continue to be granted exemptions from position limits. Enhancing Conditions for FBOT Trading Linked Energy Contracts. To enhance its ability to conduct market surveillance and to maintain market integrity, the CFTC recently announced additional amendments to the terms under which an FBOT is permitted to make its electronic trading and order matching system available to exchange members in the United States. Strengthening Regulation of Retail Off-exchange Commodity Transactions. The CFTC is working on legislative amendments to extend the commission's anti-fraud authority for off-exchange retail foreign exchange transactions to transactions in other commodities. The CFTC currently employs approximately 580 career staff. This is just under the commission's peak levels in the early 1990s. In the period 1998 to 2008, the agency shrank by approximately 20 percent in head count, while the markets grew five-fold and the number of contracts grew six-fold. Further, the complexity of the market has increased markedly over this period. The budget for this year and next should allow for staff numbers to increase, but additional funds are needed. (See also the discussion of funding under Principle 2.) The complexity of the market imposes significant demands on the regulator to hire, train, and retain staff with a high degree of expertise. The CEA permits the CFTC to provide additional compensation and benefits to employees if the same types of compensation or benefits are provided by another comparable agency; this enables the CFTC to maintain compensation and benefits that are comparable to that paid by other federal financial regulators. Even at the best paid federal regulators, salary levels are far below industry salaries, which make it challenging to attract staff with market experience and to retain skilled staff. There are regular in-house educational/training seminars keyed to the primary mission of the CFTC. Technical and computer skills are also provided to employees as needed. In addition, employees may also use various on-line, web-based, and in-house educational materials to maintain and increase proficiency.

SEC

The SEC's extensive powers and authorities are delineated in various federal securities statutes and in the rules and regulations that the SEC has adopted under these statutes.

As the SEC staff stated in its self-assessment, the recent financial crisis has illustrated the need to modernize consumer and investor protection requirements, expand those requirements to previously unregulated areas and establish structural mechanisms to ensure that gaps are addressed as soon as new products are developed. Areas identified that need to be addressed include:

OTC Derivatives. The issue and trading of OTC derivatives, such as swap agreements, are largely unregulated in the United States. While this is true in some other developed jurisdictions, the U.S. market for these instruments is significantly larger than elsewhere.

Hedge Funds. Hedge funds are significant participants in the securities markets, both as managers of an estimated US$1.5 trillion in assets and as traders of securities. However, their activities, and the activities of other private investment pools, are largely "below the radar" (as in many other jurisdictions). Under the current regulatory structure, hedge funds usually operate using exemptions from the registration and disclosure requirements of the statutes. As noted in the White Paper, requiring registration with the SEC would allow data to be collected that would permit an informed assessment of how such funds are changing over time and whether any funds have become so large, leveraged or interconnected that they require regulation for financial stability purposes. This registration would promote greater transparency in the markets, improve the ability to deter and detect fraud, and provide better oversight of the hedge fund industry by regulators and the markets.

Municipal Securities. As noted above under Principle 1 and discussed in more detail under Principle 14, there is a gap in the SEC's powers with respect to the direct regulation of disclosure requirements applicable to issues of municipal securities.

BDs vs. IAs. IAs and BDs are regulated by the SEC under different statutory and regulatory frameworks, even though the services they provide may be virtually identical from a retail investor's perspective. Retail investors are confused about the differences between IAs and BDs and the varying legal duties that financial professionals owe investors. The White Paper noted that a consistent standard should apply to any CTA, FCM, IB, BD, or IA that provides similar investment advisory services.

While the SEC's funding has increased in late years, the chair has indicated a need for additional resources to match significant growth in the BD and IA industries. The SEC has some degree of autonomy on reallocating its budget among activities. For major changes consent of the relevant legislative committees is required. Permission to reallocate funds has been granted on request in the past. (See also the discussion of funding under Principle 2.)

The complexity of the market imposes significant demands on the regulator to hire, train, and retain staff with a high degree of expertise. The SEC's ability to attract and retain experienced and skilled staff was significantly improved by the 2002 enactment by Congress of "pay parity" legislation that authorizes the SEC to create a compensation system similar to the systems of other federal financial regulators. As a result of the SEC's new pay system, the staff turnover rate has diminished significantly. At the same time, pay parity has placed pressure on the funding process to obtain the necessary budget increases to match the personnel compensation levels at other federal financial regulators, such as the Federal Reserve. It should be noted that the Federal Reserve is self-funded and not subject to the annual appropriations process. Salary levels even at the best paid federal regulators are far below industry salaries, hampering the ability of the agency to hire personnel with significant industry experience and retain skilled staff.

The SEC training program provides significant training opportunities to all staffs. Several divisions inside the SEC organize their own comprehensive training programs for new and existing staff which are especially designed for their individual needs. Every new employee and commissioner

	receives education and training on ethics.
Assessment	Partly implemented
Comments	The funding of the CFTC and SEC does not provide sufficient resources to meet the needs of the regulators in supervising markets of the size and complexity of the U.S. markets. Both agencies need more resources—human, informational, and technological—in order to fulfill their present regulatory functions more effectively. Each agency is tasked with regulating markets where the technology used by market participants is cutting edge; and products, markets, and trading techniques are changing at an accelerating rate. In this environment, regulators need to have sufficient resources in order to develop and maintain highly sophisticated electronic tools to support their supervisory tasks. The expansion of responsibilities contemplated in the White Paper and reform legislation will result in even greater funding needs. (See also the comments under Principle 2 regarding the need for assured longer term funding and the discussion under Principles 10, 17, and 21 regarding the resource needs of the examination programs.) While pay parity with other federal financial institution regulators has improved the ability of the CFTC and SEC to hire and keep skilled staff, the agencies still cannot compete with industry compensation levels. Consideration should be given to ensuring the agencies have sufficient compensation flexibility to attract and retain employees with the specialized skills and experience needed. The CFTC and SEC have extensive powers within the scope of authority currently granted to the agencies by the statutes under which they operate. However, as noted in Principles 1, 2, 14, and elsewhere in this assessment, there are gaps in that authority that is of concern—both between the agencies and within the ambit of responsibility of each. Both agencies identified several areas of concern in their self-assessments and the Joint Report and made recommendations in the latter to address the issues. The White Paper and the proposed regulatory reform legislation also will provide additional authority to the agencies. Given the size, complexity, and importance of the U.S. capital markets, it is important that these gaps be addressed promptly. The complexity of the market demands expertise and drives a tendency for specialization. This was particularly evident among SEC staff, which showed a very high degree of specialization. However, care needs to be exercised to ensure the resulting “silos” of expertise do not limit the ability to see the bigger picture when analyzing problems and developing policy responses. It also demands strong management controls to overcome fragmented organizational structures to ensure the public interest is served. It was not clear that the required level of controls were in place at the SEC to manage these issues effectively. The SEC’s ability to make policy determinations would be enhanced by a greater use of its authority to request raw data and to develop empirical analysis based on this data rather than relying on data generated and processed by exchanges, SROs, and others.
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	Overall, the CFTC and the SEC work under a high degree of transparency. **CFTC** The law provides various procedural rules for disciplinary proceedings and the reparations program, among other matters. The CFTC has implemented the laws that require open meetings of the commission. The CFTC also has adopted regulations to provide objective due process procedures to ensure that its programs are conducted with fairness and impartiality. The general criteria for granting, denying or revoking a license are contained in the CEA and the CFTC regulations and so are public. Those affected by the licensing process are entitled to a hearing with respect to the regulator’s decision to grant, deny, or revoke a license and the decision may be

appealed to the courts.

CFTC rulemaking must comply with the procedural requirements of the APA, which generally require the CFTC to publish a notice of Proposed Rulemaking and provide interested persons with an opportunity to participate in the rulemaking through submission of written data, views or arguments. The CFTC sometimes holds an open forum to permit the public to give its views on proposed rules of particular significance. The APA requires an agency to give its rationale and policy purpose in proposing or adopting a rule. In addition, the CFTC generally articulates the rationale for all interpretations, exemptions, orders or policy changes.

Before an agency rule can take effect, federal agencies must submit to each House of Congress and to the Comptroller General a report containing a copy of the rule, a concise statement relating to the rule (including a cost-benefit analysis and whether it is a major rule) and the proposed effective date.

The CFTC has created various advisory committees as a mechanism for public consultation with interested members of the commodities industry and users of the futures markets. The CFTC also holds informal roundtables and formal public hearings on issues from time to time.

All CFTC regulations are published in the U.S. Code of Federal Regulations and are available at the CFTC's website.

CFTC regulations provide that the CFTC may decline to publish or make available to the public any "non-public" record. In general, this type of information concerns trade secrets, national defence or foreign policy concerns, personal privacy, various financial statement forms and pending investigations. In addition, CFTC regulations outline the procedures by which a person submitting information to the CFTC may request confidential treatment of that information. CFTC rules implement the Privacy Act, which provides protections for information concerning an individual.

The CFTC website provides information about the regulatory mandate of the CFTC, the economic role of the futures markets, new market instruments, market regulation, international regulatory developments and cooperative initiatives, enforcement actions, customer protection issues and the diverse functions of the CFTC. In addition to issuing press releases and advisories covering the CFTC's regulatory and enforcement activities, the CFTC's web site provides an Education Center that highlights and explains important policy issues and initiatives and salient aspects of the CFTC's regulatory mandate.

The CFTC publishes brochures and educational materials about the CFTC, the futures industry and the futures and commodity option markets. The CFTC conducts research and publishes reports from time to time on major policy issues facing the futures markets.

SEC

Under the Freedom of Information Act (FOIA) all agencies, including the SEC, are required to: (1) publish certain types of information in the Federal Register, such as procedural rules and substantive rules of general applicability; (2) make available for public inspection and copying other types of information such as adjudicative opinions and staff manuals; and (3) make available to the public other types of information upon specific request for that information.

The U.S. Constitution requires administrative agencies like the SEC to conduct their proceedings with due process. All final SEC rules are accompanied by a release that is published in the Federal Register, with an explanation of the reasons for adoption and responses to the more salient issues raised in the comment letters.

The SEC also occasionally provides guidance on topics of general interest to the business and investment communities by issuing "interpretive" releases, in which the SEC publishes its views and interprets the federal securities laws and SEC regulations. These interpretations are disclosed to the public via the SEC website and the Federal Register and, in some instances, may include a

	request for comment. As is required for the CFTC, the law provides that most meetings of the SEC must be open to the public and requires the SEC to provide advance notices of such meetings. The SEC videocasts all open SEC meetings on the Internet. The SEC is subject to similar requirements under the APA as is the CFTC regarding rule-making. The SEC hosts public roundtables to which experts are invited to share their views with the SEC and the public about approaches to certain issues affecting the securities markets. Finally, the SEC has created and utilized various federal advisory committees. The SEC considers the costs of compliance of all rules it adopts, both when the rule is proposed and when the rule is adopted. The SEC is subject to both statutory provisions and its own rules that are intended to ensure the fairness of its processes. For example, the SEC is subject to restrictions relating to ex parte contacts and is required to maintain a separation of certain functions under both the APA and its own rules. The SEC is required to give written reasons for its decisions that affect the rights and interests of others. These decisions must include a statement of findings and conclusions and the reasons or basis for such, on all material issues of fact, law or discretion that are presented on the record. The SEC's criteria and application processes for registration of various entities and products are made public under SEC rules and regulations. Affected persons are entitled to hearings. Both the Exchange Act and Advisers Act contain statutory provisions that are designed to safeguard the confidentiality of information obtained in the course of examinations or investigations. The SEC also has adopted rules under the Exchange Act to permit confidential treatment of requests for certain information. The Privacy Act provides procedures for agencies when they obtain, maintain and disseminate personal information concerning members of the public. It requires that the SEC make certain disclosures to any individual from whom the SEC requests or seeks to compel information and that the SEC maintain a record of information released to persons outside the SEC. The Privacy Act generally forbids disclosure of information concerning an individual, subject to several important exceptions. The SEC plays an active role in investor education. Its investor education programs includes producing and distributing educational materials; participating in educational seminars and investor-oriented events; and partnering with federal agencies, state regulators, consumer groups, industry associations and others on financial literacy initiatives.
Assessment	Fully implemented.
Comments	While publishing its enforcement manual on the SEC website may enhance the transparency of the agency and its procedures, there is some risk that it might compromise the effective implementation of the enforcement program.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	CFTC members and staff of the CFTC and the SEC are subject to a code of ethics and professional conduct requirements which deal with issues of integrity, procedural fairness, and prevention of conflict and confidentiality. **CFTC** CFTC Commissioners and employees fall under the jurisdiction of several sets of ethical standards. Each of these establish that public service is a public trust and that all government employees must avoid both explicit conflicts of interests as well as even the appearance of impropriety in the conduct of their official business. Regulations issued by the U.S. Office of Government Ethics apply to CFTC employees and set

	basic obligations concerning gifts from outside sources, gifts between employees, conflicting financial interests, impartiality in performing official duties, seeking other employment, misuse of position, and outside activities. In addition, an Executive Order of the President mandates high principles of ethical conduct for government employees. Additionally, the CFTC has adopted specific standards of conduct for commissioners and employees, including restrictions on business and financial transactions and interests; restrictions concerning the receipt and disposition of foreign gifts and decorations; prohibitions on the disclosure of non-public commercial, economic, or official information to any unauthorized person; and restrictions of the ability of former CFTC employees to practice or otherwise represent a person before the CFTC. CFTC regulations generally provide that no member or employee of the CFTC may participate directly or indirectly in any transaction involving commodity futures and commodity options. It is a felony for a CFTC employee or commissioner to pass on or benefit from information received in the course of employment which may affect or tend to affect the price of commodities. The CEA prohibits the CFTC from publicly disclosing information that would separately disclose the business transactions or market positions of any person and trade secrets, or names of customers. CFTC rules contain recordkeeping and access requirements, including requirements governing the handling and protection of non-public information. The CEA makes it a felony punishable by a fine of up to US$500,000 or imprisonment for up to five years, or both, for a CFTC employee or commissioner to trade commodity futures and options, or to participate directly or indirectly in any investment transaction in an actual commodity if non-public information is used in the transaction or if prohibited by CFTC regulations. The CFTC has adopted rules of procedure addressing many aspects of the CFTC's program, as for example, procedural regulations relating to the review of exchange disciplinary, access denial or other adverse actions; regulations of practice that are generally applicable to adjudicatory proceedings before the CFTC under the CEA; regulations specifying the conditions for conduct of CFTC business, with a presumption of open CFTC meetings; and procedures applicable to the review of NFA decisions etc. **SEC** All staff, including commissioners, is subject to the criminal law conflict of interest statutes which prohibit them from participating personally and substantially in particular matters that would have a direct and predictable effect on their financial interests or one that is imputed to them. This statute has been implemented and supplemented by regulations issued by the U.S. Office of Government Ethics. In addition the rules applying to all governmental agencies, all SEC employees and commissioners must follow the SEC's Standards of Ethical Conduct, which is enforced by the SEC's Ethics Office. Various divisions have implemented ethics guidelines specific to the special nature of their programs (e.g., enforcement and examinations). Unlike the CFTC, SEC staff is allowed to trade in securities subject to the agency's jurisdiction but they have to comply with comprehensive rules regarding their securities holdings and transactions which were recently—after some irregularities—enhanced. These rules apply to staff, commissioners, and any of their spouses, dependent children, or other persons residing in the same household who are related to the employee by blood or marriage. The regulation also prohibits the misuse of non-public information and the purchase of a security of an issuer that the employee knows to be involved in SEC litigation or investigation. To bolster these requirements, the SEC now requires employees to certify in writing before any trade that they do not possess any non-public information about the company being traded. The SEC's regulation requires the reporting of securities transactions within five days of the receipt of the confirmation of the trade. In addition to this regulation, certain other employees are subject to government-wide financial disclosure rules.

	Employees who have the greatest risk of creating harm by misusing information or having conflicts of interest must file a confidential financial disclosure form annually. The SEC's Conduct Regulation prohibits the unauthorized disclosure of confidential and non-public information. Violations of the conflict of interest restrictions may be enforced either civilly or criminally. Violations of administrative rules can result in disciplinary action including discharge. Officers and employees of the SEC are prohibited from making confidential information or documents or any other non-public record of the SEC available to anyone outside the SEC. This includes information received from foreign regulators. SEC officers or employees who fail to comply with SEC regulations may, upon conviction, be fined up to US$1 million and/or imprisoned for a period not exceeding ten years. The government ethical standards require impartiality in the performance of official duties. In addition, the SEC's Rules of Practice establish standards of procedural fairness. An additional protection of procedural fairness may be found in other SEC codes. The Congressional review process for final SEC rules is set out in legislation and has safeguards designed to protect the integrity of the process.
Assessment	Fully implemented.
Comments	
	Principles of Self-Regulation
Principle 6.	The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.
Description	The effectiveness of the regulatory regime is to a large degree dependent on the skills and resources of the SROs. **CFTC** There are several categories of organizations authorized by the CFTC which have self-regulatory responsibilities: futures exchanges or DCMs, DCOs, and the NFA as a Registered Futures Association (RFA). In order to trade futures contracts (the regulated activity), a market must be designated as a "contract market" under the CEA. A DCM designs the terms and conditions of futures contracts (consistent with CFTC Guideline 1) and determines the mechanism and terms of trading and execution, as well as which DCO would provide clearing and settlement services. It must also carry out surveillance of the operation of its market. There are currently 15 DCMs though the number is growing as new DCMs are being set up. With one exception, DCOs are owned by or are affiliates of DCMs. Ninety percent of derivatives contracts are cleared though one DCO, which is part of the CME. The NFA is the only existing RFA. The CEA provides that the CFTC may approve rules that require persons eligible for membership to become members of at least one registered futures association. Under CFTC regulations, all FCMs which are the type of financial intermediary for U.S. commodity futures transactions that are permitted to hold customer funds, are required to be members of the NFA. The CFTC has delegated the registration functions for all commodity futures intermediaries to the NFA on behalf of the CFTC. Under CFTC regulations, examination and monitoring of members' compliance with financial and reporting requirements may be performed under agreement between SROs to reduce multiple monitoring and auditing for compliance. The CEA provides Designation Criteria for DCMs, including that such a contract market establish trading rules, discipline violators, and ensure the financial integrity of transactions and member intermediaries. Through the Joint Audit Agreement, DCMs and the NFA divide up primary SRO responsibility for monitoring the financial condition and rule compliance of joint members.

	SEC The regulatory system makes extensive use of SROs as required by the Exchange Act. By law, national securities exchanges (exchange) and registered securities associations (RSA) are self-regulatory organizations. The principal function of an association is regulating its members through a continuous program of rulemaking and interpretation, surveillance and enforcement of the applicable federal securities laws, and its own ethical standards through its disciplinary process. In a process similar to that applied to national securities exchanges, the SEC evaluates the self-regulatory authority of an association in determining whether the association and through the association its members, are fulfilling their statutory and regulatory obligations. FINRA is currently the only RSA. There are 20 other SROs, including 3 clearing agencies and the MSRB. The number is growing because of the creation of new national securities exchanges. Some are also coming together in groups to organize their regulatory functions collectively. Generally, a BD generally must register with the SEC and become a member of at least one SRO which can be a national securities exchange or FINRA. FINRA is the result of the consolidation of the member firm regulatory functions of the New York Stock Exchange (NYSE) and National Association of Securities Dealers (NASD). With limited exceptions, FINRA is responsible for regulating all securities firms that do business with the public, including with respect to professional training, testing and licensing of registered persons, arbitration, and mediation. BDs that do business with the public must be members of FINRA unless they limit their transactions to securities traded on an exchange of which they are a member or unless they limit their business to one state. BD registrations with the SEC, states, and FINRA are maintained on a central data base operated by FINRA.
Assessment	Fully implemented.
Comments	IOSCO has indicated that there are no criteria for this Principle. Assessment is subsumed within the assessment of Principle 7.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	The SEC and CFTC employ structurally different regimes to register and oversee exchanges. The SEC uses a traditional “rules-based” approach; the CFTC uses a “principles-based” approach. **CFTC** An applicant for registration as an exchange (DCM) must demonstrate that it complies with 8 Designation Criteria and 18 Core Principles set out in the CEA. DCM Designation Criterion 1 requires a DCM to demonstrate to the CFTC that the DCM meets initially and on an on-going basis the Designation Criteria and the Core Principles. A DCM must establish and enforce rules defining the manner of operations of the trade execution facility maintained by the DCM and demonstrate that the trade execution facility operates in accordance with the rules of the DCM. The eight Designation Criteria cover the range of standards required of an SRO by the IOSCO Principles, including prohibiting market manipulation; promoting fair and equitable trading; enforcement of its rules and the law; ensuring the financial integrity of transactions; and establishing appropriate disciplinary mechanism including fairness. The 18 Core Principles, with which a DCM must comply on a continuing basis, cover similar ground and also deal with other matters such as conflicts of interest; the governance of mutually owned exchanges and dispute resolution; and other futures exchange specific matters as discussed under Principles 25 and 26. The CFTC has provided additional information and guidance to applicants on how DCMs can remain in compliance with the Core Principles and Designation Criteria. An RFA application is processed in a traditional rules-based approach. The requirements largely replicate those applied to DCMs, with the exception of the exchange specific requirements. The

	CEA provides for less flexibility as to how an RFA meets the requirements. The CEA requires that the prospective RFA demonstrate that the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, being suspended, or barred from being associated with all members, or any other fitting penalty, for any violation of its rules. Following review, the CFTC may by order grant the registration if the requirements are satisfied or, after appropriate notice and opportunity to be heard, deny such registration if the application is deficient. The designation process for a DCO is described in Principle 29. Unlike the SEC, the CFTC has delegated to the registered association, in this case NFA, responsibility for processing and granting applications for registration of various categories of registrants under the CEA. The NFA has adopted the CFTC's standards defining the scope of evidence that may be presented by the applicant or registrant to challenge allegations of statutory disqualification, as well as the standards to be followed by the party reviewing the matter and making determinations. Wherever NFA has modified those procedures, the CFTC's review concluded that the modifications would not adversely affect the rights of applicants and registrants. The CFTC requires RFAs to demonstrate a capability to promulgate rules and conduct proceedings which provide a fair, equitable, and expeditious procedure, through arbitration or otherwise, for the voluntary settlement of customers' claims or grievances brought against any member of the association or any of their employees. A prospective RFA must demonstrate that its rules assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs. In addition, various CFTC regulations impose standards of procedural fairness on SRO programs. DCMs are required to monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market. A DCM must have arrangements, resources, and authority for effective rule enforcement. DCMs are required to establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants. DCMs should have rules prohibiting conduct by intermediaries that is fraudulent, non-competitive, unfair, or an abusive practice in connection with the execution of trades; and a program to detect and discipline such behavior. DCMs should have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice abuses. SROs are required to maintain the confidentiality of material non-public information and information obtained from the CFTC in connection with the exercise of their self-regulatory responsibilities. They must provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members, and contract market employees; or gained through an ownership interest in the contract market. Criminal sanctions can apply for certain breaches of the confidentiality requirements set out in the CEA. A DCM is required to establish and enforce rules to minimize conflicts of interest in the decision making process of the contract market and establish a process for resolving such conflicts of interest. The CFTC has provided guidance on how to comply. The CFTC ensures compliance by NFA with its self-regulatory obligations and DCMs with Core Principles, by conducting periodic reviews of NFA's compliance programs and Core Principle oversight reviews of DCMs. NFA oversight reviews focus on the specific program responsibilities of NFA, including review of the financial and sales practice compliance programs for FCMs, IBs, CPOs, and CTAs, as well as review of NFA's programs for arbitration, registration and fitness, and

disciplinary actions. The CFTC's audit and review of DCMs also encompass the market surveillance, audit trail, and trade practice surveillance functions. The CFTC provides the SROs with minimum standards for carrying out their surveillance of compliance by FCMs with applicable financial and related reporting requirements.

CFTC staff conducts on-site inspections, meets with NFA or DCM staff, and reviews program materials and databases, evaluates procedures and performs reviews of samples of NFA's or the DCM's files to determine whether the SRO's procedures are consistent with its regulatory obligations; whether the SRO has properly executed its program; and that the files contain sufficient documentation. The results of these reviews are presented to the CFTC and reported back to NFA or the DCM. Every two to three years, the CFTC's Division of Market Oversight (DMO) conducts a review of a DCM's ongoing compliance with Core Principles through the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation, customer and market abuses, and ensure the recording and safe storage of trade information. Upon completion of a review, a report is issued and submitted to the CFTC for approval for issuance to the SRO. These reports also are made available to the public, which provides an opportunity for external comment on the findings, critical or otherwise.

The CFTC examines FCMs to ensure that DSROs are carrying out their member regulation responsibilities and also examines FCMs for its own purposes and not necessarily just "for cause." The CFTC is authorized to abrogate any rule of the NFA if it appears to the CFTC that such abrogation is necessary or appropriate to assure fair dealing by the members of the association, to assure a fair representation of its members in the administration of its affairs, or to effectuate the purposes of the CEA. The CFTC also may alter or supplement NFA rules after notice and hearing. The CEA provides that the CFTC may suspend the registration of the NFA if it finds that the rules thereof do not conform to the requirements of the CFTC.

SEC

A national securities exchange, national securities association, and clearing agency must be registered with and have its rules reviewed by the SEC for compliance with the Exchange Act. The test is whether the entity is organized and has the capacity to carry out the purposes of the act. An SRO also must be able to enforce compliance with the act, the rules and regulations thereunder, and the SRO's own rules by its members and their associated persons. The SEC evaluates whether applicants for registration as a national securities exchange or an association which operates a market have adequate computer system capacity, integrity, and security to support the operation of the exchange.

An SRO may deny membership to a BD or bar from association with a member a natural person who is subject to a "statutory disqualification." The rules must not permit unfair discrimination between customers, issuers, and BDs or impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the act. Clearing agencies also may not permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency.

Further, an exchange or association may deny membership to a BD that does not meet financial responsibility or operational capability standards, or that does not have the minimum level of training, experience, or competence prescribed by the exchange's rules. In addition, an exchange or association may deny membership to a BD that has engaged or is likely to engage in acts or practices that are inconsistent with just and equitable principles of trade.

The act requires that the rules of an exchange, association, and clearing agency must provide for a fair procedure for disciplining members and persons associated with members, denying membership and prohibiting or limiting access to services, and for exchange and associations barring persons from being associated with members.

SROs are required to have implemented measures to ensure that information obtained during the

	course of carrying out SRO regulatory functions is not misused. These measures include internal policies or rules regarding ethical conduct on the part of staff, the preservation of the confidentiality of information that is not public, and prohibitions on the use of such information for personal benefit. The SEC reviews SRO rules and other proposals and examines SRO operations to evaluate any potential harmful impact that conflicts of interest may have on the effective oversight of the securities markets. In particular, the SEC reviews an SRO's ownership and regulatory structure and any proposed changes, with the objective of identifying conflicts of interest that the SRO may have between regulating its members and operating its business. The SEC has also taken steps to ensure that the SEC has effective tools to oversee an exchange that is controlled by an entity not fully subject to its jurisdiction. The designation process for a clearing agency is described in Principle 29. The SEC reviews all prospective exchange, association, MSRB, and clearing agency rules to evaluate whether the mandated standards have been met. Under the act, an SRO must file any proposed rule changes, additions, or deletions with the SEC. Once filed, the SEC must publish a notice of the filing in the Federal Register and give the public an opportunity to submit comments on the proposal. The SEC must approve a proposed rule change if it finds that the proposed rule change is consistent with the requirements of the Exchange Act. As part of the registration process, securities professionals who work for BDs (including prospective officers of the firm and other management and supervisory personnel involved in the day-to-day operation of the firm's investment banking or securities business) must pass an examination administered by FINRA to demonstrate competence in the areas in which they will work. These mandatory qualification examinations cover a broad range of subjects on the markets. The rules of an exchange, association, or clearing agency must provide for a fair procedure for disciplining members and persons associated with members, denying membership, barring persons from being associated with members, and prohibiting or limiting access to services offered by the exchange or its members. If the SEC finds that an exchange, association, or clearing agency has failed, without reasonable justification or excuse, to enforce compliance with any such provision by a member or person associated with a member, it may impose sanctions against the SRO including suspension, revocation, censure, and limitation of activities. If an SRO fails to take appropriate disciplinary action against a member, the SEC has its own authority to take action against such member under the Exchange Act, Advisers Act, and the ICA. As regards the governance of SROs, the Exchange Act requires that the rules of an SRO must ensure fair representation of members in the selection of the SRO's directors and the administration of its affairs. One or more directors of an exchange must be representative of issuers and investors and not associated with a member of the exchange. In order to satisfy itself that an SRO is in compliance with the obligations and responsibilities set out above, the SEC has a surveillance, examination, and enforcement program to oversee the activities of the SROs, including exchanges, associations, and clearing agencies. SEC staff conducts periodic inspections of the SROs to evaluate whether they and their members comply with applicable federal securities laws and SRO rules. These inspections focus on the SRO's regulatory programs, including: market surveillance, investigative and disciplinary programs, member examination programs, and listing and arbitration programs, among others. In practice, at least one themed inspection generally is underway at any point in time. Staff also examines an SRO's disciplinary actions against members and denials of membership in, or access to, the SRO. The SEC examines BDs to ensure that SROs are carrying out their member regulation responsibilities and also examines BDs for its own purposes and not necessarily just "for cause." The SEC has recently introduced more rigorous processes to prevent examinations remaining open

	for excessive periods without good cause and to provide BDs with better and timelier feedback. **Outsourcing** Under the CEA, a DCM may comply with any applicable Core Principle through delegation of any relevant function to the NFA or another DCM or DCO. The CFTC also permits DCMs to meet their self-regulatory obligations by using persons under contract to perform specified duties subject to the DCM "maintaining a sufficient degree of control over the persons under contract" and the "person under contract having no conflict of interest." In both cases, the DCM remains responsible for the performance of its obligations under the CEA and is overseen by the CFTC accordingly. The SEC oversees arrangements between SROs whereby responsibilities are allocated between them. These arrangements may take two forms. In the first, the delegating SRO remains responsible for meeting its regulatory obligations under the Exchange Act. In the second and subject to SEC approval, the obligations can be transferred to the second SRO. Currently, there are no third parties other than SROs performing regulatory services.
Assessment	Broadly implemented.
Comments	There are marked differences in the powers that the SEC and CFTC can exercise over SROs that are exchanges. The Joint Report published on October 16, 2009 highlighted differing authority regarding new product approval and the procedures for reviewing and approving the rules of exchange SROs. • New derivatives products listed on a securities exchange that are novel and therefore do not fit within existing listing standards must be approved in advance by the SEC. Trading rules must be pre-approved. The SEC reviews the proposal against the Exchange Act and the regulations and must take account of the views of respondents to the mandatory public consultation process. Absent a positive finding, a rule is not approved. • The CFTC has more limited authority. The CEA generally allows for the introduction of new products or changes in trading rules by a self certification process whereby the DCM files a notice with the CFTC containing an assertion that the product or change does not violate the CEA or CFTC regulation. Notification to the CFTC can be as short as the day before the product is introduced or the rule is changed. Although the CFTC reviews all new products and rules after the fact, its power to delist or require a rule to be amended is dependent on the CFTC determining that the implemented rule or newly introduced product violates the CEA. The Joint Report has identified this as one area of deficiency in the CFTC's powers and has recommended that the CEA be amended to provide the CFTC with a power equivalent to that of the SEC for rule changes; extend (from 1 day to 10, or possibly to 90 days) the advance notice requirement for new or amended rules and products; and provide the CFTC with clear authority to bring an enforcement action against an exchange (or clearing organization) for violation of a Core Principle. Self certification was introduced by Congress in the CFMA in recognition of the need to enable the futures exchanges to act quickly to benefit from their innovative endeavors in a competitive market. In the view of the assessors, implementation of the Joint Report's recommendations, while necessary, will need careful delineation to preserve this ability. There were some comments from industry participants that inflexible prior approval of rules can sometimes be used to avoid taking a decision on a politically or commercially sensitive issue or one on which the staff of the regulator are unwilling to admit that that they do not have the expertise to analyze properly. IOSCO Principle 7 accommodates a broad spectrum in the balance of power between a statutory regulator and an SRO. For example, prior approval of rules and rule changes is not mandatory, subject to the regulator determining that it is not necessary. The CFTC lacks this power as regards new products and associated rule changes. In addition, the CFTC is unable to require public comment in advance of an exchange's introduction of new products and trading rules unless the Commission stays a rule's effectiveness. IOSCO's Principles Methodology also notes that in the

	case of for-profit demutualized exchanges (as is typical in the United States for both securities and futures markets), there may be increased concern regarding conflicts of interest and inappropriate use of self-regulatory resources which call for enhanced powers of oversight by the regulator. Futures exchanges (including the exchange with a 90 percent plus market share) have retained regulatory responsibility for all aspects of their members' conduct. There are industry concerns that a demutualized exchange will abuse its powers over members to restrain dissent over important structural or other changes, which will have a negative effect on the interests of a particular member or a group of members. However, the CFTC thoroughly examined and reviewed this issue as part of a study that commenced in 2003 and culminated in 2009 with the adoption of acceptable practices for Core Principle 15 (which requires that exchanges adopt and enforce rules to minimize conflicts of interest in the decision-making process). The review included extensive public consultation. The adopted acceptable practices recognize exchanges' unique public interest responsibilities as SROs and remind all exchanges that they bear special responsibility to regulate effectively, impartially and with due consideration of the public interest. The acceptable practices include instituting boards of directors composed of at least 35 percent public directors and establishing oversight of all regulatory functions through regulatory oversight committees consisting exclusively of public directors. The acceptable practices also set forth minimum disciplinary panel composition standards to include at least one public person and define the term "public director." In the equity markets in contrast, the association (FINRA) has taken over the work of supervising BDs almost entirely, with the merger of NASD Regulation and NYSE member regulation activities (with NYSE Euronext retaining only market regulation and the listing function), which provides for full independence of the self regulatory function. Differences also exist in the licensing of BDs and FCMs. BDs must register with the SEC and then must join an SRO, which must be FINRA if they do business with the public. In the case of FCMs and others in the futures business, the CFTC has delegated the registration function in its entirety to NFA and then monitors NFA to satisfy itself that the NFA is meeting its responsibilities under the CEA. This would appear to be a more efficient approach which the SEC might wish to consider.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation, and surveillance powers.
Description	The CFTC and the SEC have comprehensive inspection, investigation, and surveillance powers. **CFTC** The CFTC has access to records, including non-public and public information, held by individuals and entities regulated by the CFTC (FCMs, floor brokers, floor traders, IBs, CTAs, CPOs, associated persons, and exchanges) including information about customers and persons that do business with regulated individuals and entities. The CFTC has access to these records using its inspection powers. No judicial action or suspected misconduct is required. The CFTC conducts a market surveillance program to detect and prevent price manipulation in futures and commodity option markets. The principal goals of market surveillance are to spot adverse situations in these markets and to pursue appropriate remedial actions, in coordination with the exchange, to avoid market disruption. The heart of the CFTC's market surveillance system (and also as an important component of its financial surveillance system) is the large-trader reporting system. In order to identify potentially disruptive futures positions, staff uses the reporting system to collect and analyze data on large trader positions in all commodities. Reportable positions—daily reports of futures positions above specified reporting levels—are obtained from FCMs, clearing members, and foreign brokers. CFTC regulations and NFA rules also impose comprehensive record creation, retention, and

	reporting requirements to ensure that all transactions in futures and options can be reliably documented and reconstructed and are readily available to investigating authorities without prior notice. All books and records required to be kept must be retained for five years and must be "readily accessible" during the first two years of that period. In addition, the CFTC can obtain information from certain ECMs. Registrants must keep a record of the identity of the owners, controllers, and principals of accounts carried by or introduced to or by them. Principals of registered intermediaries, defined as each person who is a holder or beneficial owner of 10 percent or more of the outstanding shares of any class of stock, or has contributed 10 percent or more of the capital of the entity, must provide the CFTC with identifying information. Moreover, CTAs and CPOs must provide the CFTC with names and addresses of all partners, officers, directors, and persons performing similar functions. The CFTC has delegated both inspections and enforcement functions to the SROs. (See the descriptions of these SROs in Principle 7.) However, the CFTC has full access to information concerning the SROs, and the SROs are subject to confidentiality provisions. **SEC** The SEC has sufficient legal powers to conduct surveillance, undertake examinations, inspections and investigations, obtain information, and take enforcement actions. In particular, the SEC can: a. conduct on-site inspections of all entities registered with the SEC ("registrants"), including books and records, without prior notice; b. obtain books and records and request data for information without the need for a judicial action even in the absence of suspected misconduct; and c. supervise exchanges and regulated trading systems, even if the frontline responsibility for overseeing daily trading activities and regulatory compliance on the exchanges lies with SROs. SROs have market surveillance responsibilities and have primary surveillance authority over their marketplaces. Under the Exchange Act, SROs are obliged to comply with the act and the rules and regulations thereunder, as well as the SRO's own rules. All entities regulated by the SEC are subject to books and recordkeeping obligations, both by statute (Exchange Act, ICA, and Advisers Act), the SEC's and SRO's rules. In general, the books and recordkeeping obligations require these entities to keep the documents for the period specified by applicable SEC rules. The maintained documents permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions. The SEC has authority to pursue violations of the record keeping and record retention requirements via enforcement action. All registrants are required to maintain certain records concerning client identity under the Bank Secrecy Act (BSA). The U.S.A. Patriot Act requires financial institutions to establish written customer identification programs (CIP). SEC-registered IAs are not subject to the CIP obligation. However, under the Advisers Act, an IA must maintain certain records that, as a practical matter, include the identities of its clients. The Advisers Act permits IAs to maintain the confidentiality of the identity of their clients: even during examinations by SEC staff, the IA does not have to reveal client identities. However, the SEC has the authority under various statutes and rules to determine or access the identity of all customers of registrants, such as those rules requiring registered entities to maintain specified books and records and the SEC's statutory authority to examine such books and records. The SEC may bring enforcement actions for violations of certain reporting, record keeping and record retention requirements promulgated under the BSA, including those that relate to a BD's CIP. The SEC conducts inspections of SROs to assess their compliance with federal securities laws, rules and regulations and to evaluate the SRO's programs for overseeing, enforcing and disciplining its members for compliance with federal requirements and the SRO's own rules. The Exchange Act requires that SROs, upon request of any representative of the SEC, promptly furnish

	to such representative copies of any documents the SRO makes or receives in the course of its self-regulatory activity. The SEC can issue an inspection report to the SRO noting the deficiencies and recommending that the SRO take corrective action. The SRO must submit a written response describing the corrective measures it plans to implement with respect to each deficiency noted in the inspection report. In some cases, an SRO may enter into a Regulatory Services Agreement with a registered third-party SRO whereby the third-party SRO agrees to perform certain regulatory obligations of the procuring SRO. In such cases, the procuring SRO remains responsible for meeting its regulatory obligations under the Exchange Act. As such, the SEC conducts inspections that focus on the procuring SRO to ensure that it is appropriately overseeing compliance for all activities on its exchange, including those activities directly monitored by the third-party SRO under the Regulatory Services Agreement, as well as inspections that focus on the third-party SRO to ensure that it is appropriately administering its contracted regulatory obligations. The SEC can also cause changes/improvements to be made in SRO processes by using its authority to review SRO rule-change filings under the Exchange Act and SEC rules. The SEC may bring an enforcement action against an SRO for failure to act or adequately perform required functions.
Assessment	Fully implemented.
Comments	
Principle 9.	The regulator should have comprehensive enforcement powers.
Description	The CFTC and the SEC have comprehensive enforcement powers. Both have quasi-criminal authority. **CFTC** Under the CEA, the CFTC has comprehensive power to conduct investigations to ensure compliance with laws and regulations. The CFTC can administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the CFTC deems relevant or material to the inquiry. If an individual or firm named in a subpoena refuses to comply with its terms, the CFTC may apply to a federal district court to enforce the subpoena. The CFTC has the authority to file a civil enforcement action in federal district court or an administrative enforcement proceeding in an administrative tribunal to ensure compliance with the CEA. The CFTC has the power to seek: a. preliminary and permanent injunctions barring future violations of the CEA and CFTC regulations; b. an *ex parte* order (i) prohibiting any person from destroying, altering or disposing of, or refusing to permit authorized representatives of the CFTC to inspect any books and records or other documents; (ii) prohibiting any person from withdrawing, transferring, removing, dissipating or disposing of any funds, assets or other property; or (iii) appointing a temporary receiver to administer such restraining order; c. the imposition of civil penalties; d. the appointment of a permanent receiver to administer a person's estate; e. an order directing that a person disgorges ill-gotten gains; f. an order directing that a person makes restitution to customers; g. an order rescinding contracts entered into by a person with a customer; h. an order directing that the person makes an accounting of the person's estate; and i. an award of pre-judgment interest on any sums to be disgorged or paid in restitution. <u>Sanctions</u>: All administrative complaints contain notice of the possible sanctions that may be imposed if liability is found. The following sanctions are available in administrative actions: a. an order prohibiting a person from trading on or subject to the rules of any contract market and requiring all contract markets to refuse such person all trading privileges for a period specified in the order;

	b. an order suspending (for a period of not more than six months), revoking or restricting a person's registration with the CFTC; c. an order assessing civil monetary penalties against a person, not to exceed US$140,000 per violation (US$1 million for manipulation); d. an order directing that a person makes restitution to customers of damages proximately caused by the person's violations; and e. an order directing a person to cease and desist from violating the CEA or a CFTC regulation. The CFTC has the power to refer matters for criminal prosecution to the Department of Justice (DOJ). Private persons can seek their own remedies for any misconduct relating to the CEA, including exercising a right of action for damages. The CEA: a. permits anyone complaining of a violation of the CEA or the CFTC's rules to apply to the CFTC for an order awarding damages caused by the violation; b. permits private rights of action under certain circumstances; c. permits private damage actions against anyone other than a SRO who violates, or wilfully aids and abets a violation, of the CEA; and d. establishes a private damage remedy against SROs and their officials, which in bad faith refuse to enforce their own rules, or enforce their own rules in violation of the CEA, and cause monetary loss. To the extent relevant information is available from another federal or state agency, such as a state securities regulator, the SEC or the CFTC may obtain this information by seeking access to the public and non public information in that agency's files. **SEC** The SEC has broad authority to investigate actual or potential violations of the federal securities laws and to determine the scope of its investigations and the persons subject to investigation. The SEC can rely on voluntary cooperation to obtain documents or testimony. If the SEC relies on voluntary cooperation, it generally does not issue subpoenas or require or administer oaths or affirmations, although it may do so in some circumstances. Alternatively, the SEC can authorize a formal order of investigation, which grants the SEC staff the power to issue subpoenas and administer oaths, take testimony and compel the production of documents. The SEC is responsible for civil (non-criminal) enforcement of the federal securities laws and prosecutes cases in U.S. federal courts and in administrative proceedings. If the SEC decides to institute enforcement proceedings, it has several options. <u>A. Civil Action</u>: The SEC may bring a civil injunctive action against a person or an entity that the SEC believes has violated or is violating the federal securities laws. In its civil actions, the SEC can obtain disgorgement by which a wrongdoer is required to give up any illegal profits gained as a result of violations of the laws. The SEC also has the authority to seek civil monetary penalties. In fiscal year 2008, the SEC obtained orders in judicial and administrative proceedings requiring securities laws violators to disgorge illegal profits of US$774 million and to pay civil penalties of US$256 million. The SEC may bar individuals from serving as officers or directors of public companies under the Exchange Act. In fiscal year 2008, the SEC sought orders barring 132 defendants and respondents from serving as officers or directors of public companies. <u>B. Administrative Action</u>: The SEC has the ability to institute various types of administrative proceedings against a person or an entity that it believes has violated the law. This type of enforcement action is brought by the Enforcement Division and is litigated before an SEC administrative law judge (ALJ). The ALJ's decision is subject to appeal directly to the SEC and the SEC's decision is in turn subject to review by a U.S. Court of Appeals. Administrative proceedings provide for a variety of relief. For regulated persons and entities, such as BDs, IAs,

	and persons associated with them, sanctions include censure, limitation on activities, suspension of up to 12 months, and bar or revocation of registration. For professionals such as attorneys and accountants, the SEC can order that the professional be censured, suspended or barred from practicing before the SEC. Against any person who violates or is a cause of a violation of a provision of the federal securities laws, the SEC may impose a cease and desist order. The SEC can obtain disgorgement and civil money penalties in administrative proceedings. C. Criminal Action: The SEC can refer the matter to DOJ and the individual U.S. Attorney's offices for criminal prosecution. A criminal prosecution does not preclude the SEC from taking civil action for the same conduct; and similarly, SEC action does not preclude a subsequent criminal prosecution. The SEC's enforcement powers do not compromise private rights of action seeking remedies under the federal securities laws. The laws provide for express remedies in favor of private parties who claim damages as result of specific violations of these laws. The Securities Act imposes liability: • for misstatements or omissions in registration statements; • for the sale of unregistered securities and for fraud in the sale of securities; and • on controlling persons. Additionally, private persons can seek remedies under the Exchange Act, which imposes liability: • for specified manipulations of exchange-traded securities; • for "short-swing" profits; and • for misleading statements in periodic reports filed with the commission. Private persons also can seek remedies under the Exchange Act, which: • imposes liability on controlling persons; and • imposes insider trading liability on contemporaneous traders. Federal courts have "read in" private rights of action under certain statutory provisions that, on their face, do not provide actions for monetary damages. The most significant of these is the implied private right of action under Exchange Act for securities fraud. To state a claim for securities fraud a plaintiff must prove: (1) a material misrepresentation or omission by the defendant; (2) intent; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.
Assessment	Fully implemented.
Comments	
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	**CFTC** The front line regulation (inspections, enforcement actions) of FCMs, IBs, CTAs, and CPOs is done by the SROs subject to oversight by CFTC. The NFA has oversight responsibility for CPOs and CTAs and has a program in place to monitor compliance by CPOs with all applicable CFTC regulations and NFA rules—both through on-site inspections and off-site reviews. Most new CPOs are examined in their first two years of operation and then every three to four years, based on an assessment of their risk. For FCMs and IBs, the NFA and other SROs conduct regular on-site exams of their member firms. Every member firm is to be inspected every 9 to 18 months. The CFTC does not have a routine examination program, but might conduct an on-site exam in response to an early warning notice or for other causes. Ongoing financial and other supervision of FCMs and IBs that are members of more than one SRO are shared by the relevant DCMs and NFA, with the NFA primarily responsible for FCMs that are not members of a DCM. The CFTC also conducts its own

	investigations and takes action where breaches are found. The operational integrity of exchanges is addressed through the CFTC's periodic Rule Enforcement Reviews (RER) that address market surveillance, trade practice surveillance, and disciplinary programs. There are regular reviews of each DCM's ongoing compliance with the Core Principles set out in the CEA through the self-regulatory programs operated by the DCM in order to enforce its rules, prevent market manipulation and customer and market abuses and ensure the recording and safe storage of trade information. Periodic RERs normally examine a DCM's audit trail, trade practice surveillance, disciplinary and dispute resolution programs for compliance with the relevant Core Principles. Other periodic RERs normally examine a DCM's market surveillance program for compliance with principles on monitoring of trading and position limits or accountability levels. On some occasions, these two types of RERs may be combined in a single RER. The CFTC also conducts horizontal RERs of the compliance of multiple exchanges in regard to particular Core Principles. In conducting an RER, staff examine trading and compliance activities at the exchange in question over an extended time period, typically the twelve months immediately preceding the start of the review. Staff conducts extensive review and analysis of documents and systems used by the exchange in carrying out its self- regulatory responsibilities; interview compliance officials and staff of the exchange and prepare a detailed written report of their findings. In nearly all cases, the RER report is made available to the public and posted on the CFTC website. In an emergency, the CFTC may direct a DCM or ECM to take such action as in the CFTC's judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract. The CFTC may alter or supplement the rules of a DCM under certain (limited) circumstances. In order for the CFTC to take such action, the CFTC must first make a written request to a contract market. If the CFTC determines that a DCM is violating Core Principles, it will provide notice to the entity in writing of such determination and afford the entity an opportunity to make appropriate changes to come into compliance, after which the CFTC may take further steps, including suspension or revocation of certification. The CFTC has over 95 attorneys and 18 investigators in the Enforcement Division who are charged with investigating and prosecuting violations of the CEA. As part of the commission's efforts to bolster staffing levels, an additional 14 professional staff are scheduled to join the division. Currently, there are more than 200 pending investigations. Taking into account the size and the growth of the market, the division does not appear to have adequate resources. Considering the CFTC recommendation in the Joint Report to expand the insider dealing scope and to enhance its authority with respect to disruptive trading practices, the need for an increased staff level is even more pressing. When an investigation indicates that there is reason to believe that violation has occurred, the CFTC files either an administrative or civil injunctive enforcement action against the alleged wrongdoers. In an administrative action, wrongdoers who are found to have violated the CEA or CFTC regulations or orders can be prohibited from trading on U.S. futures markets and, if registered, have their registrations suspended or revoked. Violators also can be ordered to cease and desist from further violations, to pay civil monetary penalties of US$140,000 per violation (US$1 million for manipulation) or triple their monetary gain and to pay restitution to those persons harmed by the misconduct. In civil injunctive actions, defendants can be enjoined from further violations, their assets can be frozen, and their books and records impounded. Defendants also can be ordered to disgorge all illegally obtained funds, make full restitution to customers and pay civil monetary penalties. As the CEA does not generally prohibit insider trading in the commodity futures and options markets, there have been no enforcement cases charging insider trading. The premise has been that insider trading has limited applicability to futures trading because it would defeat the market's basic economic function of allowing traders to hedge the risks of their commercial enterprises.

	Nevertheless, the CEA does recognize certain duties in connection with trading relationships. Thus, trading ahead or front running has been charged by the CFTC under the CEA's general anti-fraud provisions when persons traded for their own account (or through an associated account) ahead of a customer or an employer for whom the person was trading. Each year, the CFTC initiates between 40 and 50 enforcement actions. In fiscal year 2008, the CFTC brought 40 enforcement cases. These cases target certain program areas, for example: (1) allegations of manipulation, attempted manipulation, trade practice violations, and false reporting; (2) misconduct by commodity pools, hedge funds, CPOs, and CTAs; and (3) financial, supervision, recordkeeping, and other violations committed by registered entities. Overall Civil Monetary Penalties: During FY2008, a total of US$234 million in civil monetary penalties (CMPs) was imposed in the CFTC's enforcement actions, which included both administrative and federal district court cases. Of that amount, the CFTC collected US$141 million, or 60 percent of the amount imposed. Commodity Pools and Hedge Funds: From October 2000 through September 2008, the CFTC filed a total of 73 enforcement actions alleging misconduct in connection with commodity pools and hedge funds and the CFTC has obtained penalties of US$564 million in these actions. The majority of the commission's commodity pool/hedge fund fraud cases are brought against unregistered CPOs and/or CTAs (40 of 73 cases filed). Cooperative Enforcement: During FY2008, cooperative efforts resulted in 31 cases being filed by other domestic criminal and civil law enforcement authorities that included cooperative assistance from the CFTC. From December 2001 through December 2008, the CFTC filed a total of 98 enforcement actions against 181 firms and 193 individuals selling illegal forex futures and option contracts. To date, the CFTC has obtained approximately US$562 million in civil monetary penalties and US$453 million in restitution in these enforcement actions. Energy Market Manipulation: From December 2002 to September 2009, the CFTC filed a total of 43 enforcement actions charging a total of 73 respondents/defendants (42 companies and 31 individuals) with misconduct in the energy markets. The CFTC has obtained US$446 million in civil monetary penalties in settlement of these enforcement actions. **SEC** The SEC conducts five types of inspections/examinations of intermediaries, CIS, and their operators: • routine examinations designed to test a registrant's overall compliance; • "cause examinations" based upon complaints, tips, press reports or other information suggesting the registrant might be violating securities laws, rules or regulations; • risk-targeted sweep examinations, in which multiple firms are reviewed for a particular compliance risk; • special purpose examinations, in which examination staff review a firm for a potential issue or risk; and • SRO oversight examinations of registered BDs, during which SEC examiners analyze and sample a BD's records from the same time period and focus areas that the SRO reviewed during its examination of the BD. SEC examiners may also review the firm's activities following the SRO examination to identify new problematic behaviour or additional risks. In addition, SEC examiners may review the firm's current activities to determine whether it implements any corrective measures recommended by the SRO. The SEC communicates with the Federal Reserve when the SEC conducts examinations of certain large entities and coordinates some examinations with state regulators. The SEC has an examination program that covers both CIS and their operators. Examinations are conducted primarily to determine whether CIS and their operators continue to meet eligibility standards and

	conduct their activities in compliance with the law. The SROs examine their own members; the SEC examines the SROs to determine whether they are meeting their responsibilities. By rule, SROs are permitted to file with the SEC a plan to allocate the responsibilities among the SROs to: receive regulatory reports from persons who are common members of the SROs, examine such persons or enforce compliance of such persons with the federal securities laws. Where a firm is a member of FINRA, FINRA is generally the responsible SRO. FINRA inspects its BD members cyclically; the frequency of examination depends on the types of business the BD engages in and the perceived risk of those businesses. For instance, FINRA generally inspects BDs that hold customer funds and securities at least once every year. Other BDs are subject to less frequent on-site examinations. In addition, the FINRA reviews a BD's capital levels when periodic reports are filed. The SEC is the sole regulator for SEC registered IAs. There is no SRO to share the work as is the case with SEC registered BDs. The SEC uses a scoring process to risk-rate IAs. The SEC attempts to risk-rate IAs based on filing information, including whether the IA has custody of client assets, charges performance-based fees, its disciplinary history, the results of previous exams, and other information available to the staff. In recent years, those IAs with a higher risk profile are placed on a three-year examination cycle. However, their Office of Compliance, Inspections, and Examinations (OCIE) is currently working to create a more flexible risk management process. Once fully implemented, the frequency of examinations of "higher risk" IAs may change. Other IAs are chosen randomly for routine examinations on a less frequent basis and may also be examined as part of cause, sweep, or special purpose examinations. In order to satisfy itself that an SRO is in compliance with the obligations and responsibilities imposed upon it, the SEC has a surveillance, examination, and enforcement program to oversee the activities of the SROs, including exchanges, associations, and clearing agencies. The standard is set in the Exchange Act which mandates that each SRO complies with and enforce compliance with law and the SRO's own rules, "absent *reasonable justification or excuse*." SEC staff conducts inspections of the SROs to assess the adequacy of the SRO's regulatory programs. These inspections focus on the SRO's regulatory programs, including: market surveillance, investigative and disciplinary programs, member examination programs, and listing and arbitration programs, among others. Staff may also examine an SRO's disciplinary actions against members and denials of membership in, or access to, the SRO. Oversight of SROs is carried out by SEC staff which conducts several types of examinations and inspections as for intermediaries above. The SEC has the authority to inspect both the SROs and market participants to determine whether the various anti-fraud, anti-manipulation, and reporting regulations are being complied with. The SEC can also obtain surveillance and/or trading data from the SROs. An SRO must have procedures to survey its market and its members for securities laws violations, including violations to the SRO's own rules. On a continuing basis, the SEC will consider whether an applicant has adequate surveillance measures, as well as sufficient resources, including staff expertise and capital, to monitor its markets. Surveillance mechanisms are not standardized among the markets and the SEC recognizes that surveillance procedures may vary depending on the nature and structure of the market and the securities traded on a particular exchange. At a minimum, the SEC has said that an applicant should demonstrate that the officers that manage the day-to-day surveillance function must be familiar with federal securities laws and the role of the SRO. In addition, as part of its surveillance responsibilities, an SRO must have the capability to maintain an order audit trail for all transactions in its system. In addition to national securities exchanges, the SEC and SROs regulate ATSs for compliance with Regulation ATS and other applicable federal securities laws. Regulation ATS includes rules and obligations that provide the SEC with information necessary to monitor trading activity on these systems. Clearing agencies are SROs under the Act. See Principle 29 for a detailed description of

	the SEC's oversight of these entities. If the SEC finds that an exchange, association, or clearing agency has failed, without reasonable justification or excuse, to enforce compliance with any of its rules by a member or person associated with a member, it may impose sanctions against the SRO. The SEC has the authority to suspend an SRO for a period of up to twelve months, revoke a SRO's registration, or censure or impose limitations upon its activities, functions and operations if the SEC finds that the SRO has violated or is unable to comply with the provisions of the law or its own rules. Among other remedies and sanctions, SEC enforcement actions may seek censures, suspensions, or bars from the securities industry for violations of federal securities laws. SEC suspensions are up to 12 months, while bars are permanent with a right to reapply. In addition, an adverse adjudication in an SEC enforcement action results in an automatic disqualification from association with any SRO member. Independent of SEC actions, but in a complementary fashion, SRO enforcement actions may seek suspensions or expulsions of its member firms or individuals for violations of membership rules. The overall structure and dynamic for regulating the securities markets is dependent on vigorous SRO enforcement programs. The investigation by the OIG of the SEC into the SEC's conduct concerning the huge Ponzi scheme which came to light in 2008 identified several areas in the SEC Division of Enforcement that were problematic. These have been documented in public reports which had to be considered by the assessors. According to the OIG's report, the SEC failed to detect the scheme despite 6 substantive complaints over 16 years that raised significant red flags. One missed enforcement case, no matter how large, can happen anywhere and does not necessarily mean an enforcement program is ineffective. However, if the findings show deeper flaws, there will be concerns about the effectiveness of the whole program. The OIG report found such systemic problems. It stated that enforcement staff: • lacked adequate guidance on how to analyze complaints; • did not always exercise due diligence in their handling of critical information; • assigned to investigate the complaint were inexperienced in investigating Ponzi schemes; • did not always seek assistance from other offices and divisions as needed; • lacked supervision; • failed to verify information provided by the suspect with independent sources; • did not adequately evaluate additional information received by the SEC; and • did not complete administrative tasks associated with opening and closing the investigation promptly. Furthermore, the investigation of this case revealed that the complaint handling system to detect fraud via handling of complaints, tips, and referrals (CTRs) needs improvement. The SEC receives hundreds of thousands of investor complaints each year, including letters, calls, and emails. In the fiscal year 2008, the Enforcement Division received approximately 618,000 CTRs. Enhancements are in the process of being implemented. The OIG made 21 recommendations, with which the SEC concurred. The SEC is taking actions to strengthen its enforcement program. Based on a self-assessment and the recommendations from the OIG, the Division of Enforcement has implemented a number of important improvements. These improvements include: (1) the establishment of specialized enforcement units targeting complex products, transactions and markets, including asset management, large-scale insider trading and other market abuses, structured products and derivatives, municipal securities and violations of the Foreign Corrupt Practices Act; (2) flattening management to dedicate more resources to the core mission of enforcement investigations; and (3) offering cooperation agreements and other tools to encourage persons with knowledge of wrongdoing to cooperate in enforcement investigations. Further improvements are under way in other areas. Currently, the SEC is implementing systems to add certain qualitative measures to the current quantitative measures for assessing the enforcement program's effectiveness in enforcing regulatory requirements and in meeting program objectives.

Specifically, systems are being implemented to track whether enforcement cases of the utmost importance are bring brought, whether enforcement cases are being brought in a timely manner and whether enforcement resources are being used efficiently to meet its objectives. The SEC is also seeking to develop more sophisticated metrics to measure the deterrent impact of the enforcement cases brought. Finally, the SEC is starting to develop systems that would measure changes in industry behavior as a result of the SEC's enforcement actions.

In FY2009 the Division of Enforcement had just over 1,200 full time employees, of which 782 were attorneys. Enforcement attorneys investigate and prosecute violations of the federal securities laws. On September 30, 2009, the last day of FY2009, enforcement had over 4,300 active investigations. Each year the SEC brings between 500 and 675 enforcement actions. The SEC brought 664 enforcement actions in FY2009. In FY2008, the SEC brought 671 enforcement actions, the second highest number in its history.

Market and/or Price Manipulation

In the 2008 fiscal year, the SEC brought 52 market manipulation cases (in 2007: 36, in 2006: 27).

Insider Trading

In fiscal year 2008, the SEC brought 61 insider trading cases (in 2007: 47 insider trading cases, in 2006: 46) The distribution of the 664 enforcement cases filed in FY2009 across core enforcement areas are as follows:

Type of Case	**Number**	**% of Total Cases**
Issuer Reporting	143	22
Securities Offering	141	21
Market Manipulation	39	6
Broker-Dealer	109	16
Investment Adviser/ Investment Company	81	12
Insider Trading	37	6
Delinquent Filings	92	14
Contempt/Other	22	3
Total	**664**	**100**

CFTC and SEC

Given the size of the market, relatively few cases have been taken for criminal prosecution and even fewer have resulted in criminal sanctions.

In the United States, at state and federal level, many charges concerning securities fraud are settled. The defendant in the action neither admits, nor denies the allegations[4] in the complaint, but may have sanctions imposed on them, such as disgorgement, monetary penalties and/or restrictions on the ability to associate with registered entities. Settlements have the advantage of not requiring the regulator to prove that the elements of the offence have been committed, but at the same time, have the disadvantage that they produce less case law that would help to develop interpretation of the laws and give more certainty about the scope of the laws. However, in matters resolved by

[4] The SEC and CFTC have formal policy established by rule that does not permit a defendant to settle an action while denying the allegations. However, settlements are permitted if the defendant states it "neither admits nor denies" the allegations.

	settlement, the final orders contain findings of fact and conclusions of law that provide guidance on the type of behavior that the regulators consider to be in violation of the law. In administrative cases, settlement orders also contain an analysis of how the law applies to the facts. While not binding precedent, these orders have been cited in court decisions as evidence of an agency's interpretation of the law. <u>The Securities Regulators of All States</u> brought 8,365 enforcement actions (including administrative, civil, and criminal cases) in the last three years. They resulted in • US$178 million fines and penalties (including civil and criminal). • US$1.8 billion ordered to be returned to investors (includes restitution, rescission and disgorgement). • 2,765 years of incarceration sentenced.
Assessment	Partly implemented.
Comments	When assessing a jurisdiction's implementation of the enforcement principles, assessors do not normally have access to such a comprehensive, detailed, and painstaking independent analysis of the weaknesses in a regulator's enforcement and examination programs as that contained in the 2009 report of the SEC's IG. Indeed this assessment may be unique in that respect. Nor do assessors normally have the time or the resources to probe in depth behind a regulator's (usually positive) self assessment, and its data on enforcement cases etc., beyond some limited discussions with capital market participants on their views of the regulator's effectiveness and credibility. It remains the case, however, that assessors have generally found this Principle to be partly implemented in a relatively high proportion of jurisdictions. It is also an indication of the high level of transparency embedded in the U.S. system that the IG's detailed report was published and extensively discussed. The Division of Enforcement of the SEC has taken significant action on all of the recommendations contained in the IG's report. By the end of March 2010, it believes that over 50 percent of the recommendations will have been completed. The division's completion or "closing" of each recommendation remains subject to the approval of the IG. Implementation of the remaining initiatives will, the assessors believe, fully restore the SEC's standing as an effective and credible enforcer of the securities laws and its regulations. <u>Enforcement</u> <u>SEC</u>: As contemplated by the Principles and the Methodology assessors may make use of a variety of sources to assess the effectiveness of an enforcement program. In the case of this assessment, the assessors have looked at quantitative indicators such as the number of cases brought by the SEC, the number and amount of the fines imposed, relative to the size of the overall market. Such indicators have limited value as proxies for performance, and thus the assessors have supplemented this analysis with other publicly available information, including the OIG report mentioned earlier, and with interviews of SEC staff and market participants. All of these factors led the assessors to conclude that the SEC enforcement program has significant shortcomings, which should be addressed as a matter of priority. The assessors note that the SEC has given high priority to this task and is in the process of implementing a program of improvements. The recent SEC OIG report, which examined the failed investigation into Madoff, determined there were systemic shortcomings in the program as a whole. The OIG made 21 recommendations to improve the SEC enforcement program, the SEC concurred in all of the recommendations. Pursuant to the published timeline, all planned improvements should be implemented by mid-2010. It is also carrying out a range of internally generated improvements not explicitly recommended by the IG. The SEC also may want to consider adding staff with more accounting and economics backgrounds; the division of enforcement is largely staffed by lawyers and setting up teams with different skill sets and experience could enhance its performance. <u>CFTC</u>: Taking into account the size and growth of the market, the enforcement division needs

	more resources. Given the current limited scope of its remit and the integrated market surveillance systems it operates in close cooperation with the DCMs, (as described under Principle 28) this is not a pressing problem though it will become one if its remit is expanded (e.g., to include OTC derivatives). DOJ: Securities fraud cases are prosecuted primarily in the 94 States Attorney Offices located across the United States. Those offices are staffed by about 5,500 to 5,600 federal prosecutors. They have the authority to prosecute a full range of federal crimes, including securities fraud. In practice, other higher profile crimes (murder, drug trafficking, etc.) may take priority over securities fraud. The main office of the DOJ in Washington, D.C. has a securities fraud unit with only about ten attorneys. Complaints Handling To upgrade the complaint handling systems, the SEC has employed consultants to conduct a comprehensive review of the agency's systems and procedures for evaluating and tracking CTRs and to make recommendations as to how the process can be improved to ensure that enforcement leads and areas for high risk examinations are identified more effectively. Improvements will include implementation of a centralized information technology solution that will provide the agency with an automated mechanism for, among other things, tracking and reporting on CTR handling activities on an agency-wide basis. However, this remains "work in progress." Examinations Although the OCIE makes maximum and creative use of the resources at its disposal, lack of sufficient resources currently has a major negative impact on the effectiveness and credibility of the inspection and examination systems of the SEC with regard to IAs. The legal basis for funding this activity may also be an issue; the SEC does not charge IAs for examinations. The SEC is the sole examiner of over 11,000 IAs—a responsibility it attempts to meet with approximately 425 examiners. Only 14 percent of IAs was examined in 2008 compared to 57 percent of BDs (in the latter case most examinations are carried out by FINRA). In FY 2008, approximately 38 percent of fund/IA exams conducted by the staff resulted in significant findings (e.g., deficiencies that may cause harm to customers or clients of a firm, have a high potential to cause harm, or reflect recidivist misconduct). Extrapolated to funds/IAs in total there may be substantial undetected risk to investors. Furthermore, SIPC protection is not available to these investors when losses arise from the failure of an IA. However, SIPC coverage applies to IA client assets that are custodied at a broker-dealer.[5] Although all IAs file annual statements with the SEC, which provides input for the risk based examination system, the information collected is not comprehensive. In addition until recently, IAs identified as "higher risk" based on this and other information were placed on only a three-year examination cycle. OCIE is currently working to create a more flexible risk management process. The impact on frequency of examinations of 'higher risk' IAs would need to be examined once fully implemented. The assessors understand one of the recent regulatory reform proposals included raising the

[5] As applied to IAs, the term "custody" is defined in Advisers Act Rule 206-4(2) ("Custody of Funds or Securities by Investment Advisers"). *See also*, SEC Release IA-2176 (Sept. 25, 2003); 68 Fed. Reg. 56692–01 (Oct. 1, 2003). Among other requirements, Rule 206(4)–2 requires that IAs with custody of client funds or securities maintain those assets with broker-dealers, banks or other qualified custodians. In addition, on December 31, 2009, the SEC adopted amendments to Advisers Act Rule 206(4)–2. The amendments are designed to strengthen controls over the custody of client assets by registered investment advisers and to encourage the use of independent custodians. The SEC also adopted related amendments to Rule 204–2, Form "ADV," and Form "ADV-E" that will improve the staff's ability to oversee advisers' custody practices. For additional discussion regarding these amendments, see SEC Final Rule Release No. IA-2968 available at http://www.sec.gov/rules/final/2009/ia-2968.

	threshold for registration under the Advisers Act, thereby reducing the number of registrants in this category subject to oversight by the SEC. This would shift some of the burden to the state regulators. The SEC might also want to consider making use of the FINRA examination program when the IA is also a BD member of FINRA. As regards BDs, which are subject to examination by the SEC and FINRA, the assessors were informed by firms that from time to time there are subject matter overlaps and annual reviews which begin before the final report from the previous year had been received. Some overlap may be necessary, for example where the SEC is conducting an oversight exam of an SRO's exam program, but these overlaps should be minimized. The OCIE has recently introduced enhanced examination review processes to minimize unnecessary duplication and to provide BDs and IAs with timely feedback where appropriate. It also engages in an active program to inform and educate Compliance Officers as to the SEC's objectives in carrying out examinations and what constitutes good compliance practice.
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	**CFTC** The CFTC has authority to share public and non-public information with domestic and foreign regulators for regulatory, surveillance, technical assistance, or enforcement purposes, in connection with matters of authorization, licensing or approvals, market conditions and events, client identification, and regulated entities. External approval is not needed. The CFTC can exchange all types of information, including information and records identifying the person or persons beneficially owning or controlling bank accounts related to derivatives transactions and brokerage accounts. There are no domestic laws which impede international cooperation. An independent interest in the subject matter of the inquiry is not a precondition for the exchange of information. In order to grant access, the CFTC asks that, in the absence of a formal MOU between the CFTC and the requesting authority, the domestic authority provide a written access request setting out its need for the requested information and providing confidentiality undertakings. When exchanging information with foreign authorities, the CFTC takes into account the status of the requesting authority, the confidentiality provided, restriction of use of the information for the purposes stated within the request and reciprocity. The existence of an MOU is not precondition for information sharing. Neither does the CFTC impose a dual illegality requirement, which means, the facts stated in the request need not also constitute a violation of the laws of the United States. The CFTC can share information on an unsolicited basis. **SEC** Pursuant to the Exchange Act and SEC rules, the SEC may share public and non-public information with domestic and foreign counterparts, provided the SEC receives assurances of confidentiality from the person receiving non-public information. The SEC does not need external approval to share information. There are no limitations on the type of information that the SEC can share in connection with authorization, licensing and registration, surveillance, market events, regulated entities, listed companies, and companies that go public. This includes information concerning the beneficial ownership or control of a bank or brokerage account, provided the requesting authority shows that such information is needed and provides the SEC with assurances of confidentiality. The act authorizes the SEC to provide assistance to a foreign securities authority if reciprocity is provided and compliance with the request is not against public interest, without regard to whether the facts as stated in the foreign securities authority's request constitute a violation under U.S. laws. The SEC can share information on an unsolicited basis. The existence of an MOU is not precondition for information-sharing. There are no domestic laws which impede

	international cooperation.
Assessment	Fully implemented.
Comments	To the extent that non-public information sought by a foreign or domestic authority includes electronic communications subject to the Electronic Communications Privacy Act (ECPA) or bank records subject to the Right to Financial Privacy Act (RFPA), notice of the subpoena must be given to the bank account holder or subscriber, as appropriate. However, a government agency may delay notifying the account holder or subscriber of an administrative subpoena to a financial institution or service provider for renewable periods of 90 days. It should be noted that documents covered by the ECPA are unlikely to include bank, brokerage, or beneficial ownership information within the scope of the IOSCO MOU. Before sharing the records with foreign or domestic authorities, the commissions must ascertain that the material is relevant to a legitimate law enforcement inquiry of the requesting agency and, for domestic authorities, ensure that there is a valid access request granted to that agency that includes RFPA and/or ECPA material. There is no requirement in the ECPA that a government entity gives notice to a subscriber if the information is shared with another government entity (either foreign or domestic). The RFPA does require that a government entity gives notice to the account holder within 14 days of transferring the information to another domestic government agency, but there is no such notice requirement for sharing the information with foreign authorities.
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	**CFTC** The CFTC can enter into information-sharing arrangements (MOUs) to facilitate consultation and cooperation and to establish the conditions for the public or non-public exchange of information with domestic and foreign authorities. The CFTC has entered into more than 30 bilateral information sharing arrangements that support surveillance, enforcement and regulatory cooperation. The MOUs are in writing and publicly available on the website of the CFTC. In addition, the CFTC is a signatory to the IOSCO MMOU, the first worldwide multilateral enforcement cooperation arrangement among 55 securities and derivatives regulators. Pursuant to the various confidentiality provisions of the CEA, the CFTC can protect the confidentiality of information transmitted consistent with its uses. The CEA only permits the CFTC to disclose to foreign authorities information in the CFTC's possession when it is satisfied that the information will not be publicly disclosed except in an adjudicatory action or proceeding to which the authority is a party. Fiscal year 2008: The CFTC cooperative efforts resulted in 31 cases being filed by other domestic criminal and civil law enforcement authorities that included cooperative assistance from the agency. The CFTC made 120 requests for assistance to 38 different foreign authorities and received and responded to 47 requests from 18 different jurisdictions. **SEC** The SEC can enter into MOUs to facilitate consultation, cooperation and the exchange of public and non-public information with domestic and foreign authorities in both enforcement and supervisory matters. The SEC requires assurances of confidentiality which do not restrict the foreign authority's ability to use the information for the purposes of its investigation and/or proceeding or any resulting proceedings or its ability to transfer the information to criminal law enforcement authorities and self-regulatory organizations. The SEC has entered into over 30 bilateral information-sharing arrangements with foreign

	regulators. In addition, the SEC is a signatory to the IOSCO MMOU. The SEC enters into the negotiation of bilateral MOUs for enforcement cooperation only if a foreign securities authority is empowered to provide assistance beyond what is required by the IOSCO MMOU, such as the ability to compel testimony or the gathering of Internet service provider, phone and other records other than bank, broker, and beneficial owner information on behalf of the requesting authority. The SEC entered into four regulatory MOU with other domestic regulatory agencies under the terms of which the SEC is actively sharing regulatory and supervisory information. All MOUs are public and on the website of the SEC. Fiscal Year 2008: The SEC handled 414 requests for enforcement assistance from foreign authorities and made 594 requests to foreign authorities. In addition, the SEC answered 374 requests from foreign regulators for technical assistance.
Assessment	Fully implemented,
Comments	Disclosure to Congress: As the U.S. Congress has oversight responsibility for the CFTC and SEC, it is entitled to obtain all information from the CFTC's and SEC's files. Should the CFTC and SEC staff learn of an impending demand from Congress for production of non-public information provided by a foreign authority, the staff would recommend to their respective Commissions that the agency informs Congress that: (i) the agency has undertaken to keep the information non-public; and (ii) disclosure could harm the agency's relationship with the foreign authority and adversely impact the agency's ability to obtain information from its counterpart in the future. Disclosure Under the FOIA: The CFTC and the SEC are able to protect from public disclosure information regarding requests made by foreign securities authorities as well as information received from foreign securities authorities. Any records obtained from a foreign securities authority are explicitly exempted from disclosure under the FOIA.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	**CFTC** Under the CEA, the CFTC has the authority to conduct an investigation, including the use of compulsory powers, on behalf of a foreign futures authority on regulatory matters in its jurisdiction. This includes compelling (a) the production of documents (including, but not limited to, bank records, trading records, and records identifying beneficial owners that are critical to such investigations) and (b) the taking of statements and testimony under oath. The CFTC does not need an independent interest in the alleged violations. In exercising its statutory authority to provide such assistance, the CFTC is directed by Congress to consider whether (1) the requesting authority has agreed to provide reciprocal assistance in futures matters to the CFTC and (2) compliance with the request would prejudice the public interest of the United States. The CFTC has the authority to assist a foreign authority in obtaining a court order, including in urgent circumstances. **SEC** The SEC may conduct an investigation and use its compulsory powers under the Exchange Act as it would in its own investigations. These powers include requiring the production of documents held by regulated entities as well as the ability to use the SEC's subpoena powers to compel the production of documents or testimony from any person or entity anywhere within the United States. This information includes records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions, the name of the account holder, the person authorized to transact business, the amount purchased or sold, the time of the transaction, the price of the transaction, the individual, and the bank, or broker and brokerage house that handled the transaction and the beneficial owner. An independent interest is not a precondition for the

	exchange of information. The SEC can assist in advising a foreign authority on how to initiate a proceeding in civil court or request to the DOJ to pursue assistance in obtaining court orders through a Mutual Legal Assistance Treaty.
Assessment	Fully implemented.
Comments	As discussed under Principle 28, the scope of the explicit insider trading prohibitions under the CEA is rather narrow and focuses solely on employees and agents of the CFTC, SROs, and markets that are regulated by the CFTC. However, this limited scope does not raise concerns concerning the ability to cooperate with foreign regulators as the CFTC can provide assistance to a foreign authority even if the matter would not constitute a violation of the laws of the United States. Moreover, as described under Principle 10, the CFTC can and does bring a wide range of actions under the CEA. Right to Financial Privacy Act: The CFTC and the SEC can obtain bank records through their subpoena authority; however if seeking bank account records of a customer, defined as an individual or a small partnership of five or fewer individuals, from a financial institution both authorities must follow procedures set out in the RFPA. The RFPA requires the customer notification prior to such disclosure. If an investigative subpoena is issued, the customer must receive a copy of the subpoena. The CFTC and the SEC may also obtain bank records for a customer without first notifying the customer through a delayed notice provision which requires an ex parte hearing in front of an appropriate court in order to delay notice to the customer. In practice, this statute does not hamper the ability of CFTC and SEC to cooperate. Most foreign requests concern trading accounts with a BD to which the RFPA does not apply. Fewer requests from foreign authorities relate to bank saving or cash accounts. If such a request is received, the requesting authority is asked to decide if the customer can be notified and in most cases they agree to that. If the requesting authority does not want to have the customer informed, the CFTC or the SEC may file with an appropriate court in order to delay notice to the customer. The process of obtaining a court order takes several days.
Principles for Issuers	
These principles do not apply generally to futures under the jurisdiction of the CFTC. Futures contracts are issued by the exchange on which the instrument is traded. The disclosure provided goes to the nature of the contract and the underlying commodity, rather than the characteristics of the issuer.	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	There are extensive disclosure requirements in the legislation and regulations that apply to public offerings of most securities, including very detailed requirements that apply to prospectuses, registration statements, annual and interim financial reporting and proxy disclosure. There are also specialized disclosure regimes for particular types of securities, such as asset backed securities. Virtually all disclosure documents are filed with the SEC via the internet on an Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) maintained by the SEC and are available to the public almost immediately after filing. In addition, disclosure documents are available to investors in paper form and may be provided through issuer websites. The review of these disclosure documents takes place on a selective basis, meaning not all documents are reviewed by the SEC. Listed securities also must be registered with the SEC under the Exchange Act and are also subject to the listing standards—initial and on-going—of the relevant exchange. Both NASDAQ and the NYSE have extensive and high quality continuing disclosure standards that apply to the companies that are listed on their respective exchanges. The exchanges monitor that disclosure to ensure issuers continue to meet their requirements. Only equity securities (as that term is defined in the

	Exchange Act) registered under the Exchange Act are subject to continuing disclosure requirements. An issuer that only has sold equity or debt securities to the public that are held by fewer than 300 persons would not be subject to the continuing disclosure requirements under this statute. Legislation requires public company's continuing disclosure documents to be reviewed by the SEC at least once every three years. Annual audited financial statements are due within 60–90 days of the issuer's year-end; interim statements are due within 40–45 days of the end of each of the first three quarters. Most companies make public announcement of the fourth quarter results, which triggers a requirement to file a report on EDGAR. The shorter time periods apply to larger issuers. All disclosure is to be full, fair and contain all material facts. Anti-fraud provisions in securities legislation require "prompt" updating of public disclosure to ensure information is not misleading. Reports on material changes are required to be filed with the SEC within four days of the event being reported, while the NYSE and NASDAQ require such changes to be publicly disclosed immediately. These standards are backed up by extensive liability provisions and a very active plaintiff's bar. There are also detailed rules that govern advertising of offerings (other than via the prospectus). Derivatives are actively traded in the jurisdiction, both over-the-counter and on-exchange. Standardized options and futures are exchange traded. Swap agreements (security-based or not) are expressly stated not to be securities under the Exchange Act and so not subject to the issuer disclosure requirements. Even derivatives that would qualify as securities under legislation often are sold using one of the disclosure exemptions and so no prospectus is prepared. Options and futures that are traded on securities and futures exchanges are sold using standardized disclosure documents that include a description of the terms of the contracts, mechanics of trading and risks. In addition, customers proposing to trade in these standardized contracts through a BD (for options) or an FCM or IB (for futures) would be given a specified risk disclosure statement that provides additional information regarding the risks associated with the instruments. The issuer's most recent financial period statements (annual or interim) generally are required to be included in a registration statement once the financials are available. There are slightly different requirements that apply to initial public offerings of securities. Other financial information contained in the registration statement is to be as of a date that is as close to the date of the document as is practicable. Non-financial information is required to be "current." Disclosure by issuers is promoted through: • SEC review of filings; • stock exchange listing requirements and oversight activities; • required certification of the content of disclosure (financial and registration statements) and eligibility to use certain specific disclosure regimes; • the loss of certain benefits if disclosure obligations are not met consistently and on time; and • investigation and possible enforcement actions concerning violations of the requirements. Certification of financial statements and registration statements by officers, directors and other persons attracts liability to sanctions by the SEC and civil suits by injured investors. If a registration statement contains a material misstatement or omission, purchasers may sue all or any of the issuer, its directors, any officer who signed the registration statement, the underwriters, auditor and any expert whose opinion is included in the disclosure document, such as a geologist. Issuers are subject to strict liability. All others may be able to plead a defense of due diligence. Very limited exemptions from full disclosure exist. Information (such as parts of material contracts) may be filed on confidential basis if specified conditions are met under the FOIA—such as for trade secrets. The SEC can issue temporary cease trade orders. Stock exchanges have rules in place to halt

	trading in a company's securities temporarily while a material announcement is made. Trading in securities on insider information is subject to both criminal and civil sanctions. Regulation also imposes obligations on issuers to make prompt public disclosure if material information has been disclosed selectively. There is a separate disclosure regime for "foreign private issuers" (essentially, foreign corporate issuers) that produces disclosure that largely is equivalent to that for U.S. public companies for public offerings of securities and annual reports. The financial statements of foreign private issuers may be presented in accordance with (i) U.S. GAAP, (ii) another comprehensive body of accounting standards reconciled to U.S. GAAP, or (iii) IFRS as issued by the IASB. Each company may elect the basis of presentation. The statements must be audited by an auditor who is registered with the PCAOB and the audit must be in compliance with U.S. GAAS. The disclosure regime for municipal securities (those securities issued or guaranteed by U.S. state or municipal governments or agencies) is very different from that described above. By law, the SEC has no authority to impose disclosure requirements on these issuers. However, the information voluntarily made available to the public in connection with these offerings is viewed by the SEC as being insufficient for investors to make informed choices. To improve the disclosure for these offerings, the SEC imposes obligations on any BD acting as underwriter of an issue to ensure the certain information is made available. These "official statements" are not certified by the municipal issuer, but are made available, along with the financial statements and other continuing disclosure of the issuer, to the public through a website maintained by the MSRB. The disclosure guidance for these official statements is principles-based and far less detailed than that which would apply to a corporate issuer. However, the anti-fraud provisions of securities laws apply if the disclosure contains a misrepresentation or material omission. The issuer may be audited by an independent auditor or by the state auditor and the financial statements may or may not be prepared in accordance with U.S. GAAP.
Assessment	Broadly implemented.
Comments	While the initial and continuing disclosure regime in the United States is extensive, it is not comprehensive. There are certain limitations in the application of both the initial and continuing disclosure requirements, the timeliness of material change notices, and the disclosure regime for complex structured securities that gave rise to the assessment rating. Not all companies that have issued their securities to the public are required to provide ongoing disclosure to their investors. A public issue of securities under the Securities Act requires extensive initial disclosure and continuing disclosure for the first year thereafter, but only registration of a class of equity shares of that issuer under the Exchange Act gives rise to ongoing disclosure requirements under securities legislation. Listed securities are required to be so registered, as are equity securities that are held by more than 300 investors. Below that threshold, the only applicable requirement may be corporate law provisions that mandate delivery of annual and interim financial statements. This system creates gaps in disclosure to investors holding publicly offered securities and should be re-examined. There may be a need to reassess the disclosure regime governing distributions of complex structured products, particularly with respect to initial and on-going risk disclosure, to ensure investors and the marketplace have sufficient current information to make informed investment decisions. It would be preferable for the SEC to have authority to regulate directly the disclosure provided to investors regarding new issues of municipal securities. The SEC should have the power to mandate both initial disclosure requirements and on-going obligations on these issuers to provide the necessary financial and other information about the securities and the issuer. (See also the discussion of this issue under Principles 1 and 3.)

Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	The rights of security holders of public companies are set out in a combination of state corporate law, securities laws, stock exchange rules for listed companies, and judicial decisions. Provisions of state corporate law may differ, do not apply to issuers that are not corporations, and may not provide significant protections to holders of securities other than voting securities. Each of the enumerated topics set out in key question 1 of the Assessment Methodology is covered by one or more of these requirements and generally results in equitable treatment of voting security holders. Generally, security holders have the right to vote on changes that affect the terms of the securities they hold and on certain other fundamental changes. The company must provide reasonable notice and material information about all matters to be voted on at a security holder meeting. Both registered and beneficial owners must receive this proxy related information. The term "tender offer" is not defined under the federal securities laws or the SEC's rules. Judicial decisions have defined a tender offer as any direct offer to purchase securities from security holders where certain other criteria are present. The purpose of tender offer regulation is to provide disclosure and procedural safeguards to equity shareholders who hold securities that are registered under the Exchange Act and are subject to an offer. If a transaction meets the tests for a tender offer, the offer must be made to all holders and all must get the same (best) price. Special rules apply if the offer is made by the issuer and these rules apply even if the securities sought to be repurchased are not registered under the act. In most cases, change of control transactions would be subject to federal securities laws and/or state corporate law. However, a private agreement to acquire securities from a very limited number of shareholders may not meet the test to be a "tender offer" or trigger any other legislative provisions designed to protect the interest of security holders. For example, a purchaser may acquire control of a public company by buying the securities of an existing controlling shareholder at whatever price, without triggering an obligation to offer similar terms to other shareholders or other requirements under state law. The only statutory requirement that may be triggered by these types of transactions would be subsequent insider reporting obligations on the seller and purchaser. While there is no explicit compulsory bid rule, there are a number of features of the legal system that tend to dissuade acquirers from proceeding via private agreement. In particular, provisions of various state laws (including that of Delaware and New York) create serious obstacles for such a controlling stockholder. In essence these statutes prohibit an "interested stockholder"—an acquirer of 15 percent (for Delaware) or 20 percent (for New York) ownership—from engaging in a wide variety of transactions with the corporation, including mergers, purchases of assets, issuances of additional securities, and "any receipt … of the benefit, directly or indirectly (except proportionately as a stockholder of such corporation), of any loans … or other financial benefits … provided by or through the corporation or any direct or indirect majority-owned subsidiary," for three years (for Delaware) or five years (for New York) after becoming an interested stockholder. Both of these statutes permit the board of directors of the corporation to waive the statutory moratorium in advance of the acquirer's becoming an interested stockholder. In determining whether to grant such a waiver, the directors' fiduciary obligations require them to take into account the interests of all stockholders, not just those of the controller. Decisions that favour the controller would likely be tested in court and the directors would be required to demonstrate that their waiver decision was entirely fair to the minority shareholders. All material information relevant to a shareholder's voting decision must be disclosed for annual meetings, special meetings, and in the tender offer scenario. The rules address the time to be given to equity shareholders to make their decisions. Directors are generally subject to fiduciary duties of loyalty, good faith, and candor that are owed to the corporation and its shareholders. If a director fails to act appropriately, whether in the takeover context or otherwise, the corporation may take action against that director. Further,

	derivative actions may be brought by shareholders if the corporation fails to take action against a director for a breach of his duties. The registration statement and the annual report must include information on any shareholder holding more than five percent of any class of voting securities of the issuer. "Holding" is defined as beneficial ownership or the right to vote or dispose of the shares. There are also timely public disclosure requirements that apply to these shareholders—both initial requirement on acquiring five percent of the shares and on any change in holdings. Most holders have to disclose within 10 days, but passive institutional investors only have to disclose within 45 days after December 31 of the year the threshold was exceeded. Material changes to holdings are to be disclosed; 1 percent of the class of securities is deemed to be material. Persons acting together by agreement to buy, sell, or hold securities are deemed to be a single person and their collective holdings are subject to the reporting requirements. Holdings of voting securities by directors and senior management also are subject to disclosure requirements—both individually and collectively. The issuer is subject to requirements to disclose officer and director holdings in its registration statement and update this annually. A director or executive officer of the issuer has an individual obligation to disclose all equity securities of the issuer in which he or she has a direct or indirect opportunity to profit immediately upon becoming a director or officer. If the positions change, an amended report must be filed by the end of the second business day following the transaction. Directors and officers may also be required to pay to the issuer any profit they obtain on short-term trading in the issuer's securities. All of these insider filings are on EDGAR and available to the public promptly. If a foreign private issuer has a class of securities registered under the Exchange Act, it is required to include in its registration statement (under "risk factors") information regarding differences in shareholder rights between the foreign jurisdiction and the U.S. It must also note the existence of provisions of foreign corporate law or in the issuer's incorporating documents that have a material effect on shareholders' ability to pursue remedies or other matters affecting shareholder rights. Other foreign private issuers may, but are not specifically required, to make similar disclosure.
Assessment	Fully implemented.
Comments	
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	Issuer registration statements and annual reports must contain audited financial statements. The financial statements must include a balance sheet and profit and loss statement as well as a statement of comprehensive income, a statement of cash flows and a statement of changes in equity, plus all necessary notes. All financial statements, whether audited or unaudited, interim or annual, for U.S. issuers are required to be prepared and presented in accordance with U.S. GAAP. See the description in Principle 14 of the rules that apply to foreign private issuers. The SEC performs selective reviews of the accounting disclosure included in the financial reporting of public companies to ensure necessary information is included and presented in a manner that will be understandable by investors. To promote consistency and comparability in period to period reporting, specific guidance is provided for presentation and disclosure associated with reclassifications and changes in accounting policies, changes in estimates, changes in reporting entity and other conditions which affect comparability. The auditor is required to comment in the audit report on material changes in accounting. The SEC has the power to set standards of accounting, auditing and financial reporting for companies that file information and reports with the SEC. However, historically it has relied on the work of the accounting standard setters. Legislation sets criteria that must be met in order for the SEC to recognize the work product of an accounting standard-setting body as "generally accepted."

	The standards of the U.S. Financial Accounting Standards Board (FASB) have been so recognized for the purpose of the U.S. federal securities laws. The auditing standards used by auditors of public companies in the U.S. are the standards of the PCAOB, as modified or supplemented by the SEC. The PCAOB adopted the auditing and related professional practice standards of the Accounting Standards Board as they existed in April 2003 as interim professional standards. In addition, unaudited interim financial statements are required to be reviewed by an independent public accountant registered with the PCAOB. Independence of the external auditor is required under the U.S. system and detailed tests for independence are prescribed. FASB is part of a structure that is independent of other business and professional organizations. However, given the recent actions on fair value accounting after lobbying by companies, particularly banks, FASB's independence might be questioned. Legislation established the PCAOB to be an independent overseer of the audit of public companies that are subject to U.S. securities laws. The SEC selects the five board members of the PCAOB. SEC staff oversees the operation of the PCAOB and also monitors its standard setting work. Both FASB and the PCAOB are funded via an annual accounting support fee assessed against issuers. Both boards also provide extensive transparency with respect to their activities and standard-setting. The audit committee of the board of directors of a public company is required to oversee the selection and appointment of its external auditor. All directors on the audit committee must be independent and the tests for independence of audit committee members are more stringent than those that apply to other independent directors. The company is required to file a notice with the SEC within four days if the external auditor has resigned during a current audit, declined to stand for re-election after the completion of the audit or was dismissed by the company being audited. The SEC can use both formal (enforcement action or obtain court orders) and informal mechanisms (seek additional disclosures, agreement to make changes to future filings or restatements) to enforce compliance with accounting standards. The SEC has the authority to bar accountants from acting as an auditor or as a preparer of financial statements (such as a chief financial officer or comptroller) of a public company. These orders are posted on the SEC website. In addition, the PCAOB carries out inspections of registered audit firms and takes action where deficiencies are found.
Assessment	Fully implemented.
Comments	
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	**CFTC** The operator of a commodity pool must be registered under the CEA as a CPO and the registration function has been delegated to the NFA by the CFTC, subject to appeal to the CFTC and the courts. The commodity pool may be marketed by registered persons (the CPO, an IB, FCM or a BD registered with the SEC). The CEA sets out certain disqualifications from registration (mostly based on prior history of disciplinary/criminal offences)—both at the firm level and the level of principals/associated persons, including shareholders holding more than 10 percent of the voting shares. The NFA performs an extensive background check to determine whether a disqualification exists. No subjective inquiry is performed with respect to the business model or management capabilities of the applicant for registration. No on-site inspection is required to be done prior to registration. Prior to registration, the NFA does not routinely conduct on-site or off-site reviews of the operational capacity of a CPO applicant.

There are no initial or ongoing minimum capital requirements for CPOs.

The NFA may consult with foreign regulatory authorities to assess the fitness of applicants for registration whose applications disclose prior employment with a non-U.S. firm, or where the U.S. registrant has foreign principals. This is done either directly by the NFA, or where necessary, through the CFTC.

Clear authority is granted to the CFTC and delegated to NFA with respect to registration of CPOs and authorization of commodity pools, inspections, investigations and the taking of remedial actions in the event of any breach. The CFTC also takes action directly—particularly with respect to investigations and remedial action. The CFTC and the NFA have an array of tools available to address breaches of the law. They may take administrative proceedings against CPOs, impose civil penalties and restitution to customers or cease and desist orders and refer matters for criminal prosecution.

The NFA has oversight responsibility for CPOs and has a program in place to monitor on-going compliance by CPOs with all applicable CFTC and NFA rules and regulations—both through on-site inspections and off-site reviews. Most new CPOs are examined in their first two years of operation and then every three to four years, based on an assessment of their risk. During fiscal years 2007, 2008, and 2009, the NFA conducted examinations of 179, 250, and 211 CPOs respectively (about 20 percent per year). Off-site supervision activities include reviews of disclosure documents, financial statements, pool performance data services, hiring patterns for employees and principals, customer complaints, annual questionnaire data, and website monitoring.

Each registrant firm or applicant for registration must promptly correct any deficiency or inaccuracy in its registration information, including information about its principals and associated persons. The NFA also requires CPOs to provide annual updates regarding their registration information and business operations.

Very few commodity pools are offered to the retail public, although the practice is not prohibited. Most commodity pools are marketed to sophisticated persons and are private offerings under federal securities laws. Approximately 3.3 percent of the pools offered by CPOs are publicly offered pools, and these pools have reported about 5.2 percent of the total aggregate net asset value ("NAV") of all pools. As of December 31,2008, approximately 1,350 CPOs registered with the CFTC and filed annual reports for about 1,500 pools with a reported aggregate NAV of about US$316.3 billion. Of the 1,350 registered CPOs, 20 CPOs offered approximately 50 public pools with a reported aggregate NAV of about US$16.6 billion.

CPO regulation is not comparable in scope to requirements under the ICA applicable to SEC-regulated investment companies (i.e., mutual funds). Pools offered to the public are subject to the disclosure requirements imposed under the CEA, those of the NFA and the requirements of the Securities Act. The Disclosure Document requirements across all three sets of rules are consistent, although if a pool is subject to the Securities Act, some additional information must be provided. Most pools are offered by way of private placement and so are exempt from the registration statement requirements of the Securities Act.

Registered CPOs are required to file Disclosure Documents regarding the commodity pool and annual financial statements with the NFA for review. NFA reviews 100 percent of the initial and renewal/updated Disclosure Documents. During fiscal years 2007, 2008 and 2009, the NFA received and reviewed 1,372, 1,365, and 1,512 pool Disclosure Documents respectively. As part of the CFTC's oversight of the NFA, CFTC staff regularly reviews a sample of Disclosure Documents to determine the efficacy of the NFA's review. No Disclosure Document is required if the only participants in the pool are Qualified Eligible Persons (largely institutional investors).

If the CPO is currently soliciting potential pool participants and is not operating under an exemption, the pool's Disclosure Document must be updated within 21 days of a material change.

	There is no general obligation to issue a press release or other public notice of the change. The periodic account statement distributed to participants monthly or quarterly must disclose any material business dealings involving the CPO and any other person providing services to the pool if they have not previously been disclosed to the pool's participants. The Disclosure Document must contain a full description of any actual or potential conflicts of interest regarding any aspect of the pool. CFTC regulations do not mandate that a CPO take any actions to minimize conflicts of interest; the only requirement is full disclosure. The CPO must adhere to any information set out in the Disclosure Document with regard to best execution, trade allocations, related party transactions, etc. Bunched trades are to be allocated on an objective and fair basis. There also are rules governing closing out positions and offsetting trades that require netting of positions. Each CPO must keep books and records relating to the pool as well as to its operations as a CPO. The CEA and CFTC regulations do not prohibit a CPO from delegating functions to another person or entity. If the delegate is carrying on operator functions, it must be registered as a CPO. The delegating CPO remains primarily responsible for its obligations. The CPO is required to disclose information about entities and individuals who provide services to the commodity pool as well as any conflicts of interest that may arise. The NFA has an expanded reporting rule that will go into effect in 2010 that will require CPOs to provide some additional information on their service providers such as custodians and administrators and to update that information quarterly. **SEC** The CIS operator must register with the SEC as an IA under the Advisers Act. The shares of a CIS may be marketed by the CIS itself, its operator (if any) or a BD. Each of these entities is required to be registered with the SEC. A person may not be registered if a statutory disqualification is present—largely related to that person's history of criminal or disciplinary sanctions. Statutory provisions do not address all the criteria for eligibility to operate a CIS set out in the Assessment Methodology. There are no eligibility criteria that address the competence to carry out the functions and duties of the operator (i.e., human and technical resources); financial capacity; and adequacy of internal management procedures that are assessed by the regulator prior to licensing. Under the ICA and the Advisers Act, the SEC does not assess the qualifications of persons or firms seeking to become CIS operators, except as noted. The fact that an entity is registered with the SEC as an operator does not represent a determination by the SEC as to the fulfilment of criteria for eligibility to operate CIS that are listed above. The SEC does not make registration determinations based on those factors, except to the extent noted. The responsibility for assessing the fitness and competence of a CIS's operator is placed primarily upon the CIS's board of directors and their fiduciary duties to the CIS and its shareholders. Under the ICA, there must be written contract between the CIS and its operator but there is little guidance on what must be covered by that contract. The terms of a CIS operator's contract (and any renewal) must be approved by a vote of a majority of the CIS's independent directors. The CIS operator's contract also must be approved by a vote of a majority of the holders of the CIS's outstanding voting securities. The ICA also requires CIS directors to request and evaluate such information as may be reasonably necessary to assess the terms of the advisory contract and the operators must furnish this information to CIS directors. When shareholder approval of the CIS operator's contract is sought certain information regarding the CIS operator and the contract, including the compensation to be paid under the contract, must be provided in the proxy statement provided to shareholders. The Advisers Act requires operators that seek to become registered with the SEC to make certain public disclosures. In the case of a CIS, an operator generally provides the CIS's board of directors with a copy of the operator's disclosure form. A CIS also must disclose in its registration statement

certain information regarding the operator, including the operator's experience as an operator, the operator services that it provides to the CIS and a description of the compensation that the operator receives.

A CIS may not issue its securities to the public unless it has a net worth of at least US$100,000. State law may impose proficiency requirements on individual representatives of IAs resident or carrying on business in that state.

CIS and their operators must have written compliance policies and procedures in place that are reasonably designed to prevent violations of the law, including policies and procedures designed to ensure that the CIS's board has at least a minimum of 40 percent independent directors. In practice, most CIS have a majority of independent directors in order to be able to rely on certain exemptions.

Both the CIS and the securities it issues must be registered; the CIS must be registered under the ICA and its securities must be registered under the Securities Act. There is a common disclosure form under both acts. The registration statement for a CIS consists of three parts: prospectus, statement of additional information and supplementary information (material contracts, incorporation documents etc.). Selective reviews of registration statements, post-effective amendments, proxy statements and other periodic reports are carried out by the SEC. The reviews cover registration statements and other reports to assess, among other things, the continued eligibility of the CIS and its operator. No sales of a CIS's shares may be made before its registration statement is effective.

The SEC has the authority to inspect CIS and their operators, investigate suspected breaches and take remedial action under the ICA and Advisers Act via administrative proceedings or civil and/or criminal court actions. There are a full range of penalties that may be applied for breach of the legal requirements, such as civil fines. (See also the discussion under Principles 8 and 9 above.)

A CIS operator has a general and continuing obligation to report to the SEC, either prior to or after the event, information relating to material changes in its management or organization that are described in the operator's Form "ADV." The information in that form is required to be kept current.

CIS and CIS operators are required to maintain books and records. All books and records kept are subject to examination by the SEC at any time.

Various methods are used to address conflicts of interest, from direct legal prohibition of particular transactions to disclosure by the operator to independent review or approval by the board of directors of the CIS or its auditor. Certain transactions with affiliates are not permitted even if disclosure is made. Other conflicts between an operator and a CIS that are not specifically prohibited must be disclosed to the board of directors and may be disclosed to investors.

As a fiduciary, an operator has an obligation to seek to obtain "best execution" of a CIS's transactions. The method of allocation of trades across the accounts managed by the operator must be fair, reasonable, and consistently applied on a timely basis. CIS operators are subject to the anti-fraud provisions that would prohibit churning. The major SROs have rules prohibiting churning and excessive trading that would apply to BDs executing trades for the CIS.

There is no statutory prohibition on delegation of CIS operator functions to other persons if the advisory contract between the operator and the CIS permits the delegation. Systematic and complete delegation of core functions of the CIS operator is not prohibited. There is no specific requirement that the operator maintains adequate capacity or monitors the delegate. However, the delegate would be an operator of the CIS, and be required to be registered with the SEC and may perform services for the CIS only under a written sub-advisory contract that is approved by a majority of the CIS's shareholders and a majority of its independent directors. As an IA, the delegate would have a fiduciary duty to the CIS. The directors of the CIS are expected to oversee the performance of the operator and any service provider to the fund. By rule, CIS boards must

	approve the policies and procedures of fund service providers, including the investment adviser and to review the implementation of the service providers' policies and procedures on an annual basis. Whether the CIS operator is responsible for the actions of the delegate depends on the advisory and sub-advisory contracts. Both the operator and the delegate may be responsible for the actions of the delegate under some contracts; in other cases only the delegate is responsible. The SEC can bring an enforcement action against a CIS operator for failure to supervise a delegate if the delegate violates the law and is subject to the CIS operator's supervision. If the delegate is a sub-adviser, the statute does not permit the operator to terminate the contract without approval by either a majority of the CIS directors or its shareholders. If the delegate is another service provider, the ability to terminate the contract depends on the terms of the relevant contract. Disclosure to investors of the delegation arrangements and the identity of the delegates is made as part of the shareholder vote approving the sub-advisory contract. In addition, a CIS generally must disclose the same information about the delegate in its registration statement as for its operator. The same provisions to prohibit, restrict or disclose certain conduct likely to give rise to conflicts of interest above apply equally to delegates of a CIS.
Assessment	Partly implemented.
Comments	To meet the standards set out in the Assessment Methodology, regulators should establish specific eligibility criteria for CIS and their operators that include the necessary human and technical resources to carry out the required functions, the appropriate financial capacity, and adequate internal management and controls. In addition, the Methodology requires that the regulator be responsible for ensuring compliance with the eligibility standards. At present, the resources and internal controls of a CIS would be subject to an examination by the regulator only sometime after the fund began operation, but are not preconditions to the original approval. Neither regime imposes any initial or ongoing financial capacity requirements on the CPO or IA acting as operator. The resources at the SEC, CFTC, and NFA do not allow routine examination of the operators to take place with sufficient frequency. These weaknesses should be addressed. (See also the comments under Principle 10.) The requirements under the CEA with regard to conflicts of interest at a commodity pool need to go beyond simply requiring disclosure of the conflicts among various parties to require actions to be taken to avoid or mitigate conflicts.
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes, and the segregation and protection of client assets.
Description	**CFTC** The commodity pool almost always is a limited liability company or a limited partnership and is required to be a separate entity from its CPO. There is no restriction on the legal form that it may take. All relevant material facts and risks are to be set out in the Disclosure Document that is reviewed by the National Futures Association (NFA) and provided to investors. Any important risks associated with the pool's legal form would be included. As a matter of course, the organizational documents for the pool are provided with the Disclosure Document to the regulators and investors. The Disclosure Document cannot be used without being accepted by the NFA. All information contained in the Disclosure Document must be current as of the date of the document, including information relating to rights of participants. If the CPO is currently soliciting potential pool participants and is not operating under an exemption, the pool's Disclosure Document must be updated within 21 days of a material change. There is no general obligation to issue a press release or other public notice of the change. Also, a CPO must disclose all material information to existing or prospective pool participants even if the information is not specifically

	required by CFTC regulations. The CPO must file any amendments to the Disclosure Document, including any changes made to the rights of commodity pool participants, with NFA. All funds, securities and property received by a CPO must be received in the name of the commodity pool. No CPO may commingle the property of any commodity pool with the property of any other person. The Disclosure Document must set out the identity of the custodian or other entity (e.g., FCM, bank, or BD) which will hold the pool's assets. Detailed records of the operations of the CPO and the pool must be kept. The NFA's periodic examinations of CPOs include testing, on a sample basis, the reporting of assets in a pool's financial statements. The NFA tests all material and unusual assets, liabilities, cash inflows and cash outflows, revenues, and expenses included in a pool's financial statements. The testing of a pool's financial statements also includes confirmation of material balances with third parties. The NFA recently adopted a rule to require CPOs to report limited pool performance and operational data on a quarterly basis to enhance monitoring capabilities. This rule is designed to provide NFA with current information related to commodity pools so that risk trends can be identified and appropriate audit priorities assigned. The financial statements of the commodity pool that are required to be set out in the periodic and annual reports must be presented in accordance with U.S. GAAP and the annual report must be certified by an independent public accountant. The auditor of a commodity pool need not be registered with the PCAOB because the Sarbanes-Oxley Act established the PCAOB to oversee the audits of public companies. The CFTC has the power to obtain court orders to freeze pool and/or CPO assets and have receivers appointed to operate the commodity pool for the benefit of participants. **SEC** Open-end CIS must offer securities that entitle a CIS investor to redeem the shares held at the NAV per share upon demand. Closed-end CIS do not issue redeemable securities. There are no specific requirements on the legal form of an open-end or closed-end CIS. They usually are organized as corporations, business trusts or statutory trusts. All CIS, regardless of their legal form, are required to have a board of directors or a functional equivalent of that body. At least 40 percent of those directors must be independent of the CIS operator and other CIS affiliates. In practice, usually a majority of directors are independent. Independent directors are charged with various significant oversight responsibilities. A CIS must state whether it is an open-end, closed-end or unit investment trust (UIT) fund in its registration statement and disclose information about the redeemability of its shares, as well as the name of the jurisdiction in which it is organized. The registration statement contains exhibits, including copies of its organizational documents that would include information about its legal form and structure. The responsibility for ensuring that the structure requirements are observed rests primarily with the CIS and those who signed its registration statement. CIS registration statements are reviewed by the SEC on a selective basis to ensure the requirements are met. The SEC does not approve or disapprove a CIS registration statement based upon the merits of an investment in the CIS, the qualifications of a CIS operator or the legal structure of the CIS. A CIS is not required to give its existing shareholders prior notice of changes that do not require shareholder approval. A CIS that is making a continuous offering of its securities must maintain a current registration statement, including its prospectus. Open-end CIS and UITs must update their registration statements, including prospectuses, immediately to reflect any material changes that have been made to investor rights. Material changes include, among other things, changes in the CIS's investment objectives or fundamental policies, suspension of sales or redemption of shares, termination of an advisory contract and the resignation of the CIS's independent auditor.

	All CIS registration statements are available on the SEC's website. CIS using a summary prospectus must provide updated prospectuses on their own websites. In practice, open-end CIS generally provide updated prospectuses annually to all existing shareholders. The general objective of the rules governing the custody of CIS assets is to separate the assets of a CIS from the assets of any other person, including its operator. CIS assets are to be held by an eligible custodian, such as (a) a federal or state bank that has capital of at least US$500,000; (b) a member of a national securities exchange; (c) a securities depository; (d) a futures commission merchant or commodity clearing organization; and (e) a foreign bank or securities depository subject to certain conditions. An eligible custodian may deposit CIS assets with another eligible custodian, such as a registered clearing agency acting as a securities depository. A UIT may not maintain custody of its own assets and must designate one or more banks as trustees or custodians. There is no requirement that a CIS's custodian be legally or functionally independent from the CIS's operator. If a CIS operator or its affiliate acts as a CIS's custodian, the CIS is deemed to have "self custody" of its assets and additional requirements apply including depositing the securities in the safekeeping of, or in a vault or other depository maintained by, a federally or state supervised financial institution, segregation, limited access by staff and special recordkeeping. In addition, the CIS must employ an independent public accountant to verify the CIS's assets at least three times during the year by actual examination. The auditor must send a certificate to the SEC stating that the examination has been made and describing the nature and extent of the examination. Further, a CIS must maintain a fidelity insurance bond against larceny and embezzlement involving CIS assets. Current accounts, books, and other documents relating to the CIS's assets must be kept. The CIS must keep records for all securities transactions and ledgers for all of the CIS's accounts and detailed shareholder records. Independent accountants registered with PCAOB must conduct an annual audit of a CIS's financial statements. CIS are not required to employ internal auditors. To deregister, the CIS must obtain an order from the SEC declaring that it has ceased to be a CIS and that its registration is no longer in effect. The SEC has authority to impose conditions on deregistration as necessary for the protection of investors. Prior orders have generally been based on a finding that the company has distributed substantially all of its assets to shareholders and is winding up its affairs or that the company has sold substantially all of its assets to another CIS or merged into or consolidated with another such CIS.
Assessment	Broadly implemented.
Comments	There are very few circumstances where securities legislation or the CEA requires investors in commodity pools or mutual funds to be given notice of a change that affects their rights prior to the effective date of that change, other than where prior approval of the investors is required. Under the CEA, where a material change takes place, existing participants must receive notice of the change within 21 days of that change. This is not timely disclosure and the notice period should be shortened considerably. There is no requirement under securities or commodities legislation that the custodian of CIS assets and cash be independent of the operator or other service providers to the CIS. Both regimes do require the assets to be segregated and held in a manner that makes the CIS's interests evident, which is consistent with the standards set out in the IOSCO Principles. However, strong consideration should be given to requiring the custodian be an arm's length party, which would avoid complications if a corporate group containing a CIS operator and its custodian got into financial difficulty. Under both the securities and futures regimes, any registered entity or registrant may be audited by anyone who is qualified to render an audit opinion under state law and is independent of the party being audited. Auditors of securities mutual funds must be registered with and subject to inspection

	by the PCAOB. However, the audit of a CIS (or for that matter the audit of a market intermediary) may need someone who has specific experience in the area. While U.S. auditing standards require an auditor to ensure that the engagement team (which includes the audit partner in charge) has the necessary competencies, consideration should be given to requiring the audit partner in charge of the audit have some relevant experience.
Principle 19	Regulation should require disclosure, as set out under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	**CFTC** Commodity pools, if offered publicly, are subject to both the CEA and the Securities Act, meaning the prospectus/Disclosure Document must meet requirements of both acts. However, the majority of pools are distributed by private placement and so would only be subject to the CEA/NFA requirements outlined here. If the pool is offered only to Qualified Eligible Persons (largely institutional investors), the Disclosure Document is not required and there are less onerous periodic reporting requirements. The information contained in any Disclosure Document must not be misleading. CPOs must provide a detailed Disclosure Document to prospective participants before accepting their subscriptions for interests in a commodity pool. The disclosure requirements set out specific information that must be included and there is a general requirement that all material information be provided. NFA rules require the use of plain language. The Disclosure Document requirements address the range of topics enumerated in the Assessment Methodology. Prior to using a Disclosure Document, a CPO must submit the Document to NFA and receive an acceptance letter confirming that the Document can be used to solicit. If the Document does not meet regulatory requirements, NFA will provide notice of deficiencies. The Document may not be used until all issues are addressed. There are rules regarding advertising and marketing materials that include rules that prohibit any false or misleading communications with the public. No Disclosure Document may be used that is more than nine months old. See also the material change update requirements set out in Principle 18. The CPO is required to provide the commodity pool's annual audited financial statements and annual report within 90 days of the pool's year end to its participants and the regulators. It must also provide periodic account statements to its participants, either monthly for pools with assets greater than US$500,000, otherwise quarterly, within 30 calendar days of the end of each reporting period. These periodic reports and annual financial statements must be prepared in accordance with U.S. GAAP and annual reports must be audited in accordance with U.S. GAAS. **SEC** Key information is required to appear in plain English in a standardized order at the front of a CIS's prospectus. Under a new disclosure regime that is in the process of being implemented, an investor may get the key information in the form of a summary prospectus so long as the full prospectus is easily accessible on a website. A CIS's prospectus must include all information that would be material to an investment decision by a prospective investor. The specified disclosure items include the full range of topics enumerated in the Assessment Methodology. A prospectus must be delivered to an investor purchasing a CIS in a primary distribution. An open-end CIS may describe the types of investors for whom the CIS is intended or the types of investment goals that may be consistent with an investment in the CIS. In addition, FINRA rules impose suitability requirements on any BD that recommends to investors that they purchase a CIS's securities. The registration statement must include extensive disclosure on all of the disclosure items set out in the Assessment Methodology. There are some differences in requirements across the various

	types of CIS, as some items are not applicable to all types of CIS, particularly UITs. The SEC may intervene in an offering if it appears that the registration statement includes an untrue statement of material fact or omits to state any material fact required to be stated or necessary to make the statements not misleading. It may issue stop orders or cease and desist orders to stop offerings. It also can institute a proceeding against a person or seek an injunction in federal court for violations of the ICA or Securities Act. A CIS may use brochures or advertisements and may market through the full range of media. Like offering documents, all marketing materials are subject to the anti-fraud provisions of the law and may not contain material misstatements or omissions. There are specific, detailed requirements that apply to various types of advertising. Copies of all advertisements and sales literature must be filed with the SEC. If a CIS's shares are sold by a FINRA member BD, FINRA requires the BD to file any advertisement or sales literature that it uses to market the company. These advertisements and sales literature are reviewed by FINRA. Advertisements and sales literature filed with the SEC may be reviewed. Each open-end CIS always must have a current, effective registration statement. An open-end CIS must amend its registration statement at least annually to include updated financial information or more frequently, if necessary, to reflect material changes in its operations. The Securities Act requires a CIS to maintain a "current" statutory prospectus, any prospectus used more than nine months after the registration statement's effective date must contain financial and other information as of a date not more than sixteen months prior to such use. CIS prepare and send annual and semi-annual reports to their shareholders. The reports must include full financial statements for the CIS prepared in accordance with U.S. GAAP, including a schedule of portfolio holdings that shows the amount and value of each security owned by the CIS on that date. The annual report must include audited financial statements, accompanied by a certificate of an independent public accountant that is a member of the PCAOB. There is also a semi-annual financial reporting requirement to investors and a requirement that the CIS's portfolio statement be sent to the SEC quarterly. CIS must transmit reports to shareholders and file information with the SEC within 60 days after the end of the period for which each report is made. The auditor is required to include procedures designed to detect illegal acts, identify related party transactions and evaluate the CIS's ability to continue as a going concern. If the auditor becomes aware that an illegal act has occurred, the accountant has obligations to promptly notify the CIS's operator and ensure that the CIS's audit committee or directors. In some circumstances, the auditor must report the issues directly to the SEC.
Assessment	Fully implemented.
Comments	See comments under Principle 18 regarding the timing of notice of material changes under the CEA.
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	**CFTC** The NAV of a commodity pool must be calculated using U.S. GAAP, consistently applied. Valuations are to be reported in the Statement of Changes in Net Assets included in the periodic and annual reports of the pool. U.S. GAAP requires the use of Statement of Financial Accounting Standards (FAS) 157, *Fair Value Measurements*. This statement includes provisions for fair value of commodity pools, establishes a framework for measuring fair value under U.S. GAAP and expands disclosure about fair value measurements. Information in the CIS's annual report on the valuation of the assets and calculation of NAV must be audited by the independent auditor. The NAV of a pool is disclosed to participants in the

	periodic account statements provided by the CPO. The Disclosure Document must contain a complete description of any restrictions on the transferability of a participant's interest in the pool and the frequency, timing and manner in which a participant may redeem interests in the pool. This must include how the redemption value of a participant's interest will be calculated, the conditions under which redemption will be made (including time between request for redemption and payment) and any restrictions on redemption. There are no specific requirements that govern pricing errors, other than what would be covered by the general disclosure and audit requirements. The suspension and deferral of routine valuation, pricing and redemptions are covered by disclosure requirements and otherwise are not subject to review or involvement by the regulators. However, the CFTC and NFA have the power to take action where necessary. The CFTC has the authority to take court action under the CEA, and the NFA may take a Member Responsibility Action pursuant to NFA Compliance Rules. In 2010, new NFA rules on quarterly reporting requirements for CPOs will require CPOs to provide the NFA with notice of the suspension or deferral of redemption rights. The CFTC and NFA have and exercise the authority to enforce requirements regarding asset valuation and pricing. Regular reviews are conducted by NFA of CPO operations that would cover the CPO's valuation and pricing practices and procedures. Actions have been taken where breaches have been found. **SEC** CIS assets must be marked to market or otherwise valued at fair market value as required by U.S. GAAP. As is the case for commodity pools, FAS No. 157, *Fair Value Measurements* applies. There is no specific requirement regarding the frequency of calculation of the NAV of a CIS. Open-end CIS may be redeemed only at a price based on the NAV of such security next computed after receipt of a redemption request (forward pricing). The ICA generally prohibits a closed-end CIS from issuing its common stock at a price below its current NAV. A CIS's independent auditors must verify the CIS's NAV calculations and test the process by which the CIS values its portfolio securities as part of the CIS's annual audit. The SEC has issued detailed guidance on how this audit verification is to be conducted. The CIS' board is responsible for overseeing the valuation of CIS portfolio securities, must approve the valuation criteria and are responsible for reviewing the CIS's valuation methods to assure that the valuations of the CIS's portfolio securities are fair and accurate. Federal securities laws do not require that the prices of a CIS be disclosed or published on a regular basis to investors other than in the CIS' annual or semi-annual reports. In practice, the current price of a CIS is generally available in financial publications and websites every business day. There are industry rules of practice on pricing errors that have been adopted by some CIS boards of directors. These set out when price adjustments should or do not need to be made (i.e., set *de minimis* standards). The valuation procedures of a CIS generally provide for the reporting of any material pricing errors to the board and may call for the board to review or approve any corrective action that was taken. Pricing errors that are not considered material would be corrected on a going-forward basis. A CIS typically would not report pricing errors to the SEC unless the error is required to be reflected in its financial statements, i.e., is material. CIS may, but are not required to, suspend redemptions and postpone payment for redemptions already tendered for any period during which the NYSE is closed. A CIS also may suspend redemptions for any period during which (a) trading on the NYSE is restricted, or (b) an emergency exists, as determined by the SEC, as a result of which it is not practicable for the CIS to liquidate its portfolio securities, or fairly determine the value of its net assets. Otherwise, a CIS cannot suspend the right of redemption or postpone the date of payment more than seven days after the tender of the security to the CIS or its redemption agent. The CIS must amend its prospectus to

	discuss any suspension or deferral of redemption rights. Such an update would be filed with the SEC. If a CIS wants to suspend redemptions for any reason other than those discussed above, it must request an order from the SEC, which will be granted only if the order is necessary for the protection of the CIS's shareholders. The SEC has the power to enforce compliance with the rules on asset valuation and pricing through its examinations and enforcement actions. The SEC reviews CIS asset valuation and pricing during its examinations of CIS, CIS operators and third-party administrators that perform operational and administrative functions for CIS. The SEC has taken enforcement actions against entities for having inadequate review procedures to identify pricing deviations or where pricing practices breach the law—such as for late trading. The SEC has the authority to intervene when the suspension of redemptions is in breach of the law and in certain other situations. It also has the authority to seek a court order to suspend redemptions.
Assessment	Fully implemented.
Comments	The CFTC should consider providing guidance to the industry on how to address pricing errors in the valuation of commodity pools.
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	**CFTC** Legislation requires anyone carrying on business as an FCM, IB, CPO, or CTA to be registered with the CFTC. If these firms are dealing with the public they must also be members of the NFA. The CFTC has delegated the responsibility to the NFA to receive and review registration applications and grant or deny registrations, subject to appeal to the CFTC and the courts. The CFTC oversees the operations of the NFA. (See also the discussion under Principle 7.) There are published minimum standards that require information be provided to ensure that no statutory bar to registration is present (such as a criminal record or certain financial sector offences) and other proficiency requirements are met, such as courses and experience etc. for individuals. This assessment extends to principals who beneficially own 10 percent or more of the equity of the firm. The regulators have authority to refuse licensing if one of the statutory bars is present. The NFA also has minimum educational and other requirements that apply to specified personnel at all FCMs, IBs, CPOs, and CTAs. An assessment of the internal controls, back office capabilities, record keeping systems, etc., of applicants is not mandatory before registration is granted. The NFA's practice is to perform an off-site review of an FCM's or non-guaranteed IB's policies and procedures as part of the licensing process. DCOs and DCMs generally perform reviews of the internal controls and back office capabilities of applicants for clearing membership. Applicants that are required to provide audited financial statements must have those statements certified by an independent auditor. This certification process involves review of the firm's accounting system, internal accounting controls and procedures for safeguarding customer or firm assets. If material inadequacies come to light, the certifying accountant must notify the applicant/registrant, who must notify NFA, the firm's designated self-regulatory organization (DSRO), and the CFTC. Each firm registrant or applicant for registration must promptly correct any deficiency or inaccuracy in its registration information, including information about its principals and associated persons. Only FCMs and non-guaranteed IBs have minimum capital requirements and each of these types of firms is required to give immediate notice if it falls below the required on-going capital thresholds. Various actions may be taken by the regulators as a result. (See the discussion under Principles 22 and 24.) The firm must give notice within 20 days of any new principal of the firm. If the principal is not suitable, the regulator may take action against the firm to ensure the

	principal ceases to be associated with the firm. Detailed information on firms and individuals is publicly available on the NFA website. Information available on the site extends to the disciplinary history of both firms and individuals. CTAs may manage client assets on a discretionary basis but they are not permitted to have custody of those assets. There are no capital requirements for CTAs. They must keep accurate and current records concerning their clients and their activities. They must disclose specific information to clients, including the business background of the CTA and its principals who will make trading or operational decisions, any material actions against the CTA and principals, a description of the trading program and related risk factors, fees, any actual or potential conflicts of interest and past performance of its client accounts. The usual warning that past performance does not predict future returns must be included if performance information is provided to clients. The disclosure also must include a full description of any actual or potential conflicts of interest regarding any aspect of the CTA's trading program and other material conflicts of interest. The general anti-fraud standards also apply to disclosures made by these firms. Unlike IAs registered with the SEC, CTAs are not automatically fiduciaries, although that standard may apply if the common law tests of trust and reliance are met. **SEC** Any person engaged in the business of effecting transactions in securities for the account of others or of buying and selling securities for his own account, through a broker or otherwise, must register with the SEC as a BD and be a member of at least one SRO. If the BD carries on customer business it must be a member of FINRA. State law may require BDs and their personnel to register with state securities authorities. There are some exceptions from the definition of a BD, including banks engaged in certain limited activities, persons trading solely on their own account, and issuers. There are also exemptions from the registration requirement for foreign brokers only carrying on limited activities; BDs operating only intra-state; or a BD only trading in exempted securities, commercial paper, bankers' acceptances, or commercial bills. The application form for a BD requires extensive information about the background of the applicant, its principals, controlling persons (defined as having at least 25 percent of the voting shares of the company) and employees, the type of business it proposes to engage in and discipline history of any of these persons or affiliates. To carry on business as an IA (in the business of providing advice, making recommendations, issuing reports, or furnishing analyses on securities, either directly or through publications), a person must register with the SEC or a state securities authority. There are the usual exceptions for banks, lawyers, accountants, journalists, etc. Firms that manage investments on a discretionary basis register as IAs. In specified circumstances, an advisor may choose not to register. For example there is a *de minimis* exemption for an adviser that has fewer than 15 clients, does not hold itself out generally to the public as an IA and does not act as an IA to a registered investment company or certain other persons. An adviser is **prohibited** from registering with the SEC <u>unless</u> the adviser has assets under management of US$25 million or more; advises a registered investment company; or is exempt from the prohibition by SEC rule or order. Smaller IAs generally must register with the securities authorities in the state in which they are organized and in each of the states in which they do business as an IA. Note that even if registered with the SEC, IAs are still subject to state laws regarding anti-fraud, filing of materials as with the SEC and the payment of fees to states. The IA registration process is disclosure based. An IA registers with the SEC by filing an application for registration on Form "ADV" under the Advisers Act. The form requires extensive information regarding the adviser's background and business practices. Part II of the Form must be provided to the IA's clients. The SEC may deny registration if a statutory bar is present. (See also

	the discussion under Principle 17.) An assessment of the internal controls, back office capabilities, record keeping systems, etc. of applicants for IA registration is not mandatory before registration is granted. A BD applicant must comply with net capital and other requirements established by SEC rules and any SRO requirements that may be higher. FINRA requires most BD employees directly involved in investment banking or brokerage sales to register with FINRA and have suitable experience/have passed required proficiency exams. OTC derivatives dealers are exempt from certain BD requirements such as SRO membership, regular BD margin rules and the application of the Securities Investor Protection Act (SIPA). They are subject to special requirements including limitations on the scope of their securities activities, specified internal risk management and control systems, recordkeeping obligations and reporting responsibilities. These dealers may calculate their net capital based on the use of Value at Risk models. The SEC does not have authority under the Advisers Act to impose initial or on-going capital requirements on IAs. Only the IA firm, not the persons who are associated with the adviser, must register with the SEC. There are no minimum proficiency standards for individuals acting for an IA under the federal regime, although individual states impose requirements as part of their registration process. FINRA requires applicants to have: • financial controls to ensure compliance with the federal securities requirements and the SRO's rules; • compliance, supervisory, operational and internal control practices and standards that are consistent with those regularly employed in the securities business, for the nature and scope of the applicant's proposed business; • appropriate systems of customer protection, risk management and internal controls; • a written business continuity plan with procedures that are reasonably designed to enable it to meet its existing obligations to customers in the event of an emergency or a significant business disruption; • a supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls) and compliance procedures designed to detect and prevent violations of the applicable standards; • an explicitly delineated supervisory hierarchy, including the designation of a direct supervisor for each representative and the assignment of specific supervisory responsibilities; and • measures to monitor compliance with its policies and procedures under FINRA rules; and • a designated chief compliance officer. These are checked by FINRA before membership is granted; the SEC does not conduct any separate assessment of these matters. The BD is also required to certify annually to FINRA that the BD has a process to establish, maintain, test, and modify its supervisory procedures. Registered IAs must adopt and implement written compliance policies and procedures (CP&P) reasonably designed to prevent the violation of the legislation by the IA or any of its supervised persons and address potential conflicts of interest with its clients and other compliance factors creating risks for clients. An IA must designate a single chief compliance officer (CCO) to administer the CP&P. The CP&P must be reviewed annually by the IA for adequacy and effectiveness. These IA requirements apply to registered firms and are not assessed by SEC prior to the grant of registration, but may be reviewed on an examination. The SEC can refuse an applicant a license as a BD or IA if its application is incomplete, contains false information or a statutory bar to registration exists. It may also deny an IA's registration if the firm is prohibited from registering with the SEC. The SEC's registration decisions are subject to

	judicial review. The SEC has the authority to withdraw, suspend or condition a registration if the firm breaches the law, has ceased to carry on business or is no longer eligible to be registered. If a new controlling shareholder does not qualify for registration, the SEC (and FINRA for BDs) may suspend or impose conditions on the firm's license. FINRA is the front line regulator of BDs. The SEC reviews/approves all SRO rules, plus inspects its membership and licensing processes. (See the detailed discussion under Principle 7.) Generally, IAs are not members of SROs, unless they are also BDs. A BD must promptly file an amendment to its registration form if the information changes. An IA must file an annual updating amendment to its registration form. Also, the registration form must be amended to keep it current. If material information on the form becomes inaccurate, it must be amended promptly. There is no specific guidance on what "promptly" means. For IAs, other corrections or updates, including a required annual update, must be made within 90 days of the IA's fiscal year end. Completed registration forms and annual audited financial statements for BDs are publicly available. The form indicates the types of business conducted by a BD, the states and SROs with which it is registered and information on its senior managers etc. FINRA maintains regulatory information about its BD members and their associated persons and make much of this information publicly available on its website. The public may confirm an IA's registration status with the SEC through the SEC's web site or by consulting the staff. The public may confirm state registration status by consulting with the relevant state securities commission. Information on the IA's activities, directors, officers and controlling shareholders are set out in its registration form. See the discussion of the examination programs that apply to intermediaries set out under Principle 10. An IA with custody of client funds or securities must hold the client assets at a "qualified custodian," (a similar list of entities as for an eligible custodian for a CIS) and subject to conditions regarding segregation of assets, reporting to clients and periodic checks/verifications by an independent auditor. The qualified custodian is not required to be at arm's length to the IA. There are also special record keeping requirements that apply to an IA with custody of client assets regarding client transactions and positions. Part II of Form "ADV" that must be given to clients of the IA must contain detailed disclosure on: the adviser's educational qualifications, relevant industry experience, disciplinary history (if any), investment strategies, fee structure and other client charges, potential conflicts of interest, and past investment performance. A guarantee of future investment performance would generally be unlawful as a fraudulent, deceptive, or manipulative act. Misuse of client assets also would violate the anti-fraud provisions of the law. IAs are subject to examinations by the SEC using a risk-based assessment model. Those with a higher risk profile are placed on a three-year examination cycle. Other IAs are chosen randomly for routine examinations and may also be examined as part of cause, sweep or special purpose examinations. However, there are over 11,000 IAs registered with the SEC and only about 300 examiners available. These resource constraints limit the frequency of the reviews of the operations of these market participants, particularly for routine reviews.
Assessment	Broadly implemented.
Comments	The standards of this Principle regarding intermediary entry requirements are met for registered BDs and FCMs, each of which is required to be a member of an SRO and is thereby subject to entry requirements. For other futures intermediaries and IAs there are gaps in the entry requirements and/or the process of verification of compliance with those standards prior to registration being granted.

	Although the SROs may review certain policies and procedures of an FCM applicant before granting registration, there is no general requirement that on-site or off-site examinations of the back-office capabilities and internal control of applicants under the CEA be performed, prior to registration. The practice at the DCOs, NFA, and DCMs is to conduct such examinations prior to granting an FCM membership in the SRO. These reviews are neither required, nor routinely carried out for other categories of firms under the CEA prior to registration. Compliance with the required standards would be assessed as part of the examination process after the registration was granted. FINRA performs these reviews for all BD applicants for membership; no one performs these tasks for IA applicants. See the comments under Principle 10 above regarding the effectiveness of the examination program for firms, particularly for IAs. FINRA should have clear authority to examine and address all securities-related activities of members, including their registered IA activities. The SEC and the CFTC use differing ownership thresholds to identify those persons who are presumed to control an intermediary or applicant. The CFTC requires detailed information be provided on all persons who exercise a controlling influence over the firm or, among other things, own 10 percent or more of the voting securities of a firm. The BD registration form requires a listing of all persons who own more than 5 percent of a firm's shares and presumes control to exist (subjecting the person to detailed scrutiny) where a person owns 25 percent or more of the firm's voting securities. The CFTC's lower threshold is the one more commonly seen in other jurisdictions and adoption of this lower figure by the SEC would enhance the common standards across the two agencies. If an IA holds or has authority to obtain client funds or securities, those assets are to be held at a qualified custodian but the custodian is not required to be independent of the IA. These custody rules were under review at the time the assessment was performed. Under the new rules that were implemented in March of 2010, additional safeguards are required if the assets are not held at an independent custodian. If the custodian is not at independent, the IA must receive an annual report from an independent public accountant on the custodian's internal controls on its custody functions such as Type II SAS–70. In addition, if the custodian is not independent of the IA and not 'operationally independent' from the IA, the IA must also engage an independent public accountant to perform a surprise examination of client assets during the year. The auditor must certify to the SEC that the examination has been completed and describe the nature and extent of the examination. If discrepancies are found, the auditor must give notice to the SEC within one business day. The independent auditor that prepared the internal control report and performs the surprise examination would be required to be registered with the PCAOB and subject to that entity's quality standards and oversight process. The assessors understand that SEC staff is reviewing recommendations to enhance the rules governing BD custody of customer assets.
Principle 22.	**There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.**
Description	**CFTC** Only FCMs and IBs must meet the minimum financial requirements that the CFTC prescribes. Each FCM and IB must maintain adjusted net capital in an amount that meets or exceeds the greatest of several alternative amounts. There are no initial or ongoing capital requirements for CPOs or CTAs. IBs do not require capital if their obligations are guaranteed by an FCM and they deal only through that FCM. For FCMs, the minimum capital requirement is the greatest of: US$250,000; the minimum amount of net capital required by the NFA (US$500,000); 8 percent of customer plus 4 percent of non-customer maintenance margin requirements; or, if an FCM is also registered as a BD by the SEC, the amount of capital required by the SEC. For IBs the minimum is the greatest of US$30,000; the minimum amount required by the NFA (US$45,000); and for IBs also registered as BDs, the amount of capital required by the SEC. The CFTC has proposed substantial increases in these

	minimum capital amounts because as the amounts were adopted in 1996, they do not reflect inflation and no longer are consistent with the regulatory objective of requiring registrants to maintain a minimum base of liquid capital from which to meet their financial obligations, including those to customers. In reality, the capital a firm is required to hold is higher, as there are early warning thresholds that must be met that are 10 to 50 percent above these minimum amounts. The definition of capital is net liquid capital—current liquid assets (discounted by the required haircuts) less all liabilities. The terms and calculations are consistent with those used by the SEC for BDs. The capital calculation based on maintenance varies with market risks and is directly related to increases in margin requirements for the futures and options positions held by the firm. The capital calculations require all positions to be marked to market. The CFTC's net capital regulation includes provisions that address certain asset liquidity, funding, and affiliate risks. The capital regulation generally addresses these risks by imposing specific deductions (or haircuts) on the value of assets for purposes of determining whether the firm meets minimum capital requirements. Funding risk is reflected through the application of a haircut on proprietary futures and options on futures positions that is equal to 100 percent or more of the margin requirement of the position, and a haircut for margin calls made to customers and non-customers (generally affiliates) that are not satisfied within a brief period of time (no more than three business days). The regulation also includes a calculation that is tied to a percentage of the risk maintenance margin requirements of its customers and noncustomers, which results in increased capital requirements as the amount of such required risk margin increases. Unsecured receivables, including unsecured receivables from affiliates, are also generally subject to a 100 percent haircut. There are no express capital requirements to cover other types of risk. However, the early warning threshold requirements and the 100 percent margin requirement for proprietary positions do provide an additional capital buffer to address these other risks. These capital requirements, coupled with the requirements for strict segregation of client assets, have permitted orderly wind-downs of firms without loss to customers or disruption to the market attributable to the registered firm. Each FCM and IB must be in compliance with applicable capital requirements at all times and must be able to demonstrate such compliance at any time. Capital and segregation requirements must be calculated daily and any deficiency rectified and reported immediately. There are also detailed recordkeeping requirements relating to the financial condition of FCMs and IBs and to the customer funds held by FCMs. An FCM must provide detailed monthly reports on its financial condition to its regulators (the CFTC and its SROs). IBs provide the same reports semi-annually. FCMs that are also BDs with the SEC may file the financial reporting form used by the SEC (the FOCUS report) with the CFTC, rather than the using the financial reporting form required under the CEA. The SEC does not accept the CFTC form for BDs that chiefly are FCMs. Ongoing financial and other supervision of FCMs and IBs that are members of more than one SRO are shared by the relevant SROs, with the NFA primarily responsible for FCMs that are not members of a DCM. FCMs and IBs are subject to independent audit requirements. In addition, the audit must include tests of the accounting system of the firm, its internal accounting controls, and its procedures for safeguarding customer and firm assets. The audit procedures must provide reasonable assurance that any material deficiencies will be discovered. If deficiencies are found, the auditor must notify the firm, which must then notify the regulators. The NFA and other SROs conduct regular on-site exams. All of the futures SROs participate in the Joint Audit Committee (JAC). JAC has issued a joint audit program. NFA's audit modules follow the objectives established by this program. The JAC program is used for FCMs that are members of an exchange (regardless of whether the FCM is a member of multiple exchanges). Every member firm is to be inspected every 9 to 18 months. The CFTC does not have a routine

	examination program, but might conduct an on-site exam for cause. If material deficiencies in capital are found, the firm's business may be restricted or other actions taken by the firm's DSRO or the CFTC. They have authority to impose more frequent reporting requirements and/or restrictions on the intermediary's business and/or a requirement to transfer accounts to another FCM. For example, Bear Stearns was subject to daily reporting after its capital dropped 45 percent. (See the discussion under Principle 24.) Note that equity withdrawals of less than 30 percent of excess capital only require notice to the regulators after the fact. Prior notice is otherwise required. The CFTC has the authority to deny a request for a withdrawal. Affiliate risk generally is addressed through mandatory reporting and filing requirements. Further, the capital calculations of FCMs and IBs must exclude from their current assets any deposits at affiliates, whether licensed or not. Also, certain off-balance sheet items must be reported as non-current assets in the capital computations of FCMs and IBs. There are operational requirements that address management of the risks that may be posed by FCM affiliates. The CFTC is authorized to obtain information about affiliates of an FCM that might jeopardize the FCM's ability to meet financial requirements or to otherwise remain in business. FCMs are required to monitor their affiliates whose activities are reasonably likely to have a material impact on the FCM's financial or operational condition. The FCM's risk assessment filings identify who its affiliates are and the regulators have the authority to ask for additional detailed information from the FCM. **SEC** There are capital requirements only for BDs, not for firms that are just IAs, even if the IA has custody of client assets. The Net Capital Rule (NCR) requires that all BDs maintain certain minimum level of liquid net assets at all times. All BDs are subject to the NCR. If a firm's net capital falls below the level required, the firm must cease doing securities business The minimum dollar amount of net capital applicable to BDs differ based upon the types of business each firm engages in and the perceived relative risk associated with these activities. A firm's net capital requirement may be determined using either the standard or alternative method. In both cases, the firm must calculate its liquid assets using the formula set out in the NCR. Among other things, the formula applies haircuts (or discounts) to the value of assets on the BD's books based on the nature of those assets (their liquidity, market and credit risks). For example, non-marketable securities are generally subject to a 100 percent haircut/discount. The standard method requires the firm to have liquid net assets greater than the minimum dollar amount specified, which varies based on the nature of the business undertaken by the BD. This minimum amount varies from US$5,000 to US$250,000. In addition, the BD's aggregate indebtedness to all other persons must not exceed 800 percent (for its first year of operation) or 1500 percent (thereafter) of its liquid net capital. If the BD elects to use the alternative method, the BD must maintain net capital of at least the greater of US$250,000 or 2 percent of aggregate customer debit items. This method was designed primarily for firms that hold customer assets and the debit items tend to increase with the amount of customer business a firm does. This method is used by many of the larger firms. The aggregate indebtedness limit of the standard method does not apply to these firms, The NCR also permits OTC derivatives dealers and certain other BDs to calculate their net capital using Value at Risk models. The use of this method by BDs that are not OTC derivatives dealers is subject to several conditions, including the supervision of the BD's ultimate holding company. The holding company supervision focuses on its financial and operational condition and its risk management methodologies, with the aim of reducing the likelihood that weakness at the holding company will destabilize the BD or the financial system as a whole. Under the SEC rules, a BD's holding company and its affiliates (known as consolidated supervised entities, or CSEs) may elect to be subject to group-wide SEC supervision. In electing to operate under this program, the holding company must, among other things, compute its group-wide capital monthly in accordance with

the Basel standards. However, there are no such firms as of February 2010.

All SROs may set capital requirements for BDs at higher levels than the NCR. SROs also may prevent a firm from expanding its business or otherwise limit its business to the extent that the firm fails to maintain sufficient levels of net capital. For example, FINRA prohibits a member from expanding its business when its net capital is less than 150 percent of its minimum requirement and that condition has existed for more than 15 consecutive business days.

Customer assets must be segregated from proprietary assets so that if liquidation were to occur, customer assets would not be available to the creditors of the BD. This customer protection rule requires BDs to maintain a reserve account that contains at least the net dollar amount of cash the BD owes to its customers. This may be held in cash, U.S. government securities or those securities guaranteed as to principal and interest by the U.S. government.

On one recent large failure of a BD and its affiliates, eligible customers of the BD were made whole through a combination of these requirements and Securities Investor Protection Corporation (SIPC) coverage, but markets were disrupted and counterparties did lose money. The failure of the group had a significant impact on global markets. Adjustments may be necessary to address funding, liquidity and affiliate risks, particularly under stress, more directly. The assessors understand the relevant capital and related rules are under review by the SEC.

Capital levels are monitored through filing of periodic and annual reports by the BD and through on-site inspections. Monthly or quarterly reports on capital calculations must be filed with FINRA within 17 days after the period end. The BD must give prompt notice to the SEC and FINRA if it breaches one of the early warning threshold tests (net capital below 120 percent of minimum or below 5 percent of aggregate debit items). Generally, the equity capital of a BD may not be withdrawn without written notice to the SEC, the SRO and, if applicable, the CFTC.

An audited annual report must be filed with the SEC and SRO within 60 days of year end. Financial statements must be audited by an independent public accountant meeting the same qualifications and tests for independence as for auditors of securities CIS and issuers. The auditor must review the firm's accounting system, internal accounting controls, and the procedures for safeguarding customer funds or firm assets. There is a similar reporting obligation on the auditor, as for the auditor of CIS and public issuers, if deficiencies are found.

FINRA inspects its BD members periodically; the frequency of examination depends on the types of business the BD engages in and the perceived risk of those businesses. For instance, FINRA inspect BDs that hold customer funds and securities at least once every year. Other BDs are subject to less frequent on-site examinations. In addition, the FINRA reviews a BD's capital levels when periodic reports are filed.

If a BD is in violation of the NCR or the customer protection rule, it must cease to conduct securities business and must give its regulators immediate notice. The regulators may restrict the ability to withdraw capital from the BD if certain parameters have been broken and the SRO may restrict the activities that the BD may carry on or require the BD to reduce the business on its books. The SEC may also petition the court to place a freeze on the BD's assets. More frequent reporting may also be ordered.

The NCR requires that a BD consolidate, for purposes of calculating net capital and aggregate indebtedness, the assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses, or assumes directly or indirectly the obligations or liabilities. The NCR also requires deductions of affiliate positions.

In addition, BDs are required to have policies, procedures, or systems for monitoring and controlling financial and operational risks to the BD resulting from activities of affiliates whose "business activities are reasonably likely to have a material impact on the financial and operational condition" of the firm. Included in these requirements are risk management policy information, financial data (including consolidating and consolidated financial statements, securities, and other

	financial product position data) and financial instruments with off-balance sheet risk, among other things. BDs are required to report quarterly on these matters.
Assessment	Partly implemented.
Comments	The capital rules on both the securities and futures sides are focused on ensuring customers are protected on the failure of a firm. The rules address market risk, credit risk, certain operational and funding risks and asset liquidity and certain operational risks faced by the firm. The formulae are conservative in their treatment of assets and liabilities. This conservatism, coupled with the higher early warning thresholds produces capital buffers that provide additional cover for other risks not expressly addressed, such as broader operational risks (e.g., reputational and legal risks). However, in common with many other jurisdictions, these latter risks are not specifically addressed in the capital formula. In particular, the recent crisis highlighted issues relating to the impact that reputational, funding and liquidity risks may have on regulated firms, particularly under stress. A re-evaluation of the capital rules, risk management expectations and other prudential requirements imposed on FCMs and BDs in light of recent circumstances is warranted. Further, the treatment of affiliate risk would bear reexamination and strengthening, through some combination of changes to the capital rule, enhanced risk management requirements or other regulatory or oversight mechanisms. In particular, all aspects of the exposure to risk at the regulated firm when a related company is in trouble may not be reflected fully. The SEC's temporary rules on reporting of affiliate exposures (Rules 17h-1T and s17h-2T) should be finalized as soon as possible, a project we also understand to be in train, although the assessors understand that their temporary status does not affect their enforceability. The current CFTC capital formula for firms registered with both the CFTC and SEC may not reflect fully the scope of the customer activity by both securities and futures customers as it only mandates the higher of the CFTC or SEC capital amounts—not the combined amount of the two sets of requirements. Because unsecured receivables associated with uncleared OTC positions are excluded as assets under regulatory capital rules, while payables are counted as liabilities, uncleared OTC derivatives are rarely carried in an entity registered as an FCM or BD (other than an OTC derivatives dealer). There are proposed changes to the futures capital rules to address gaps with respect to cleared OTC derivatives transactions and improve the sensitivity of the formula to the actual risks undertaken by the firm which would be helpful. The crisis brought to light weaknesses in the regime governing investment bank holding companies. The conversion of the remaining entities into bank holding companies has, in practice, eliminated the pressure to address these issues at the SEC level at the present time. The wider challenge of the effective supervision of global financial conglomerates is an issue in many jurisdictions. As noted by the Joint Report, the segregation and margining rules under the futures and securities regimes operate differently and serve different purposes. The treatment of the segregated accounts also differs on a bankruptcy. The introduction of risk-based portfolio margining where the margin requirements take into account offsetting positions in related instruments in one account highlight the need for reconciling the two regimes. Also, the recent crisis highlighted some concerns that the risks associated with custody of client assets may not be addressed fully. There are deductions for assets held at affiliates, but the risk of failure of other depositories holding client cash may not be fully reflected in the various applicable rules. For futures firms, margin requirements for particular contracts are set by the exchanges, not the CFTC. At the very least, the CFTC should have authority to review and approve/disapprove these requirements.

	The audit of a market intermediary may require someone who has experience in the area. Consideration should be given to requiring the audit partner in charge of the audit have some relevant experience. Specific information on the auditor used by a market intermediary should be obtained as part of the application process and tracked so that problem auditors may be identified more easily.
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk and under which management of the intermediary accepts primary responsibility for these matters.
Description	**CFTC** FCMs and IBs that are not guaranteed by an FCM are required to provide certified financial statements to the regulators prior to registration and on an ongoing basis. (See the description of the scope of the certification process described under Principle 21.) Further, FCMs may be required to provide the regulators with current organizational charts that identify affiliated persons; written policies, procedures or systems concerning methods for monitoring and controlling financial and operational risk, capital adequacy, internal controls with respect to market, credit and other risks relating to proprietary and non-customer clearing activities; and fiscal year-end consolidated financial statements. The ongoing review of the firms' internal controls etc. falls within the scope of the SRO audit and surveillance obligations. There is no requirement for an independent periodic evaluation of internal controls and risk management processes for FCMs and IBs other than those associated with the certified financial reporting requirements. FCMs must separately account for customer funds in their records and segregate these funds from their own funds and those of related persons. The amount in segregation must equal 100 percent of the gross account equity of all customers; the value of any under-margined account must be made up from the firm's own funds. FCMs may pool all customer funds in a single account that is clearly identified as belonging to customers. Customer funds must be deposited by the FCM with a bank, trust company, DCO, or another FCM and the depository must acknowledge that these are customer funds. The depository does not have to be at arm's length to the FCM and the other requirements do not address the risk of failure of a depository. Proprietary positions held at an affiliated depository may not exceed a specified threshold; assets above the threshold attract a 100 percent capital requirement. Segregation calculations must be done daily, any deficiencies rectified immediately and the FCM must give immediate notice to the CFTC and DSRO if it is not in compliance with these requirements. The only disclosure document required to be provided to clients is an extensive risk disclosure statement and the firm must keep the clients' signed acknowledgements of receipt of the statements. Customers generally may obtain written contracts, although the specific form and content of the agreement are not mandated. The NFA has a Know-Your-Customer (KYC) rule that is tailored to the requirements of the futures markets. Unlike the securities industry where investors can purchase instruments with varying degrees of risk and that serve very different investment objectives, all futures contracts are highly volatile and risky instruments. In the futures market, the suitability determination has to be made on a customer by customer basis rather than on a contract or transaction basis. The KYC rule requires extensive information about each customer be obtained before opening an account. Based on that information, the FCM has to make a judgment whether the customer requires additional risk disclosures beyond the standard information required by CFTC regulations or to refuse the account because futures trading are too risky for that customer. This standard applies even if the FCM makes no recommendations to the customer. Further, the NFA has a rule that governs both oral and written communications. Among other provisions, it prohibits misleading or high-pressure communications. FCMs must provide each customer with a monthly account statement regarding the details of transactions in the account, as well as charges and credits to the account. The FCM also must

	provide confirmation statements of each transaction by the next business day following the transaction. For customers of an IB, the carrying FCM provides these statements. CFTC regulations and NFA rules require each registrant (except an associated person with no supervisory duties) to “diligently supervise” the handling by its partners, officers, employees and agents of all activities relating to its business as a CFTC registrant. There is no requirement that any specific person or group have overall responsibility for compliance with regulatory and legal requirements. There is no requirement for a CCO at any futures intermediary. NFA rules do require that a principal subject to NFA jurisdiction be in charge of firm activities such as review of promotional material, review of financial statements and certification of annual questionnaires. There are extensive books and records requirements for FCMs and IBs. More limited requirements apply to CPOs and CTAs. Further, there are specific requirements that relate to customer protection, risk disclosure, financial and other recordkeeping and net capital compliance. However, the CEA and CFTC regulations do not require intermediaries to adopt specific internal and risk management controls outside of these requirements, nor do they require the testing of these controls, other than through the certification of financial statement requirements. The NFA requires its members to conduct a formal review of their operations on a yearly basis. With respect to risk management, the CFTC’s Risk Surveillance Group (RSG) conducts extensive review and analysis of risks posed by traders, FCMs, and DCOs, including assessment of their risk management practices. On a daily basis, the RSG endeavors: (i) to identify significant financial risks from positions in products that an FCM clears through a DCO and fall within the jurisdiction of the CFTC; and (ii) to confirm that such financial risks are being appropriately managed. The RSG undertakes these tasks at the trader level, the firm level and the clearing level. It identifies both traders that pose risks to FCMs and FCMs that pose risks to DCOs. It also reviews financial resources and risk management practices at traders, FCMs and DCOs. FCMs and IBs are required to establish and enforce internal rules, procedures and controls to ensure, to the extent possible, that orders received from customers are transmitted before any order in the same commodity for the benefit of a proprietary account. CTAs and CPOs are subject to mandatory conflict of interest disclosure requirements. There is no general requirement that would require all intermediaries to avoid, or establish procedures to mitigate, conflicts of interests with their clients. **SEC** There are rules that require all BDs to have appropriate controls in place to protect the interests of their clients and to manage risk properly. In addition, a BD that is an OTC derivatives dealer must have a system of controls to manage the full range of risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks. The SEC does not have specific standards that a BD’s risk management procedures and internal controls must meet. So long as the relevant systems in place at the BD facilitate its compliance, they are considered to be adequate by the SEC. Under FINRA rules, each firm must implement a supervisory system reasonably designed to achieve compliance with applicable securities requirements and that includes designation of one or more persons responsible for reviewing the BD’s supervisory system and taking action to achieve requisite level of compliance. FINRA requires a BD to appoint a chief compliance officer. IAs must disclose information on its management on Form “ADV.” They also must have in place CP&P and are required to appoint a chief compliance officer. All supervisors, including senior management, are subject to liability for failure to supervise. Every BD is required to periodically inspect all aspects of its business. An examination of the accounting system, the internal accounting controls, and the procedures for safeguarding securities are included in the scope of the annual audit and must be certified by the auditor, who must be registered with the PCAOB. Owing to some gaps in the relevant legislation, the PCAOB does not

	have authority to oversee the activities of a BD auditor. An IA's CCO is not independent, but must have enough seniority and authority to conduct an independent compliance review and compel others to comply with the CP&P. Only an IA with custody of client assets who chooses to send account statements directly to its clients must have an independent public accountant verify all of those funds and securities by actual examination at the custodian at least once each year. Other IAs do not to have their controls assessed or to report material breakdowns in controls to senior management or to the regulator. Generally BD customer agreements require that disputes be arbitrated. FINRA rules require its members to arbitrate any eligible dispute submitted by a customer. BDs are required to keep records of client complaints. An IA is not required to provide a particular mechanism for the resolution of investor complaints. Customers of IAs may have private rights of action under securities legislation or otherwise. Both the SEC and FINRA have extensive rules governing holding of client assets designed to ensure they remain separate from those of the BD—covering recordkeeping, segregation, use of free credit balances, and excess securities in margin accounts. See the description in Principle 21 regarding IA custody requirements. BDs must obtain KYC information regarding customers when accounts are opened, including the customer's employment status, net worth, annual income and investment objectives and for each cash and margin account, the name and address of the beneficial owner of the account. Also, BDs have an obligation to recommend only those specific investments or overall investment strategies that are suitable for their customers. The concept of suitability also appears in FINRA rules. Registered IAs must make a reasonable determination that the investment advice provided is suitable for the client based on the client's financial situation and investment objectives. AML requirements apply to BDs and some CIS, but not *IAs*. Written contracts are only required for certain types of BD accounts (e.g., margin, options, and discretionary accounts). In practice, many firms have a client agreement to ensure that they are able to enforce contractual provisions against the customer, such as arbitration clauses. FINRA requires prior written authorization for discretionary trading. The investment advisory contract is the basis for the relationship between the IA and its clients. The legal framework specifies items required to be or prohibited from being included in an investment advisory contract, but there is no prescribed form of contract. BDs must provide clients with specific risk disclosure statements for certain types of trading (such as options and futures) in the secondary market. They also must make available prospectuses for new issues and conflict of interest disclosure statements. A BD is required to send its customers written trade confirmations, account statements (monthly if options are held, otherwise quarterly) and other reports disclosing activities and transactions it has taken on the customer's behalf. Registered IAs are not required by statute to provide their clients with any specific documents etc. other than Part II of Form "ADV." An IA's duty to provide other documents to its clients (such as confirmations, statements and proxy related materials for securities held in the account) depend on the terms of its client contracts. There is no general requirement that IAs send account statements to their clients. The BD that is used to carry out trades would be responsible for generating these documents. However, many IAs do send monthly or quarterly client account statements. Only IAs who hold client assets must send statements at least quarterly setting out specific information about the client's assets and transactions during the period. The SEC and FINRA have detailed rules regarding the books and records that a BD must keep. BDs are required to maintain these books and records for specific periods of time and to produce such records promptly to examiners. There are also simpler recordkeeping requirements imposed on IAs to maintain business accounting records as well as those that relate to the fiduciary nature of its business.

	A BD has a duty of fair dealing towards its customers and is also required under FINRA rules to observe high standards of commercial honor and just and equitable principles of trade, which include the suitability obligation, engaging in fair and balanced communications with the public, providing timely and adequate confirmation of transactions, providing account statement disclosures, receiving fair compensation, disclosing material information, charging prices reasonably related to the prevailing market, fully disclosing any conflicts of interest and giving customers the opportunity to resolve disputes through arbitration. There also are requirements to limit conflicts of interest on investment research. Further, BDs must disclose to their customers if they have any control, affiliation or interest in a security they are offering or with the issuer of the security. Finally, a BD has a legal duty to seek to obtain best execution of customer orders. A BD may have a fiduciary duty to its clients under certain circumstances, either under state common law which varies by state, or otherwise. Generally, courts have held that BDs that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a broad fiduciary duty similar to that imposed on IAs. An IA is subject to a fiduciary duty to act in the utmost good faith with respect to its clients. An IA is required to treat all clients fairly where conflicts of interest arise between several of the firm's clients and have written procedures in place to prevent the misuse of material non-public information by the IA or any associated person.
Assessment	Broadly implemented.
Comments	Given the experiences of the recent crisis, a reexamination of the risk management expectations for BDs and FCMs, particularly with regard to management of liquidity, funding, and reputational risks, is warranted. All licensed futures intermediaries (FCMs, IBs, CPOs, and CTAs) should be required to avoid, or establish procedures to mitigate, conflicts of interests with their clients. FCMs and IBs should be required to disclose conflicts of interest to their clients. There may be a need to reassess the disclosure provided to investors regarding complex structured products, to ensure they receive sufficient current information to make informed investment decisions. (See also Principle 14.) See the comment above under Principles 17 and 21 regarding IAs holding client assets at non-arm's length custodians. Note also, that very few IAs are subject to any sort of audit requirement so there is no routine outside confirmation (other than by the SEC through its examination program) that they have the appropriate internal controls in place, even to ensure the requirements regarding not holding client assets are observed. However, for those IAs that are also operators of CIS subject to the ICA, some additional review of the appropriateness of internal controls comes from the CIS board (including its independent directors), the CCO, and periodic certification by CIS officers with respect to certain internal controls. See also the comments above under Principle 22 regarding the general risks associated with where the client assets are held and the lack of limitations that apply if the depository is at arm's length to the FCM or BD.
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	**CFTC** The CFTC has a contingency plan in place to address failures of FCMs. The CEA and CFTC regulations, in conjunction with the Bankruptcy Code, provide a clear framework for the CFTC to follow in managing the failure of an FCM. Part 190 of the CFTC's regulations and Chapter 7, Subchapter IV of the Bankruptcy Code specifically addresses failures of commodity brokers, including FCMs. The CFTC may apply to court for the appointment of a receiver. Customers of a

	failed firm are notified as part of the process under the framework. The FCM must notify the CFTC upon the occurrence of one of a number of events, any of which may indicate financial distress. CFTC has the power to restrict activities of an FCM in financial difficulty, require accounts to be transferred or apply to have assets frozen or for the appointment of a receiver/monitor etc. Derivatives Clearing Organizations (DCOs) also have default rules and processes in place to manage the obligations of failing/failed FCMs to minimize the impact of the failure on other participants. These rules may permit the DCO to access a guarantee fund held at the DCO. These default procedures include notices to other participants. As a matter of practice, on a failure there are frequent conference calls among affected regulators and exchanges, both domestic and foreign. **SEC** There is a contingency plan at the SEC for responding to a BD failure. If the SEC staff have concerns about a broker-dealer they will send examiners into the firm to determine if a self-liquidation is possible. If a firm's net capital falls below the required level, the firm must immediately cease doing securities business and must give notice to SEC and its SRO. If a BD fails or is in danger of failing to meet its obligations to customers and the firm is insolvent or not in compliance with applicable financial responsibility rules, the BD will be liquidated under SIPA if a self-liquidation is not possible. As far as possible, client accounts are transferred quickly to another firm. There is no general disclosure requirement that would apply to all cases of financial difficulty. If the firm is a public company, the usual prompt public disclosure of material change standard would apply. Also, a BD is required to tell clients if their accounts have been transferred. SIPC is available to compensate investors if their assets or cash are not available when a BD fails. SIPC does not cover IAs. The legislation does not provide expressly for the SEC to take action if an IA is in financial difficulty. The SEC only has the power to intervene if an IA's financial difficulties are related to a violation of the federal securities laws. If so, the SEC can request that a federal court appoint a monitor, receiver, curator or other administrator. The SEC would not provide notice to an IA's clients or the general public about an IA's financial condition. Information about an IA's financial condition may otherwise be public via Form "ADV" disclosures as IA may have obligations to disclose it is in 'precarious financial condition'. See the detailed discussions under Principles 11 and 12 regarding cooperation with other regulators. For example, on the failure of the Lehman Brothers group, there were daily conversations among the regulators involved in winding up the regulated firms.
Assessment	Fully implemented.
Comments	The crisis brought to light weaknesses in the regime governing investment bank holding companies. The conversion of the remaining entities into bank holding companies has, in practice, eliminated the pressure to address these issues at the SEC level at the present time. As noted by the Joint Report, the treatment of segregated accounts under the futures and securities regimes differs on a bankruptcy. The introduction of risk-based portfolio margining and greater overlap between futures and securities activities highlight the need for reconciling the two regimes.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

Description	See Principle 7 for a description of the legislative and regulatory framework governing authorization and oversight of SROs generally, including exchanges. **CFTC** Apart for the exceptions described below, any market that seeks to provide a trading facility to trade futures, options on futures or options on commodities must apply to the CFTC to become a DCM. The CFTC analyzes the DCM application before deciding to grant or reject the application. The CEA establishes the basis for requiring markets to register. Criteria, procedures, and requirements for designation as a DCM are set out in the CEA and CFTC regulations. A DCM may list for trading futures or option contracts based on any underlying commodity, index, or instrument. However, there are special requirements for security futures products, which are subject to joint CFTC/SEC oversight under rules promulgated by these agencies in 2001. One category of trading system is not subject to regulatory authorisation as required by the Principle Methodology—ECM and another category is exempt from both authorisation and oversight—EBOT. ECMs are merely required to notify the CFTC that they intend to operate under the exemption provided in Section 2(h)(3) of the CEA and they must comply with the requirements of the exemption provision. An ECM becomes a registered entity, like a DCM, and is subject to greater oversight by the CFTC only after the CFTC makes a formal determination that a contract traded on an ECM is an SPDC. This determination has been made for one contract on one ECM. For EBOTs, the only requirements that apply are limited anti-fraud and anti-manipulation provisions. Under the CFTC's regulations, an applicant for contract market designation must provide substantial documentation for the CFTC's approval. A DCM is required to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market and any other persons with direct access to the facility. DCMs are required to adopt and enforce rules for ensuring the financial integrity of transactions and the market integrity of the trading mechanism. The CFTC provides detailed guidance on all areas of the designation criteria as to the standards it expects an applicant for designation to meet. The CFTC has further stated that it believes that the guidelines issued by IOSCO in 1990 ("Principles for Screen-Based Trading Systems") and adopted by the CFTC on November 21,1990 as supplemented in October, 2000, are appropriate guidelines for an electronic trading facility to apply to electronic trading systems. As regards new products and new or amended rules, the CFTC is required to be informed of the types of products to be traded through the two listing methods—self-certification (as discussed under Principle 7) and CFTC prior approval. The latter is only mandatory for certain listed agricultural commodities. There are also formal listing requirements that must be satisfied for security futures products as part of joint CFTC/SEC oversight. Except for certain enumerated agricultural commodities a DCM may also implement most new rules and rule amendments by self certification. Fair access to the exchange is established via Designation Criteria, Core Principles, Acceptable Practices, and CFTC-adopted guidance. As regards competition, a DCM must endeavour to avoid, unless necessary or appropriate to achieve the purposes of the CEA, adopting any rules or taking any actions that result in any unreasonable restraints of trade; or imposing any material anticompetitive burden on trading on the contract market. The fairness, consistency and transparency of order routing procedures and execution rules are set out in the Designation Criteria, Core Principles, and CFTC guidance. A DCM is required to store all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

	SEC **Exchange Trading Systems** An exchange must register with the SEC as a national securities exchange, or be exempt from registration, before it may begin operations. The Exchange Act sets forth the SEC's responsibilities and obligations upon the filing of an exchange application. Once registered, a national securities exchange becomes an SRO. See Principle 7 for a description of the legislative and regulatory framework governing authorization and oversight of SROs generally. In addition to the rules that applies to SROs generally as set out under Principle 7, the SEC reviews exchange applications against criteria specific to the provision of a secondary market, such as relevant information about the operators of any electronic trading system that is used to effect transactions; the operation of the trading system, including, among other things, the means of access; the procedures for entering and displaying quotes; procedures for order routing and execution and reporting; and clearing and settling transactions for reliability, resilience, and fairness; record keeping; and emergency powers. The SEC seeks to ensure, among other things, that an applicant's rules do not confer unfair trading advantages of members over non-members, or investors generally. The SEC also requires, among other things, a list of members and a schedule of all securities listed on the exchange or association; all securities traded on the exchange or association pursuant to unlisted trading privileges; all securities exempt from registration and traded on the exchange or association; and other securities traded on the exchange or association. In addition to satisfying the requirements of the Exchange Act, a prospective exchange or association must demonstrate to the satisfaction of the SEC prior to authorization its ability to operate as part of the national market system as set out in Regulation National Market System (NMS). Regulation NMS contains rules that, among other things, require trading centers to avoid trading through the protected quotations of other trading centers that display automated quotations. **Non-exchange Trading Systems** In addition to exchanges and associations, ATSs operate electronic trading markets. An ATS can register as an exchange or a BD. If an ATS chooses to register as a BD, it must be a member of an SRO and comply with additional reporting and record-keeping requirements set out under Regulation ATS. Like any other BD, an ATS must have sufficient clearing capabilities in place by either becoming a member of a registered clearing agency, or being affiliated with a member of a registered clearing agency through which the ATS can clear and settle trades. ATSs registered as BDs are subject to FINRA rules in addition to Regulation ATS and other SEC rules governing BDs. An ATS that trades 5 percent or more of the volume in a national market system security must: • be linked to a national securities exchange or registered securities association so that the best priced orders in that security that are placed in the ATS and are displayed to more than one subscriber are also disseminated into the public quote stream and provide access to such orders that is equivalent to that of other orders displayed by the exchange or association; and establish objective standards to grant or deny access to the trading system (with respect to that security) and apply them in a non-discriminatory manner. In addition, an ATS must comply with the rules that govern execution priority and obligations that are imposed by the SRO to which the ATS is linked. If an ATS has 20 percent or more of the trading volume in any single national market system security, the ATS must follow certain procedures to ensure adequate systems capacity, integrity, and contingency planning. Currently, no ATS has reached this threshold and in some cases, actively manage their system to avoid exceeding the 20 percent limit.

	Cross Trading System Issues Continued compliance with the initial registration requirements is a condition for continued registration. Registered exchanges and associations are required to maintain rules, policies and procedures consistent with their statutory obligations and to have the capacity to carry out their obligations and prevent fraudulent and manipulative acts and practices. ATSs that meet the volume thresholds in the rules must publicly disseminate their best priced orders, limit the fees they charge, and satisfy certain system capacity, integrity, and security standards. The SEC has an Automation Review Program (ARP). Staff conducts reviews on application and subsequently (at least annually) of the information technology systems operated by the exchanges, clearing agencies and certain ATSs that publicly display quotations (electronic communications networks or "ECNs") to evaluate whether the systems have sufficient capacity and resiliency to accommodate conditions of increased volume and disruptions to normal operations. All exchanges and ATSs are required to have rule and procedures governing audit trails to aid in the surveillance of their market. In general, an audit trail requires information about the parties to the trade, the security, the type of order, the time of the trade, the number of shares to which the order applies and the price of the trade. Exchanges and ATSs are required to make available to the public monthly electronic reports that include uniform statistical measures of execution quality. FINRA and the SEC have emergency powers, including trading halts, trading suspensions, and the SEC's emergency authority and market closure decisions. The exchanges can impose trading halts and suspensions for a variety of reasons. An exchange also has the authority to suspend trading in all securities on that market, adopt abbreviated trading hours or close the exchange if such actions would be in the public interest. The listing standards of the exchanges address when a listed company is required to notify the exchange of certain material events. The listing of new products is normally subject to the rule filing and approval process described in Principle 7. However, the SEC allows certain new derivative securities products to be listed without a proposed rule change if: • the product meets the definition of "new derivative securities product" set out in the rule; • the exchange that introduces the product has established generic trading rules, procedures and listing standards for the product class that would include the new derivatives securities product; and • the SEC has approved the SRO's standards. The SEC also has the power to issue rules governing the trading of a product, rather than reviewing proposed rules filed by an SRO. It also has broad authority to amend the rules of an SRO as it deems necessary or appropriate to insure the fair administration of the SRO and to conform its rules to the requirements of the Exchange Act. **Fair Access** As discussed under Principle 7, an exchange or association's ability to deny membership to its market is limited. ATSs are required to provide fair access to their systems only if they meet certain volume thresholds. For example, an ATS is subject to fair access with respect to a national market system stock only if it trades five percent or more of the stock's average daily volume over four of the previous six months. The SEC has provided a broader exemption for one ATS using its exemptive authority under the Exchange Act.
Assessment	Broadly implemented.
Comments	**CFTC** The powers of the CFTC over the authorization of DCMs raise no significant issues as regards the

	IOSCO Principles. Issues concerning oversight are dealt with under Principle 7. However, the lack of an authorization power over ECMs and Exempt Boards of Trade (EBOTs) is not consistent with Principle 25. It should be noted that under the OTC derivatives legislation recently passed by the U.S. House of Representatives, and in the discussion draft versions of OTC legislation offered by the U.S. Senate Banking Committee, both the ECM and EBOT market categories would be abolished. Ongoing oversight, at least of ECMs, is no longer a significant issue, as discussed under Principle 26. **SEC** Based on data published by the SEC and discussions with market participants, the assessors have concluded that the authorization provisions currently applied to some non-exchange trading systems do not fully meet the standards of Principle 25 concerning adequate transparency. The problem lies in the rules governing exchanges and alternative trading systems, known as Regulation ATS, which were introduced in 1998, and in particular the impact on pre-trade transparency, or the publication of best bids and best offers to investors and market participants generally, of the 5 percent rule described above. As IOSCO has observed, "*The wide availability of information on bids and offers is a central factor in ensuring price discovery and in strengthening users' confidence that they will be able to trade at fair prices. This confidence should, in turn, increase the incentive of buyers and sellers to participate, facilitate liquidity, and stimulate competitive pricing.*" The number of active ATS authorized by the SEC, operating under the 5 percent rule (so called "dark pools") and trading NMS stocks has increased from approximately 10 in 2002 to approximately 32 in September 2009. At that time, the trading volume of these dark pools was estimated by the SEC as approximately 7.9 percent of the total share volume in NMS stocks, One consulting firm has put it as high as 12 percent. As the SEC has observed, "*Given this dispersal of volume among a large number of trading venues, dark pools collectively represent a significant source of liquidity in NMS stocks.*" The SEC has published proposed rule changes to reduce the 5 percent limit to a mere 0.25 percent and to extend the definition of an order to cover so called "actionable indications of interest" which are currently being used by some dark pool ATSs and others as a way around the 5 percent limit. The SEC has also proposed exemptions for large orders to enable institutions which trade in large size to execute their orders with other similar sized institutions without causing damaging market impact or short term volatility effects. These proposed rule changes, if implemented, would appear to meet the Principle 25 benchmark that authorization requirements for exchanges and other trading systems provide for adequate transparency. See also the comments under Principle 27.
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	**CFTC** The CFTC monitors DCMs and ECMs that trade SPDCs (as determined by the CFTC based on price linkage, arbitrage, material price reference and material liquidity) on an ongoing basis through compliance reporting and "for cause" inquiries. CFTC staff also periodically reviews the programs and procedures adopted by each DCM to ensure compliance with the relevant core principles and to assess the effectiveness of those rules and procedures. A recent amendment to the CEA has given the CFTC powers of ongoing oversight of ECMs in certain circumstances. The CFTC is now empowered to require that ECMs which trade SPDCs comply with 9 Core Principles concerning transparency, anti-manipulation, position limits or accountability levels. The amendment does not apply to EBOTs. The CFTC has emergency authority to direct a DCM or ECM to maintain or restore orderly trading

	in or liquidation of any futures contract. The CEA authorizes the CFTC to alter or supplement the rules of a DCM under certain circumstances. The CFTC has the power to suspend or revoke a DCM's designation. **SEC** In most cases, trading rules must be pre-approved. There are limited exceptions that permit trading rules to be filed on an immediately effective basis, such as where they are substantially similar to a rule of another exchange. However, the SEC can block a rule from becoming immediately effective for up to 60 days after it was filed, which essentially means the proposal is required to go through the regular notice and approval process. The SEC reviews a proposed rule against the requirements in the Exchange Act and regulations and must take account of the views of respondents to the mandatory public consultation process. A proposed rule change is not approved unless it is consistent with the Exchange Act. Ongoing supervision is carried out by SEC staff which conduct several types of examinations and inspections including routine or cycle examinations and inspections, which test an entity's compliance with applicable laws and regulations; "for cause" examinations and inspections and risk-targeted examination sweeps, that focus on particular compliance risks. These include the staff's inspections of the exchange's regulatory programs, including their examination, surveillance, investigative and enforcement programs, among others. The SEC has the authority to inspect exchanges, associations, ATSs and other market participants to determine whether the various anti-fraud, anti-manipulation and reporting regulations are being complied with. The SEC can also obtain surveillance and/or trading data from the SROs. An exchange or association must have procedures to survey its market and its members for securities laws violations, including violations of the exchange's own rules. The SEC considers on an on-going basis whether an exchange has adequate surveillance measures, as well as sufficient resources, including staff expertise and capital, to monitor its markets. See Principle 29 for a detailed description of the SEC's oversight of clearing organizations. The exchanges are required to maintain certain operational capability standards such that market participants can be confident in the exchanges' ability to handle the foreseeable volume of securities transactions directed to them. The SEC requires that exchanges have adequate computer system capacity, integrity and security to support the operation of their markets. In addition to reviewing the systems capability of an exchange, the SEC will consider whether an exchange has sufficient capital to maintain its automated systems and staff with technical expertise. The exchanges are also required to have rules that preserve the integrity of the market and that protect against risks to market integrity. While the Exchange Act does not set out minimum levels of funding for maintaining the self-regulatory function, the SEC has considered the funding of the self-regulatory functions of an exchange in the context of recent exchange demutualizations. In these filings, the SEC has sought to ensure that fees, fines, or dues collected by an exchange are not used for commercial purposes and that mechanisms have been established that are designed to ensure a proper level of funding of the self regulatory function. The SEC has the authority under the Exchange Act to cancel, suspend or revoke the registration of an exchange or association. The Exchange Act provides the SEC with the authority to impose penalties on exchanges or associations and their members for violations of the federal securities laws and/or SRO rules. Specifically, the SEC has the authority to suspend or revoke the registration of an SRO; censure or impose limitations on its activities; and remove from office or censure officers or directors of an SRO for violations of the Exchange Act or the SRO's rules. The SEC also has the authority to suspend or expel any member or person associated with a member from an SRO for violations of the federal securities laws or rules. The SEC has the authority to enforce an SRO's rules and to compel an SRO to enforce its rules with regard to its members.

Assessment	Fully implemented.
Comments	The CFTC has issued guidance on how DCMs might comply with the Core Principles and has also described acceptable practices to achieve the same end. Some have argued that this limits the extent to which DCMs are able to diverge significantly from what the CFTC believes to be appropriate. The assessors are not persuaded of this. It is also argued that the move to a principles-based approach has enabled CFTC staff to focus more on the risk management and controls of a DCM rather than engaging in what can become a "tick box" approach of a conventional rule-based examination, which can overlook important systemic issues. This argument may have more merit. If changes are to be made it will be important to ensure that an efficient and effective balance is struck. As regards ongoing regulatory supervision of ECMs, the CFTC has been successful in obtaining legislative amendments which empower it to ensure that, in markets where the CFTC determines that ECMs are significant, they operate in an orderly and transparent manner. A separate issue in the authorization and oversight of exchanges and trading systems is that of capital. Unlike for BDs or FCMs, there are no explicit capital requirements for exchanges at the application or operational stages. The IOSCO Principles are silent on the matter except where an exchange takes principal risk. This situation is unusual, although in the case of most DCMs which are part of groups with integrated clearing organizations, affiliate risk is an issue. In the absence of explicit amounts of required capital, the staffs of the Commissions are required to make judgments as to whether the overall financial resources of the exchanges they monitor are adequate to maintain all their commercial and regulatory functions, staffing levels and IT expenses. The SEC focuses on two aspects, IT capacity and resilience and funding of the self-regulatory functions, although there are other demands on financial resources. The issue of financial resources has been growing in importance with demutualization of existing exchanges and the growing number of new exchanges in futures and derivatives where ownership is concentrated and the owners are themselves "for profit" entities that may assume significant principal risk in their main businesses. Where they are firms active in capital markets, their profit and loss profiles are likely to strongly correlate with the profit and loss profiles of the exchanges they are acquiring or establishing, which might expose an exchange to sudden commercially driven financial pressures in a crisis. Under the principles-based approach employed by the CFTC, it is not clear precisely what the CFTC's powers are in this area and staff are working with Congress to get explicit statutory authority to impose financial resource requirements on DCMs.
Principle 27.	Regulation should promote transparency of trading.
Description	**CFTC** Transparency is mandated by the CEA and CFTC regulations which require transparency and fair treatment. Core Principle 8 requires a DCM to make public daily information on settlement prices, volume, open interest and open and closing ranges for actively traded contracts. Regulation 16.01 requires the DCM to report specified information no later than the business day following the day to which the information pertains. In practice, exchanges publicly disseminate trade data, including last transaction price and size and current bid and offer information, on both a real time (generally for a fee) and delayed basis for free (the delay is at most ten minutes). Third-party data providers typically aggregate and publish data for all exchanges, not just contracts traded on a single exchange. At least one exchange posts quote data on its website on a real-time basis, including the bid-ask spread and the size of the bids and asks, for all of its contracts. The CFTC has generally found these methods of data dissemination acceptable and the only issue that occasionally raises concern is whether exchanges are providing data to third-party vendors on a fair and equitable basis. As regards ECMs, to date the CFTC has determined that only one contract traded on an ECM is a significant price discovery contract. The ECM publishes delayed quotes for this contract for free.

	Real-time quotes for this product are available by subscription. **SEC** **Equity/option markets** The SEC administers a system for pre- and post-trade transparency for securities traded on exchanges (both equities and options). Over-the-counter trades in national market system equity securities are also covered by that system. Exchange rules require real-time reporting of transactions occurring on the exchanges and FINRA rules require real-time reporting of transactions in equity securities occurring in the OTC market. The dissemination of pre- and post-trade information for equities and options is governed by national market system plans (Plans) that operate in accordance with the Exchange Act. The text of the Plan or amendment thereto must be filed with the SEC. No Plan or amendment is effective unless approved by the SEC, with some limited exceptions for routine filings. The exchanges and FINRA submit all transaction information to the relevant Plan processor for immediate public dissemination. Similarly, exchanges collect order and quotation information from their members and submit their best bids and offers and associated sizes to the relevant Plan processor. Information collected by the Plans is widely disseminated via subscription. Subscriptions must be on terms that are fair and reasonable and not unreasonably discriminatory. Exchanges can offer proprietary market data products via subscription, but offering such products does not eliminate their duties to contribute real-time data to the Plans. Such subscription products must also be offered on terms that are fair and reasonable and not unreasonably discriminatory. Quotes from OTC market-makers whose executed volume in a security is one percent or less of the aggregate trading volume in such security and quotes on ATS that trade less than five percent of the volume in a national market system security are not subject to consolidation and public dissemination through the Plans. One "dark pool" ATS operates under a 20 percent limit approved by the SEC in 2005. The number of active "dark pools" trading NMS stocks has risen from approximately 10 in 2002 to approximately 29 in 2009. For the second quarter of 2009, according to the SEC, the trading volume of these dark pools was approximately 7.2 percent of the total traded volume in NMS stocks. **Debt markets.** In addition, comprehensive systems for post-trade transparency exist for corporate debt securities (through the TRACE system administered by FINRA) and municipal debt securities (through the RTRS system administered by the MSRB). In government securities there is limited pre-trade transparency but no mandatory trade publication. These markets are OTC dealer markets with no central exchange. Their detailed transparency requirements are public and have been intensively negotiated and researched over recent years.
Assessment	Fully implemented
Comments	**CFTC** The CEA and CFTC regulations have not been updated to reflect modern concepts of timely publication. However, consistent with Principle 27, the practice in futures markets is real time publication. A short delay for free publication is the normal practice in many jurisdictions. Derogations for block trades and other trades involving the interaction of futures with cash commodities and swaps appear reasonable. Since the markets the CFTC supervises are all on exchange, as required by the CEA, OTC business, whether carried on by telephone or otherwise, is not an issue as it is in securities markets, nor, until recently, have similar contracts been listed on more than one DCM/ECM. The current exclusion of swap transactions from oversight by the CFTC (or the SEC) and therefore the opacity of this market is a matter of current legislative and regulatory debate. **SEC** In making a judgment as to whether the regulation of the U.S. equity market fully meets the

	IOSCO benchmark that there be requirements or arrangements for providing pre-trade (e.g., posting of bids and offers) and post-trade (e.g., last sale price and volume of transaction) information to market participants on a timely basis, the assessors had to balance several issues. In their view: • As regards post trade transparency the SEC's requirements fully meet the standard. • SEC requirements for pre-trade transparency or publicly displayed liquidity, that is bids and offers submitted to and displayed by trading venues such as exchanges, displayed ATSs and ECNs, fully meet the standard. This is estimated to amount to 75 percent of total liquidity in NMS stocks (September 2009). According to most independent research, full implementation of Regulation NMS in October 2007 generated a significant increase in publicly displayed pre-trade transparency. • A substantial amount of liquidity is not publicly displayed. The SEC believes that this amounted to 25 percent of total liquidity in September 2009. Dark pool ATSs authorized by the SEC under Regulation ATS are one component of this non-publicly displayed liquidity. Internalization of client order flow by BDs is another. The percentage may have grown by more than 20 percent between September 2008 and September 2009 according to some industry estimates. The reasons for this growth are disputed—indeed some query whether there has been an increase at all. However, the SEC is concerned about the issue and its impact on investors. In the November 2009 release proposing rule changes for dark pools (Regulation of Non-Public Trading Interest) referred to in Principle 25 the SEC sets out, repeatedly, its fears that a two-tier market may be emerging that provides valuable order information on the best prices for NMS stocks only to selected market participants. So, for example, the National Best Bid and Offer (NBBO) or publicly displayed best quote in 1000 shares may be US$5.25 to 29. A dark pool may have a BBO of US$5.26 to 28 in the same size but these better prices are only transparent to, and available for trading by, clients of the dark pool operator. As the SEC has stated, its proposed rule changes are intended to "*to promote the Exchange Act goals of transparency, fairness, and efficiency.*" In the judgment of the assessors, taking account of the three elements of transparency set out above the issue as to whether the Principle has been fully implemented in U.S. equity markets is finely balanced. However, on balance the assessors' view is that the IOSCO benchmark is met. In addition to the proposed dark pool rule changes the SEC issued, in February 2010, a Concept Paper on Equity Market Structure in which it seeks public comment on a wide range of market structure issues that have arisen in recent years, including high frequency trading, order routing, market data linkages, and undisplayed or dark liquidity. The commission intends to use the public's comments to help determine whether regulatory initiatives to improve the current equity market structure are needed and, if so, the specific nature of such initiatives. This is a timely exercise. The assessors have observed that well financed lobbying on these issues has begun. Historically, market regulation has been viewed by many broker dealers, exchanges ad trading system operators as a competitive tool. This phenomenon is not limited to the United States. There is therefore a high probability that data provided by various major market participants will support their own business models and seek to denigrate their competitors' as will the rationales they claim their data "proves." Thus, it is vitally important that, in evaluating the responses, the SEC directly obtains comprehensive raw data on what is actually happening in the equity market, where and when trades are being done, at what prices and with what impact on investors of all classes in order to reach correct conclusions. As observed under Principle 3, the SEC's ability to make policy determinations would be enhanced by a greater use of its authority to request raw data and to develop empirical analysis based on this data rather than relying on data generated and processed by exchanges, SROs and others. See also the comments under Principle 25.

Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	**CFTC** In general, Section 4b of the CEA makes it unlawful to cheat or defraud in connection with futures contracts. The CEA also prohibits fictitious trading or trading which would cause the market to reflect a price that is not "*true and bona fide*." As regards insider trading, the CEA provides an explicit but limited scope prohibition against insider trading for certain persons and not for persons generally as is the case in the securities market The CFTC has its own comprehensive market surveillance program to detect and prevent market manipulation. The CFTC's market surveillance program uses many sources of market information to accomplish its objectives. Some of this information is publicly available and some of the information is highly confidential, which includes data from exchanges, intermediaries and large traders. The CFTC is currently in the process of significantly upgrading this system to enhance its ability to detect trade practice violations, including wash trading and trading ahead. When problems develop, surveillance economists prepare weekly summary reports of futures and option contracts for regional surveillance supervisors, who immediately review these reports. Surveillance staff informs the CFTC and senior staff of potential problems and significant market developments at weekly surveillance meetings so that they will be prepared to take prompt action when necessary. Reports and briefings are prepared more often, as needed. The market surveillance process is not conducted exclusively at the CFTC. Surveillance issues are usually handled jointly by the CFTC and the appropriate exchange. If an exchange fails to take actions that the CFTC deems appropriate, the agency has broad emergency powers under which it can order the exchange to take actions specified by the CFTC. Such actions could include imposing or reducing limits on positions, requiring the liquidation of positions, extending a delivery period, or closing a market. As regards domestic cross-market trading issues, there are numerous mechanisms and structures by which information can be shared and cooperation achieved. The Inter-market Surveillance Group (ISG) provides a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential inter-market manipulations and trading abuses. The CEA provides for robust sanctions in administrative and civil cases of manipulation and other unfair trading practices which serve the twin purposes of punishing the wrongdoer and deterring misconduct by others, all in an effort to protect the integrity of the futures market. The sanctions apply across all markets within the CFTC's jurisdiction and to registrants and non-registrants alike. These sanctions include: trading bans, registration sanctions, restitution, disgorgement, fines, preliminary and permanent injunctions, and cease and desist orders. In addition to the civil remedies and penalties available to the CFTC, manipulation, cornering, conversion, false statements to a registered entity or to the CFTC and all other willful violations of the CEA and regulations are also felonies that may be prosecuted by the DOJ and are punishable by a fine of up to US$1 million or imprisonment for up to ten years or both. **SEC** The SEC is an operationally independent agency and brings enforcement cases in the civil and administrative arenas based on the facts and evidence, as appropriate. The U.S. federal securities laws prohibit market participants from engaging in fraud. The Exchange Act prohibits the full range of manipulative, fraudulent and deceptive practices such as price manipulation, disseminating misleading information, insider trading, front running and other activities. In addition to the Exchange Act's broad anti-fraud provisions, the Securities Act, Advisers Act, and ICA all contain anti-fraud provisions which provide a meaningful and useful arsenal for combating

fraud across sectors of the securities industry. Charges may be brought under any or all of these provisions in, for example, a manipulation case depending on the facts and evidence. The anti-fraud provisions of each of these Acts operate in a complementary, not duplicative, manner.

The federal securities laws empower the SEC to prescribe rules that it deems necessary and appropriate to protect investors and the public interest. These requirements and prohibitions are supplemented by rules of the SROs.

Laws in the United States are developed and established through the judicial system as well as through legislation. The broad anti-fraud provisions of the Exchange Act make it unlawful to engage in fraud or misrepresentation in connection with the purchase or sale of a security. It is well established in case law that illegal insider trading is a violation of the anti-fraud provisions of the Exchange Act. Interpretations of the anti-fraud provisions by federal courts provide valuable flexibility for the successful prosecution of new schemes for insider trading. The definition of what constitutes illegal insider trading can and has evolved through case law. This process provides the SEC with the agility to attack novel insider trading schemes head on. The typical theories used in insider trading cases, classical and misappropriation theories, are examples of the successful evolution of federal case law in this area and are well-accepted theories across the federal courts, including the U.S. Supreme Court.

The SEC regularly brings insider trading enforcement actions against:

- Corporate officers, directors, and employees who traded the corporation’s securities after learning of significant corporate developments.
- Friends, business associates, family members, and other “tippees” of such officers, directors, and employees, who traded the securities after receiving such information.
- Other persons who misappropriated and took advantage of confidential information from their employers.

Where the SEC identifies a possible gap in judicial interpretation of securities law, it has the ability to seek to close that gap through rulemaking. For example, because issuer selective disclosure bears a close resemblance to “tipping” and insider trading and their adverse market effects are essentially the same, the SEC promulgated Regulation FD. Regulation FD targets the practice of issuer selective disclosure by establishing requirements for full and fair disclosure by public companies

In addition, the Exchange Act imposes liability for short-swing profits in the issuer’s stock upon all persons required to file reports under Section 16(a) of the Exchange Act (officers, directors, and beneficial owners of more than ten percent of any class of equity security). These statutory insiders must disgorge to the issuer any profit realized as a result of a purchase and sale or sale and purchase of covered equity securities occurring within a six-month period.

The SEC investigates and enforces a wide variety of misconduct under the anti-fraud provisions of the Exchange Act. Examples of these fraudulent practices and market abuses include: inter-positioning, front running, unauthorized trading in customer accounts, undisclosed revenue sharing, breach of best execution, excessive mark-ups, suitability violations and a variety of colloquially described activities involving “boiler rooms,” “churning,” “scalping,” “pump and dump” and other forms of manipulative schemes. Hacking into client accounts at on-line brokerage firms and trading in their accounts has emerged as a problem in recent years. The Enforcement Division has brought many cases addressing this and other forms of securities fraud stemming from on-line activities and new technology.

With respect to gathering and analyzing information, monitoring market participants, and generating alerts, the SROs collect and analyze information relating to trading activities. Exchange and FINRA systems capture order details throughout the lifecycle of a trade. Unusual trading activity is reviewed to determine whether fraudulent activity is occurring. FINRA spends more than US$30 million per annum on market surveillance technology necessary to keep pace with market developments. Market surveillance by NYSE Regulation is estimated to cost

US$62 million in 2009 with a further increase scheduled for 2010. The SROs may take remedial action for violations of such rules or refer violations of federal securities laws to the SEC. The SEC also has an office within the Division of Enforcement that monitors the markets for suspicious activity. This office serves as a liaison for the SROs, each of which has primary responsibility for monitoring their respective markets. The SEC and SROs work closely and collaboratively in exchanging information regarding suspicious market activity. The SEC's surveillance systems technology requires significant investment to bring it up to date.

Cross market issues are dealt with under the auspices of the ISG. See reference above under CFTC. As regards other foreign linkages, see the description and comments under Principle 13.

As to whether the sanctions available for violations are effective, proportionate and dissuasive, in fiscal year 2008, the SEC brought 671 enforcement cases, which was its second highest number in history. Additionally, in fiscal year 2008, the SEC obtained orders in judicial and administrative proceedings requiring securities violators to disgorge illegal profits of approximately US$774 million and to pay penalties of approximately US$256 million.

The SEC is responsible for civil enforcement of the federal securities laws. In addition to the significant number of civil cases the SEC brought in fiscal year 2009, criminal prosecutors filed indictments, informations, or contempt charges in 154 SEC-related criminal cases. In fiscal year 2008, criminal prosecutors brought 108 SEC-related cases.

The SEC files its cases in U.S. federal courts and in administrative proceedings. As in other civil cases, the SEC's burden of proof is that of preponderance of the evidence. The SEC may seek either temporary or permanent injunctive relief in a U.S. federal district court. It can seek a broad range of sanctions. In civil suits, the SEC seeks injunctions, which are orders that prohibit future violations. A person who violates an injunction is subject to fines or imprisonment for contempt. The SEC also may ask a federal court for emergency relief, generally in the form of a temporary restraining order. The SEC may also request that a court issue an order "freezing" assets to preserve the ability to obtain monetary relief at the successful conclusion of the case and return money to defrauded investors.

In a civil action, in addition to injunctive relief, the SEC may and typically does, seek other equitable relief to remedy the harm caused by the violation. Such relief may include an accounting or disgorgement of ill-gotten gains where a defendant has profited from a violation of law. The SEC is also authorized to seek civil money penalties and court orders barring a defendant from serving as an officer or director of a public company or from participating in an offer of penny stock.

The SEC may also institute administrative proceedings against a person or an entity regulated by the SEC or any person that it believes has violated or is violating the law. Administrative proceedings provide for a variety of relief, including a censure, a limitation on activities (in the case of a regulated entity or associated person of a regulated entity) such as suspension or revocation of registration (in the case of a regulated entity), suspension of up to twelve months or a bar from the industry (in the case of an associated person), a cease-and-desist order, accounting or disgorgement, or civil money penalties. In both civil injunctive actions and administrative proceedings, the SEC has the power to enter into enforceable settlements. In the typical settlement, the settling party neither admits nor denies the SEC's allegations. In a civil action, the SEC requests that a court issue an order reflecting the settlement. In administrative proceedings, a settlement order is entered by the SEC describing findings of fact tied to the violations of the federal securities laws.

The SEC may suspend trading in a particular security or a group of securities and national securities exchanges have the authority to suspend or remove a security from trading.

In addition, the Exchange Act empowers the SEC to deregister and de-list securities for the protection of investors and to approve or reject voluntary and involuntary deregistration and de-

	listing of shares requests from issuers or exchanges, pursuant to rules of the applicable exchange. By rulemaking, the SEC has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur. This rule is designed to address situations where the SEC settles a case only to have the defendant or his or her counsel take issue with the legal or factual basis for the SEC's action. Thus, where there is a settlement of an enforcement action, the defendant settles "without admitting or denying" the allegations. This language safeguards the deterrent effect of the sanctions in that the defendant cannot, without breaking the terms of the settlement, denounce publicly the basis for the SEC action. The SEC enforces the "neither admit nor deny" provision in its settlements.
Assessment	Broadly implemented.
Comments	**CFTC** The issue which accounts for the assessment is the very narrow scope of the insider dealing provisions in the CEA. The statute's current prohibitions on insider trading generally cover trading on the basis of CFTC, exchange, or SRO information by certain persons associated with those institutions. However, trading ahead or front running has been charged by the commission under the CEA's general anti-fraud provision when persons traded for their own account (or through a associated account) ahead of a customer or an employer for whom the person was trading. The assessors strongly support the recommendation in the Joint Report for a further extension of the insider dealing offence to misappropriation and trading on the basis of material non-public information from any government authority. The assessors recognize that there may be legitimate reasons for different approaches to insider dealing for securities and futures given the differences in the nature of the markets. However, the assessors also recommend that the CFTC undertake a study to examine whether there should be an expansion of insider trading prohibitions beyond what is recommended in the Joint Report. Such a study would complement the current debate in Europe as to the appropriate coverage of insider trading laws in derivatives markets. The assessors also strongly support the recommendation to require FCMs and IBs to erect Chinese walls between their research departments and their traders. If implemented, this latter measure would replicate the measures the SEC imposed on equity BDs following the misuse of research in the dotcom bubble and would be a step towards a harmonised approach in this area. **SEC** The absence of additional offences of insider trading may be a limiting factor in the SEC's enforcement effort in this area. However, it has not prevented the SEC from prosecuting cases under the civil law and existing specific offences of insider trading in connection with a tender offer (Rule 14e–3) and under rules that define (i) when a purchase or sale constitutes trading on the basis of material, nonpublic information (Rule 10b5–1); and (ii) the circumstances in which a person has a duty of trust or confidence for the purposes of the misappropriation theory of insider trading (Rule 10b5–2). The courts appear to have been willing to be supportive when interpreting the law. But criminal convictions and civil judgments generally depend on proving a breach of a duty of care and that the person acted with intent. **Cross market comparison** There is a major difference in the efficiency with which overall market surveillance is carried out in the securities and futures markets. In the equity markets no one body sees the whole picture. FINRA now monitors trading on most exchanges except NYSE and Chicago Board Options Exchange (CBOE) and on all the ATSs. Further consolidation is under discussion to create a consolidated surveillance structure to oversee the consolidated market. However, with current technology it will still be difficult to look through to identify the underlying traders. In contrast, in

	the futures markets the CFTC, working in cooperation with the exchanges, sees almost the total picture across all futures as a matter of daily routine and can identify the major traders who are clients of the FCMs, if necessary, with ease and in a timely fashion. Its ability to measure the financial exposure of all FCMs on a daily basis and changes in the size and ownership of the open interest is significantly in advance of what the SEC and the equity exchanges can achieve now or in the near future. However, in the case of both the SEC and CFTC, their IT resources are limited and outdated due to budgetary limitations and the problems of planning long-term IT projects when the commission's budget is determined annually by Congress. However, in 2009 the CFTC has been able to commit to spend almost US$26 million on IT, up from US$11 million in 2008.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	**CFTC** As discussed in connection with Principle 23, the CFTC deals with the issues of large exposures, default risk and market disruption via its Risk Regulatory Surveillance Group (RSG). The RSG has developed or obtained access to a number of automated systems and applications, which collectively permit the RSG to receive timely data on clearing members and large traders. The RSG attempts to be proactive rather than reactive. Accordingly, RSG staff attempts to identify traders and FCMs who might pose risk before a market becomes volatile, not just after the volatility appears. Concentration of risk is a key indicator that the RSG focuses on when it examines data. If there is a problem in a futures market, both the CFTC and DCMs have a number of emergency powers such as the power to suspend and halt trading, set margin, position limits, and price limits, and impose "circuit breakers" or otherwise intervene in the market. The CFTC can also alter or supplement the rules of a registered entity and direct a registered entity to take such action as in the CFTC's judgment is necessary to maintain or restore orderly trading in or liquidation of any futures contract. CFTC enforcement powers are comprehensive and authorize civil injunctive actions for failing to comply with requests for required information and subpoena enforcement actions for failure to comply with subpoena demand for documents or testimony. Failure to comply with a court order is punishable as contempt of court. DCMs must have rules which provide for the exercise of emergency authority, in consultation or cooperation with the commission, where necessary and appropriate, including the authority to—liquidate or transfer open positions in any contract; suspend or curtail trading in any contract; and require market participants in any contract to meet special margin requirements. The CFTC has provided guidance on these procedures. In terms of information sharing, the CFTC and DCMs have executed agreements to share information that is prompted by, among other things, large exposures. The CFTC essentially has the same information that DCMs have with respect to large exposure information. Wherever the exchanges manage position limits, they inform the CFTC of any exemptions granted. The exchanges are able to monitor the exposure size within each contract on an intraday basis. Frequent conversations occur between exchange and CFTC staff when liquidation or acquisitions of large exposures create a heightened concern. The increasing volume traded on an ECM that settles off a futures contract has prompted the CFTC to increase oversight of certain "linked contracts." The CFTC has issued rules regarding a category of contract deemed to be SPDCs which encompasses linked contracts. Under these rules, ECMs and clearing organizations will have the same reporting obligations with respect to SPDCs as DCMs have for futures contracts. In the meantime, a hybrid situation exists in which the ECM is reporting a form of large trader positions but not yet meeting the quality standards the CFTC requires. Internationally, the key documents are the Declaration on Cooperation and Supervision of

International Futures Markets and Clearing Organizations and its companion Exchange Memorandum of Understanding. (For international information sharing and cooperation more broadly see Principle 13.)

If an FCM is executing transactions on a DCM, then such FCM must clear such transactions through a DCO. In general, most DCOs publish their default procedures on their websites. In practice, 90 percent of all futures contracts clear through the DCO which is part of the CME group.

Issues concerning the bankruptcy of an FCM are dealt with in Principle 24.

CFTC Regulation of DCOs

The CFTC supervises DCOs in three main ways. First, the CFTC evaluates applications from entities seeking to become DCOs. Second, the CFTC conducts periodic reviews of registered DCOs. Third, the CFTC surveys, on a daily basis, DCO exposures and compares such exposures to DCO financial resources. Additionally, the CFTC may review and approve DCO rules.

Under the CEA, an entity that wants to register as a DCO must submit an application to the CFTC which demonstrates that it complies with the Core Principles applicable to DCOs. The CFTC provides guidance to applicants on how to demonstrate compliance with the core principles.

The Core Principles set out a range of requirements including adequate financial, operational and managerial resources; appropriate standards for participant and product eligibility; adequate and appropriate risk management capabilities; the ability to complete settlements on a timely basis under varying circumstances; standards and procedures to protect member and participant funds; efficient and fair default rules and procedures; adequate rule enforcement and dispute resolution procedures; and adequate and appropriate systems safeguards, emergency procedures and plans for disaster recovery. There are also record keeping requirements, obligations to report to the CFTC, public availability of its rules and operating procedures and obligations to share information domestically and internationally.

As regards ECMs, transactions executed on an ECM, if cleared, must be cleared by a clearing organization that satisfies the requirements of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) as amended by the CFMA. This includes DCOs, registered securities clearing agencies, various banks and clearing organizations supervised by a foreign financial regulator that one of the U.S. federal financial regulators has determined satisfies appropriate standards.

SEC

For a detailed assessment of clearing and settlement in securities markets see the CPSS IOSCO reports.

The only explicit large exposure disclosure requirements imposed by the SEC cover BDs with outstanding options positions to the extent that those positions exceed an aggregate position of 200 or more option contracts on the same side of the market covering the same underlying security or index. In addition, to the extent any option position exceeds certain limits; the firm is required to decrease the position. These reports generally must be submitted on the day that the position parameters are exceeded or change.

Continuous monitoring of BDs' open positions and large exposure is primarily the responsibility of the clearing agencies They receive data on a real time basis and review positions at end of day and frequently intraday. Under the Exchange Act, clearing agencies are SROs and have full self regulatory powers and responsibilities, including the power to discipline participants for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of activities, functions and operations, fine, censure, or any other fitting sanction. They have authority to require increased margin and/or collateral deposits. Clearing agencies generally do not compel participants to reduce their exposures, although increased margin calls may cause a participant to reduce its exposure. The securities depository registered with the SEC requires that all settlement

	obligations of participants be fully collateralized. The rules of a clearing agency must be pre-approved by the SEC. The SEC conducts on-site examinations of each clearing agency on a two-year cycle and “for cause” using examiners with particular knowledge and expertise in relevant subject matter such as VAR modeling. A BD must also comply with the rules of each SRO of which it is a member such as an exchange or FINRA. To the extent that a BD fails to furnish information requested by an SRO, the SROs have rules as to what action the SRO may take. The margin rules also help SROs control the risk of open positions. The SEC has entered into MOUs with other domestic regulatory agencies regarding the clearance and settlement of financial products which provide, inter alia, for consultation in order to minimize the adverse effects of market disruptions. These include the CFTC and the Federal Reserve. In addition, the SEC has entered into bilateral agreements with various international agencies that allow the SEC to share information on a timely basis. Information regarding large options positions is shared on a case by case basis, as appropriate. The SEC participates in five of the recently established international colleges of regulators although the U.S. BD component of these groups is relatively small. When a BD must be liquidated, the United States bankruptcy laws will apply. In addition, if a BD holds customer funds or securities, SIPA may also apply. Finally, if the BD is a member of a clearing agency, the clearing agency rules may apply to the rights of the clearing agency to close out any open exposures to its defaulting clearing members. Clearing agencies are required to publish their rules and procedures on their web sites including those relating to participant defaults. Apart from the corporate finance rules on disclosure of beneficial ownership of positions by insiders (see Principle 15), there is no automatic disclosure of the beneficial ownership of securities. The SEC must rely on the rule which requires BDs maintain records regarding all securities positions and the accounts to which they belong. This information includes the size of every position held in each account and the identity and address of the beneficial owner of each account. BDs are required to provide this information to the SEC upon request.
Assessment	Fully implemented.
Comments	The difficulty which the SEC faces in obtaining beneficial ownership details of securities holders is typical of securities regulators globally. However, in the United States, it compares poorly with the ease and timeliness with which the CFTC can obtain large trader information in futures and related markets. This is a limitation which the authorities should consider correcting.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	A separate CPSS-IOSCO assessment was conducted for the securities markets. Arrangements in the futures markets were not assessed.
Assessment	
Comments	