ISLAMIC FINANCIAL SERVICES BOARD

IFSB-21

CORE PRINCIPLES FOR ISLAMIC FINANCE REGULATION

[ISLAMIC CAPITAL MARKET SEGMENT]

DECEMBER 2018

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The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include the banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a stringent due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which includes holding several Working Group meetings, issuing exposure drafts and organising public hearings/webinars and reviews by the IFBS's Sharī'ah Board and Technical Committee. The IFSB also conducts research and coordinates initiatives on industry-related issues and organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

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ABBREVIATIONS

BCBS	The Basel Committee on Banking Supervision
CPICM	Core Principles for Islamic Capital Markets
CPICMWG	Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment) Working Group
CPIFR	Core Principles for Islamic Finance Regulation
CPIFRWG	Core Principles for Islamic Finance Regulation Working Group
CRA	Credit Rating Agency
ETF	Exchange Traded Fund
FSAP	Financial Sector Assessment Programme
ICIS	Islamic Collective Investment Scheme
ICM	Islamic Capital Market
IFSB	Islamic Financial Services Board
IFSI	Islamic Financial Services Industry
IIFS	Institutions offering Islamic Financial Services
IOSCO	International Organization of Securities Commissions
KQ	Key Questions
MMF	Money Market Fund
MoU	Memoranda of Understanding
REIT	Real Estate Investment Trust
RSA	Regulatory and Supervisory Authorities
SRO	Self-Regulatory Organisation

Bism Allah al-raḥmān al-raḥīm

Allahumma ṣalli wa sallim ʻalā Sayyidina Muḥammad waʿalā ʾālihī wa ṣaḥbih

LIST OF CORE PRINCIPLES FOR ISLAMIC CAPITAL MARKET REGULATION (CPICM)

A. Principles Relating to the Regulator

CPICM 1: The responsibilities of the Regulator should be clear and objectively stated. (IOSCO 1)

CPICM 2: The Regulator should be operationally independent and accountable in the exercise of its functions and powers. (IOSCO 2)

CPICM 3: The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. (IOSCO 3)

CPICM 4: The Regulator should adopt clear and consistent regulatory processes. (IOSCO 4)

CPICM 5: The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality. (IOSCO 5)

CPICM 6: The Regulator should have or contribute to a process to identify, monitor, mitigate and manage systemic risk, appropriate to its mandate. (IOSCO 6)

CPICM 7: The Regulator should have or contribute to a process to review the perimeter of regulation regularly. (IOSCO 7)

CPICM 8: The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. (IOSCO 8)

B. Principles for Self-Regulation

CPICM 9: Where the regulatory system makes use of Self-Regulatory Organisations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. (IOSCO 9)

C. Principle Relating to Sharī‘ah Governance

CPICM 10: The Regulator should require that Sharī‘ah governance is upheld for all products, activities, services and/or institutions implicitly or explicitly claiming Sharī‘ah compliance in the Islamic capital market. (No IOSCO equivalent)

D. Principles for the Enforcement of Securities Regulation

CPICM 11: The regulator should have comprehensive inspection, investigation and surveillance powers. (IOSCO 10)

CPICM 12: The regulator should have comprehensive enforcement powers. (IOSCO 11)

CPICM 13: The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme. (IOSCO 12)

E. Principles for Cooperation in Regulation

CPICM 14: The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts. (IOSCO 13)

CPICM 15: 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. (IOSCO 14)

CPICM 16: 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. (IOSCO 15)

F. Principles for Issuers

CPICM 17: There should be full, accurate and timely disclosure of financial results, risk and other information, which is material to investors’ decisions. (IOSCO 16)

CPICM 18: Holders of securities in a company should be treated in a fair and equitable manner. (IOSCO 17)

CPICM 19: Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality. (IOSCO 18)

CPICM 20: *Ṣukūk* should be subject to specific disclosure requirements commensurate with their specific nature and risk characteristics and which provide sufficient disclosures and transparency in all aspects related to compliance with Sharīʻah requirements**.** (No IOSCO equivalent)

G. Principles for Auditors, Credit Rating Agencies, and Other Information Service Providers

CPICM 21: Auditors should be subject to adequate levels of oversight. (IOSCO 19)

CPICM 22: Auditors should be independent of the issuing entity that they audit. (IOSCO 20)

CPICM 23: Audit standards should be of a high and internationally acceptable quality. (IOSCO 21)

CPICM 24: Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision. (IOSCO 22)

CPICM 25: Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them. (IOSCO 23)

H. Principles for Islamic Collective Investment Schemes

CPICM 26: The regulatory system should set standards for the eligibility, governance, organisation and operational conduct of those who wish to market or operate an Islamic collective investment scheme. (IOSCO 24)

CPICM 27: The regulatory system should provide for rules governing the legal form and structure of Islamic collective investment schemes and the segregation and protection of client assets. (IOSCO 25)

CPICM 28: Regulation should require disclosure, as set forth under the CPICM for issuers, which is necessary to evaluate the suitability of an Islamic collective investment scheme for a particular investor and the value of the investor's interest in the scheme. (IOSCO 26)

CPICM 29: Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in an Islamic collective investment scheme. (IOSCO 27)

I. Principles for Market Intermediaries

CPICM 30: Regulation should provide for minimum entry standards for market intermediaries. (IOSCO 29)

CPICM 31: There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake. (IOSCO 30)

CPICM 32: Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organisation and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters. (IOSCO 31)

CPICM 33: There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to investors and to contain systemic risk. (IOSCO 32)

J. Principles for Secondary and Other Markets

CPICM 34: The establishment of trading systems including securities exchanges should be subject to regulatory authorisation and oversight. (IOSCO 33)

CPICM 35: 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. (IOSCO 34)

CPICM 36: Regulation should promote transparency of trading. (IOSCO 35)

CPICM 37: Regulation should be designed to detect and deter manipulation and other unfair trading practices. (IOSCO 36)

CPICM 38: Regulation should aim to ensure the proper management of large exposures, default risk and market disruption. (IOSCO 37)

SECTION 1: INTRODUCTION

1.1 Background: The Need for Core Principles

1. The Islamic financial services industry (IFSI), with its proposition of inclusiveness, has progressed rapidly across the globe, embracing not just Muslim-majority economies but also other emerging markets and advanced economies as well. The development of this industry encompasses an increase in the business volume and number of institutions offering Islamic financial services (IIFS), an enhanced variety of the products and services offered, improved legal and regulatory infrastructure, and new initiatives for international cooperation. Accordingly, the IFSI has gained significant market share, and now constitutes an important building block of the financial systems in many jurisdictions. This development and growth has raised a number of challenges for the resilience and stability of financial systems, and for the protection of their users.

2. Core principles for regulation in the financial sector, such as those issued by the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), have become standard tools to guide regulatory and supervisory authorities (RSAs) in developing their regulatory regimes and practices. They also serve as the basis for RSAs themselves, or external parties such as the multilateral agencies, to assess the strength and effectiveness of regulation and supervision.

3. The global financial crisis (GFC) in 2008 and the sovereign debt crisis in 2010–11 highlighted the significance of a well-articulated microprudential and macroprudential policy framework for ensuring financial sector stability focusing on: (a) assessment of risks to the financial sector; (b) the financial stability policy framework; and (c) capabilities for resolving crises. In addition, the increased integration of the IFSI into the global financial system makes it necessary for the RSAs of the IIFS to ensure that their regulatory frameworks remain relevant in line with the changes in the global financial environment.

4. However, many RSAs, including those new to the regulation and supervision of the IFSI, face challenges in identifying and applying appropriate principles and benchmarks for assessing the gaps in the existing structures and policies in their jurisdictions. This is in part because the unique features of IIFS call for special regulation and supervision that effectively addresses their specificities. The approach to regulating and supervising IIFS needs to reflect: (a) the nature of risks to which IIFS are exposed; and (b) the financial infrastructure needed for effective regulation and supervision, which will result in additional or different regulation and supervisory practices to address the potential risks inherent in the IIFS' operations.

5. In line with its mandate, the Council of the Islamic Financial Services Board (IFSB), at its 21st meeting held on 12 December 2012 in Jeddah, Kingdom of Saudi Arabia, approved the preparation of a set of IFSB Core Principles for Islamic Finance Regulation (CPIFR) and the setting up of a Core Principles for Islamic Finance Regulation Working Group (CPIFRWG) for this purpose. Accordingly, the IFSB Secretariat prepared a detailed analysis[1] of the applicability of the core principles of the BCBS, IOSCO and the IAIS, and their applicability to Islamic finance, and a less detailed analysis of certain other core principles.

6. Following the completion and presentation of this IFSB study, it was decided that the CPIFRWG should focus initially on the banking sector, with work on the other segments – the Islamic capital market (ICM) and *takāful* – to follow later. The core principles for the banking segment were issued in April 2015.[2] Subsequently, the IFSB Council, at its 27th meeting held on 8 December 2015 in Jeddah, Kingdom of Saudi Arabia, approved the next stage in this programme, the preparation of the *Standard on Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment)* (CPICM) and the setting up of a working group (CPICMWG) for this purpose.

7. It is this working group, CPICMWG, under the direction and guidance of the Technical Committee, which has developed the CPICM and the associated assessment methodology, building upon IOSCO's "Objectives and Principles of Securities Regulation and its Methodology"[3] (released in May 2017). The work has been further informed by a survey of RSAs with supervisory responsibilities for Islamic capital markets in their jurisdictions. This survey, and the CPICMWG's own deliberations, identified a number of areas in which existing IOSCO principles and/or the assessment methodology's Key Questions either do not deal, or deal inadequately, with the specificities of Islamic capital markets, thus confirming the need for the present exercise.

1.2 Main Premises and Objectives of this Work

8. The first objective of the IFSB is: "*To promote the development of a prudent and transparent Islamic financial services industry through introducing new, or adapting existing, international standards consistent with Sharīʿah principles, and recommending these for adoption*." In pursuit of this objective, the IFSB's approach is to build on the standards adopted

[1] A refined version of this analysis was published in 2014 as the IFSB Working Paper 02: *Evaluation of Core Principles Relevant to Islamic Finance Regulation.*
[2] http://www.ifsb.org/standard/IFSB-17%20Core%20Principles%20for%20Islamic%20Finance%20Regulation%20(Banking%20Segment)%20(December%202015)%20(final).pdf
[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD562.pdf

by relevant conventional standard setters – in this case, principally IOSCO – and to adapt or supplement them only to the extent necessary to deal with the specificities of Islamic finance.

9. The main objective of the CPICM is to provide a set of core principles for the regulation and supervision of the ICM, taking into consideration the specificities of Islamic finance, while complementing the existing international standards, principally IOSCO's "Objectives and Principles of Securities Regulation and its Methodology" (May 2017). In particular, the objectives of the CPICM are:

a. to provide a minimum international standard for sound supervisory practices for the regulation and assessment of the ICM;

b. to protect consumers and other stakeholders by ensuring that the claim to Sharīʿah compliance made explicitly or implicitly by any ICM product or service is sound and supported by appropriate disclosures; and

c. to enhance the soundness and stability of the ICM – as an integral part of the IFSI and the global financial system – by helping RSAs to assess the quality of their relevant supervisory systems and identify areas for improvement as an input to their reform agenda.

10. The IFSB envisages that these CPICM will be used by jurisdictions as a benchmark for assessing the quality of their regulatory and supervisory systems, and for identifying future work to achieve a baseline level of sound regulations and practices for ICM products and services. The CPICM will promote further integration of Islamic finance with the international architecture for financial stability, while simultaneously providing incentives for improving the prudential framework across jurisdictions so that it is harmonised and consistently implemented across the globe. Furthermore, the CPICM may also assist IFSB member jurisdictions in: (a) the International Monetary Fund (IMF) and the World Bank financial sector assessment programme (FSAP); (b) self-assessment; (c) reviews conducted by private third parties; and (d) peer reviews conducted, for instance, within regional groupings of capital market RSAs.

11. Based on the above premises and objectives, the following subsection describes the general approach to the 38 CPICM presented in this document.

1.3 General Approach of the CPICM

12. The starting-point for development of the CPICM has been a careful analysis of the areas in which the IOSCO Principles did not adequately address the specificities of Islamic

finance in general, and Islamic capital markets in particular. Following this, two new Core Principles have been developed for CPICM, while two IOSCO Principles have been omitted at this stage. The two new Core Principles concern Sharī'ah governance in the ICM (CPICM 10) and the issuance of *ṣukūk* (CPICM 20). The two IOSCO Principles omitted are:

- Principle 28 on hedge funds. This reflects the fact that Sharī'ah restrictions on, for example, short selling and the use of derivatives make it generally impossible within the ICM to structure a hedge fund as commonly understood.[4]

- Principle 38 on clearing and settlement. This is currently not assessed as part of IOSCO's Principles; any assessment in this area is against the Principles for Financial Market Infrastructures, to which Principle 38 refers. In addition, there has been insufficient work as yet on clearing and settlement in an ICM context to allow a standard to be drafted covering this area.

13. Some IOSCO Principles have been amended, generally at the level of the supporting text and Key Questions rather than the Principles themselves. Most of the changes have been minor, but in two areas significant amounts of text have been omitted. Some of this concerns derivatives, which, as already mentioned, are, for Sharī'ah reasons, not a feature of Islamic capital markets. In addition, the IOSCO Principles deal with so-called stable net asset value money market funds; again, there are strong Sharī'ah reasons why such funds are not a feature of the ICM, as opposed to variable net asset value funds, whose establishment is not impossible provided they adhere to Sharī'ah rules and principles. However, most of the IOSCO Principles have been retained in view of their common applicability to both conventional and Islamic finance. The text of these is unchanged except for changes such as use of the terms "ICM" and "Sharī'ah-compliant" at some points. In addition to the relevant IFSB standards, some relevant IOSCO standards are referred to in the footnotes of this document. These IOSCO standards provide additional background on relevant issues, but these references should not be taken as implying that the standards are in all respects applicable to Islamic finance.

14. In principle, the approach of the CPICMWG has been to retain IOSCO Principles in their existing form wherever possible and to group issues related to Sharī'ah governance and *ṣukūk* in the two new CPICM introduced. The table in the appendix indicates the approach that has been taken and provides a roadmap for navigating between the IOSCO Principles

[4] There is no internationally agreed definition of a hedge fund, though the term usually implies the use of leverage, derivatives and/or short selling. The IOSCO Methodology discusses this at greater length. Currently, there are a small number of funds that self-identify as Sharī'ah-compliant hedge funds, but it has not been possible to confirm how far they follow such strategies.

and the CPICM. Each CPICM is supported by assessment criteria as elaborated and discussed further in sections 1.6 and 1.7.

15. The IFSB stands ready to encourage work at the national level to implement the CPICM in conjunction with other supervisory bodies and interested parties. The IFSB invites international financial institutions and other agencies to use the CPICM in assisting individual jurisdictions to strengthen their supervisory arrangements. The IFSB will continue to collaborate closely with those institutions and agencies, and remains committed to further enhancing its interaction with supervisors from non-member jurisdictions.

16. Where the IFSB has already published standards in a relevant area, these are reflected at a high level in the CPICM.[5] In some areas, the IFSB has done limited work, and the CPICM are therefore its first definitive standards; in such areas, the IFSB may define standards in more detail in the future. Revisions to existing IFSB standards and guidance, and any new standards and guidance, will be designed to strengthen the regulatory regime. Supervisory authorities are encouraged to move towards the adoption of updated and new international supervisory standards as they are issued.

1.4 Objectives of Islamic Capital Markets Regulation

17. In principle, the three IOSCO core objectives of securities regulation are equally relevant for the ICM. Those objectives are:

a. to protect investors;

b. to ensure that markets are fair, efficient and transparent; and

c. to reduce systemic risk.

18. The three objectives are closely related and, in some respects, overlap. Many of the requirements that help to ensure fair, efficient and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many of the measures that reduce systemic risk provide protection for investors.

19. However, in supervising the ICM, the objectives need to be approached in ways that recognise the specificities of Islamic finance. For example, for the purposes of protection of

[5] A bibliography is included at the end of each section, showing the CPICM listing, equivalent IOSCO documents and relevant IFSB standards.

investors, the claim of Sharīʿah compliance of ICM products and services needs to be sound, based on appropriate due process and backed by adequate disclosures to the investors.

20. ICM regulators seek to achieve these objectives through setting and effectively enforcing standards, supervising markets and market participants, and cooperating closely with other regulators.

21. The objectives of ICM regulation are further described below.

1.4.1 The Protection of Investors

22. Investors should be protected from misleading, manipulative or fraudulent practices, including insider trading, front running or trading ahead of customers, misuse of client assets and misleading claims of Sharīʿah compliance. Investors in the securities markets are particularly vulnerable to misconduct by intermediaries and others, but the capacity of individual investors to take action may be limited. Investors should have access to a neutral mechanism (such as courts or other mechanisms of dispute resolution) or means of redress and compensation for improper behaviour. There should also be additional guidelines in relation to matters of Sharīʿah compliance and remedial processes (and purification of income) should incidents of Sharīʿah non-compliance occur.[6]

23. Contracts in the ICM also need to ensure clarity for the investors in relation to the governing law that will guide cases of dispute (if any) and the courts where cases will be heard. This factor is important for investors wishing to gauge the legal treatment that will be accorded to Sharīʿah-compliant contracts – specifically, how courts will handle Sharīʿah-related arguments.

24. Further, the complex character of securities transactions and of fraudulent schemes requires strong enforcement of securities laws. Where a breach of law does occur, investors should be protected through strong enforcement of the law.

25. Full disclosure of information material to investors' decisions is the most important means for ensuring investor protection. This includes adequate disclosure of Sharīʿah compliance processes in relation to products and services, and of the general rights, responsibilities and exposures of investors based on the underlying Sharīʿah-compliant contracts. Investors are, thereby, better able to assess the potential risks and rewards of their investments, and thus, to protect their own interests. As key components of disclosure

[6] IFSB-1 defines Sharīʿah non-compliance risk as the risk that arises from the failure by institutions offering Islamic financial services to comply with the Sharīʿah rules and principles determined by the Sharīʿah board of the IIFS or the relevant body in the jurisdiction in which the IIFS operate.

requirements, accounting and auditing standards should be in place and should be of a high and internationally acceptable quality.

26. Only duly licensed or authorised persons should be permitted to hold themselves out to the public as providing investment services – for example, as market intermediaries or the operators of exchanges. Initial and ongoing capital requirements imposed upon those licence holders and authorised persons should be designed to achieve an environment in which a securities firm can meet the current demands of its counterparties and, if necessary, wind down its business without loss to its customers.

27. Regulation of market intermediaries should assist investor protection by setting minimum standards for market participants. Investors should be treated in a just and equitable manner by market intermediaries according to standards that should be set out in rules of business conduct. Supervision by regulators should include a comprehensive system of inspection, surveillance and ongoing compliance programmes, including regular interaction between regulator and market intermediaries.

28. Effective supervision and enforcement depend upon close cooperation between regulators at the domestic and international levels.

1.4.2 Ensuring that Markets are Fair, Efficient and Transparent

29. The fairness of markets is closely linked to investor protection and, in particular, to the prevention of improper trading practices. Market structures should not unduly favour some market users over others. The regulator's approval of exchange and trading system operators and of trading rules helps to ensure fair markets.

30. Regulation should detect, deter and penalise market manipulation and other unfair trading practices. Regulation should aim to ensure that investors are given fair access to market facilities and market or price information. Regulation should also promote market practices that ensure fair treatment of orders and a price formation process that is reliable.

31. In an efficient market, the dissemination of relevant information is timely and widespread and is reflected in the price formation process. Regulation should promote market efficiency.

32. Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available on a real-time basis. Pre-trade information concerns the posting of firm bids and offers as a means to enable investors to know, with some degree of certainty, whether and at what prices they can deal. Post-trade

information is related to the prices and the volume of all individual transactions actually concluded. Regulation should ensure the highest levels of transparency.

1.4.3 The Reduction of Systemic Risk

33. The reduction of systemic risk is closely linked to investor protection; however, risk taking is essential to an active market and regulation should not unnecessarily stifle legitimate risk taking. Rather, regulators should promote and allow for the effective management of risk and ensure that capital and other prudential requirements are sufficient to address appropriate risk taking, allow the absorption of some losses and check excessive risk taking. An efficient and accurate clearing and settlement process that is properly supervised and utilises effective risk management tools is essential.

34. There must be effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction.

35. Instability may result from events in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

36. Although regulators cannot be expected to prevent the financial failure of market intermediaries, regulation should aim to reduce the risk of failure (including through capital and internal control requirements). Where financial failure nonetheless does occur, regulation should seek to reduce the impact of that failure and, in particular, attempt to isolate the risk to the failing institution. Market intermediaries should, therefore, be subject to adequate and ongoing capital and other prudential requirements. If necessary, an intermediary should be able to wind down its business without loss to its customers and counterparties or systemic damage.

1.5 The Regulatory Environment

37. Regulation of Islamic capital markets is necessary for the achievement of the three core objectives of capital markets regulation. It should facilitate capital formation and economic growth. Nevertheless, inappropriate regulation can impose an unjustified burden on markets and inhibit market growth and development.

38. In the context of regulation, there should also be recognition of the benefits of competition in the marketplace.

39. It is possible to identify general attributes of effective regulation that are consistent with sound economic growth:

- There should be no unnecessary barriers to entry and exit from markets and products.
- Markets should be open to the widest range of participants who meet the specified entry criteria.
- In the development of policy, regulatory bodies should consider the impact of the requirements imposed.
- There should be an equal regulatory burden on all who make a particular financial commitment or promise.

40. More generally, there must be an appropriate and effective legal and accounting framework within which the ICM can operate. ICM laws and regulations cannot exist in isolation from other laws; there must be appropriate and effective legal, accounting and auditing requirements in a jurisdiction. This may include framework documents, such as a constitution or charter, as appropriate. There must also be clear guidelines in relation to matters of Sharī'ah within the ICM.

1.6 Scope of Assessment Methodology and Intended Scope of Assessments

41. This methodology is intended to apply to jurisdictions that have material Islamic capital markets. It is applicable to securities markets, intermediaries, information service providers (such as credit rating agencies) and products addressed by the CPICM, and its application should take account of the actual configuration of the markets, the stage of their development, and participation therein. In most cases, the jurisdictions will also have substantial conventional capital markets, and many elements of assessment will be very similar. The scope of the assessment methodology includes, in addition to the common requirements that apply equally to both Islamic and conventional capital markets, requirements that should be considered for jurisdictions where ICM activities are being undertaken.

42. The term "securities markets" is used, as the context permits, to refer compendiously to the various market sectors.[7] The same interpretative convention applies to the use of the term "securities regulation". In determining whether the context permits the application of a principle, assessors should take into account the functional differences between, and the

[7] For an explanation of the scope of "secondary markets", see the Preamble to the Principles Relating to Secondary and Other Markets.

relevant jurisdiction's statutory treatment of, securities and Sharī'ah-compliant hedging instruments (if any).

43. The methodology does not apply to markets such as the currency, bullion, or physical commodity markets except to the extent that securities intermediaries deal for customers in such markets. The methodology also contains information on the legal framework relevant to meeting the objectives addressed by the CPICM.

1.7 The Assessment Process and Assessment Measures

1.7.1 Implementation Intended to Be a Dynamic and Constructive Process for Regulatory Improvement

44. The assessment is not an end in itself. Rather, assessment should be viewed primarily as a tool for identifying potential gaps, inconsistencies, weaknesses, and areas where further powers or authorities may be necessary, and as a basis for framing priorities for enhancements or reforms to existing laws, rules and procedures. This Methodology specifically contemplates that the assessment process will involve a dialogue in which the regulator will explain the details of its Islamic capital market structure, laws, and regulatory programme, and how, in view thereof, the regulator believes its regulatory programme addresses the Key Questions and Key Issues so as to meet the objectives of the CPICM.

45. In this regard, the CPICM are not intended to be a pure checklist. The regulator and the assessors will need to exercise judgment when using the Methodology as a tool, in particular when Key Questions relating to the sufficiency of a programme or of resources, or to the degree of achievement of a certain CPICM, is being assessed.

1.7.2 Adequacy of Implementation Depends on the Level of Development and Complexity of the Market

46. There is often no single correct approach to a regulatory issue. Legislation, regulatory and Sharī'ah governance structures vary between jurisdictions and reflect local market conditions and historical developments. The particular manner in which a jurisdiction implements the objectives and CPICM described in this Methodology must have regard to the entire domestic context, including the relevant legal and commercial framework as well as the degree of development and maturity of the Islamic capital market in that jurisdiction. The assessor needs to be aware of the basic legal structure of a jurisdiction, including its civil, commercial and criminal law.

47. Consistently, this Methodology should not be interpreted as limiting the specific techniques or actions that may be taken to achieve sound securities regulation, provided that the objectives of the CPICM are met. Accordingly, in order to apply this Methodology in a manner that appropriately reflects the nature of the market situation in the jurisdiction being assessed, it will be necessary to provide, or to obtain, a complete and clear description of a jurisdiction's Islamic capital market sector as part of any assessment. 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 CPICM, 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.

48. Thus, a jurisdiction could satisfy an assessor that its approach, while not explicitly described in the Methodology, nonetheless meets the objectives of a particular CPICM. Similarly, a jurisdiction could document that the application of a particular approach was not applicable to the particular trading system but that the objectives of market integrity, for example, were achieved through other means. In general, this opportunity to explain is often contained in the Key Questions themselves or in the Explanatory Notes or scope. Accordingly, in all circumstances, assessors must explain the reasons for reaching their conclusions as to whether a Key Question is satisfied, why they reach a "Yes" despite the presence of some deficiencies, why they reach a "Yes" answer based on an alternative means of achieving the objectives set out in the Key Issues and related Key Questions, or why they believe a particular Key Question is not applicable or material in a particular jurisdiction's circumstances.

49. The regulator should frequently review the particular way in which securities regulation is carried out, as markets themselves are in a constant state of development; therefore, the content of a jurisdiction's regulation must also change if it is to continue to facilitate and properly regulate evolving markets.

1.7.3 How to Use the Methodology

50. This Methodology addresses each CPICM in detail. It provides interpretative text to the CPICM; sets out the Key Issues addressed by each Principle; establishes the Key Questions relevant to the assessment of how the jurisdiction is addressing the Key Issues; provides Explanatory Notes where necessary; and provides benchmarks for evaluating the level of implementation.

51. This Methodology envisions that the assessor will establish bases for testing whether the objective of the CPICM is sufficiently met from two perspectives:

a. *From a legal (or design) perspective*, by identifying the powers and authorities conferred on the regulator, the relevant provisions of applicable laws, rules and regulations issued for the Islamic capital market, and the programmes or procedures intended to implement these that form the framework of securities regulation in the jurisdiction.

b. *From the perspective of the exercise of those powers and authorities in practice*, by documenting or otherwise measuring (through statistics, interviews with regulators, regulated firms and market participants, and other methods) how the powers and responsibilities contained in the laws, rules and regulations are being exercised and whether enforcement of the relevant framework is effective. It is understood that, with respect to judging the effectiveness of the framework from a legal perspective, understanding of the basic legal structure of the jurisdiction is important, and from an empirical perspective, the fact-finding processes need to be carefully designed.

52. Where firms, products or transactions are exempted from regulatory requirements, or where the regulator has discretion to grant such exemptions, the reason the exemption is conferred and the process by which it is conferred should be transparent, give similar results for similarly situated persons or sets of circumstances, and be explainable in the context of the CPICM.

53. The ability to test implementation will understandably be limited by the scope of the inquiry, the assessor's need to rely in certain respects on statistical and anecdotal information, and the fact that implementation will be as of a point in time and not continuing or periodic. Generally, an assessment of the level of implementation of the CPICM assesses only the quality of securities regulation in a jurisdiction. There may be other factors (such as the economic and political climate) that affect consistent delivery of a fair and equitable regulatory system. Any assessment of implementation cannot be expected to provide assurance against a political or economic failure or the possibility that a sound regulatory framework can be circumvented.

54. Certain CPICM should be assessed in conjunction with one another. The Methodology and, more specifically, the benchmarking have been consciously drafted to recognise, evaluate and record gaps and flaws that recur across various CPICM. In practice, this means that in a number of cases a fundamental deficiency could impact the assessment of several

CPICM, with the result that a regulator may find its assessment rating has been "downgraded" across a number of CPICM.

55. This could be particularly the case in the evaluation that assessors make of the effectiveness of supervision. For example, deficiencies in the supervisory programme of a regulator could initially impact the grade of CPICM 13; however, they could also affect the grade of one or more other CPICM if such deficiencies have had a direct impact on the supervisory programme of one or more types of participants (e.g. if they have impacted issuer supervision, Islamic collective investment scheme (ICIS) supervision, intermediaries' supervision, etc.). Conversely, assessors should determine what, if any, impact the deficiencies identified in the supervisory programme of one or more types of participants (e.g. issuers, ICIS, intermediaries, etc.) may have on their evaluation of the overall effectiveness of the supervisory programme of a regulator and, depending on such evaluation, the grade of CPICM 13 might also be affected. Another example is lack of resources, which could initially impact the grade of CPICM 3 but could also impact the grades of one or more other CPICM, depending on the effect that resource challenges could have on the supervisory programme of one or more types of participants or even on the effectiveness of the overall supervisory programme. Similarly, deficiencies in CPICM 10, dealing with Sharī'ah governance, could affect the grade of one or more other CPICM if deficiencies in Sharī'ah governance aspects are directly related to the requirements indicated in those CPICM.

56. However, care should be taken in regard to the application of this "cascading" effect. For example, an inability to cooperate in the context of CPICM 6 (a specific standard designed to identify, monitor, mitigate and manage systemic risk) is not intended to adversely affect the broader requirements in CPICM 14 to 16. The intention of the Methodology is that any undue severity is avoided.

57. Assessors using this Methodology should refer to the assessed jurisdiction's responses to the Key Questions as a first step in the conduct of an assessment.

58. In assigning an assessment rating, the assessor should be aware that the CPICM relating to the Regulator, and for Enforcement and for Cooperation should be considered to be applicable to all jurisdictions, whether or not they have a market. In contrast, the other CPICM that relate to regulatory functions may not apply to some jurisdictions.

59. For example, if a jurisdiction does not operate or permit direct access to a secondary or other market, the CPICM for Secondary and Other Markets may not apply. However, even in a jurisdiction without its own secondary or own other market, there should be laws that

permit the jurisdiction to combat insider trading or other market misconduct originating from its jurisdiction into other jurisdictions.

Assessment Measures

60. The Methodology sets out clear guidance on the Key Questions that must be answered in the affirmative for a jurisdiction to score a Fully, Broadly or Partly Implemented rating (see below for an explanation on these assessment measures). It is understood that, where a Key Question is applicable, either "Yes" or "No" answers to Key Questions used for testing implementation should be augmented by explanations that explain the status of implementation in the context of a particular jurisdiction and that answers might be qualified to explain any departure from a full "Yes" or full "No" response.

61. Nonetheless, assessors should consider the materiality of any weaknesses and the applicability to the jurisdiction of the Key Questions when making an assessment of compliance with individual Key Questions. Where a Key Question refers to the existence of specific powers or authorities, the judgment as to implementation will generally be precisely specified, limited only by applicability. However, where a Key Question addresses the sufficiency of resources, or the sufficiency of application of a system of enforcement, or effective achievement of specific regulatory functions, the jurisdiction and the assessor may need to make a judgment as to the sufficiency of the programme or related resources or degree of achievement.

62. Although this Methodology contemplates that judgment must be applied in assigning assessment categories in these circumstances along the spectrum between Partly and Fully Implemented, the reasons for such judgments should be expressed by reference to the Key Questions, the assessment criteria in the Benchmarks and the related objectives of regulation expressed in the Key Issues, and should be documented.

63. It is also expected that the status of implementation will be tested as at a specific point in time, that is, the time of the assessment. Where changes are planned, the manner in which those changes further implement the CPICM, the timetable for their implementation and the reasonableness of the timetable should be reflected in the comments, but should not alter the assignment of an assessment rating.

64. Where new legislation, programmes or procedures have been adopted recently and are untested in their application, the jurisdiction may receive a Fully Implemented status only as to having in place the necessary powers, and/or the design of necessary programmes, to effectuate the affected CPICM and not as to full implementation of the powers or the

programme designed to use those powers.[8] Additionally, failure actually to use the powers, or to apply the programme, however well designed, may also implicate an assessment of the existence of the powers.

65. After having assessed the responses to all the Key Questions of a CPICM, the assessors determine the assessment rating according to the CPICM benchmarking. Once this has been established, assessors should see whether this rating is in line with their general appreciation of the regulatory system in relation to the given CPICM. If this is not the case, based on clear explanation, the assessors may decide to decrease or increase the assessment rating by one category.

66. Wherever a regulatory framework is assessed to be Broadly, Partly, or Not Implemented with respect to a particular CPICM, recommendations should be proposed for achieving full implementation. Where a jurisdiction has adopted but not yet implemented new legislation or procedures, the assessor may refer to these in its recommendations.

1.7.5 Assessment Categories

67. *Fully Implemented:* A CPICM will be considered to be Fully Implemented whenever all assessment criteria (as specified in the Benchmark) are generally met without any significant deficiencies.

68. *Broadly Implemented*: A CPICM will be considered to be Broadly Implemented whenever a jurisdiction's inability to provide affirmative responses to applicable Key Questions for a particular CPICM is limited to the Questions excepted under the CPICM's Broadly Implemented Benchmark and, in the judgment of the assessor, such exceptions do not substantially affect the overall adequacy of the regulation that the CPICM is intended to address.

69. *Partly Implemented*: A CPICM will be considered to be Partly Implemented whenever the assessment criteria specified under the Partly Implemented Benchmark for that CPICM are generally met without any significant deficiencies.

70. *Not Implemented*: A CPICM will be considered to be Not Implemented whenever major shortcomings are found in adhering to the assessment criteria as specified in the Not Implemented Benchmark.

[8] If, however, the regulator's prior programme would have been fully implemented and the new programme would be an enhancement, the jurisdiction should have an opportunity to demonstrate this and should not be penalised for improving its programme.

71. *Not Applicable*: A CPICM will be considered to be Not Applicable whenever it does not apply given the nature of the securities market in the jurisdiction and relevant structural, legal and institutional considerations. Criteria defining this assessment rating are not indicated for every CPICM.

SECTION 2: PRINCIPLE-BY-PRINCIPLE ANALYSIS

2.1 Principles Relating to the Regulator

2.1.1 Preamble

72. In this Standard, the regulator refers to the authority or authorities responsible for regulating, overseeing and supervising Islamic capital markets ("regulator"). Responsible, or competent, authority(ies) are those with jurisdiction over each of the issues addressed in the CPICM under the headings: Issuers; Auditors; Credit Rating Agencies and Other Information Service Providers; Islamic Collective Investment Schemes; Market Intermediaries; and Secondary and Other Markets, and may include other law enforcement, governmental and regulatory bodies.

73. The CPICM do not prescribe a specific structure for the regulator, nor do they prescribe a particular Sharīʿah governance model at the level of the regulator. Ideally, the regulator should have an approach to Sharīʿah governance[9] in order to be assessed under the CPICM. Where it does not, CPICM 10 will not be considered as Fully Implemented. However, in such circumstances other approaches, including disclosure, may nevertheless make a substantial contribution to upholding the objectives of ICM regulation, specifically investor protection, in relation to products, activities and/or services claiming to be Sharīʿah-compliant.

74. In this Standard, the term "regulator" is used compendiously.

75. There need not be a single regulator. In many jurisdictions, the desirable attributes of the regulator set out in the CPICM are in fact the shared responsibility of two or more government or quasi-government agencies with governmental powers.

76. The CPICM establish the desirable attributes of a regulator. An independent and accountable regulator with appropriate powers and resources is essential to ensure the achievement of the three core objectives of regulation. The CPICM consider the enforcement and market oversight work of the regulator and the need for close cooperation between regulators essential to the achievement of the regulatory function. The potential role of self-

[9] A number of different Sharīʿah governance models are practised in the market currently, including an embedded Sharīʿah board within the structure of the regulator; a centralised board outside the structure of the regulator that has recognised authority over matters of ICM; and a Sharīʿah systems approach, whereby the regulator does not have a Sharīʿah board at jurisdictional level but expects the market participants to take due steps to ensure that their products and services are Sharīʿah-compliant. All of these approaches are mentioned in IFSB-10: *Guiding Principles on Sharīʿah Governance Systems* (http://www.ifsb.org/standard/IFSB-10%20Shariah%20Governance.pdf). However, they raise important questions in relation to principles relating to the regulator and are accordingly addressed in CPICM 1 through 8.

regulatory organisations and the desirable attributes of such organisations are separately addressed under CPICM 9.

77. Regulators also have an important role to play in identifying, monitoring, mitigating and managing systemic risk, in regularly reviewing the perimeter of regulation, and in addressing conflicts of interest and misalignment of incentives.

78. The regulator and the effectiveness of its actions should be assessed in the context of the regulatory framework and the legal system of the jurisdiction being assessed. The regulator should also be assessed taking into account the situation, and stage of development, of the market of the assessed country (see section 1.3).

79. To the extent objectives or tasks are to be achieved or powers exercised by the "regulator," a jurisdiction should be deemed to have implemented the CPICM as long as one of the competent authorities can achieve each individual objective or task, or exercise a specific power even if the various objectives or tasks are achieved, or the various powers are exercised, by several different law enforcement, governmental and regulatory authorities.

80. CPICM 1 to 5 closely interrelate with CPICM 11 to 16. Therefore, evaluations of these CPICM should be consistent. For example, it should be impossible to conclude that CPICM 3 is fully implemented if the regulator is not endowed with comprehensive surveillance powers as required under CPICM 11.

81. In every case, regulators should be held accountable for issuing and implementing rules and regulations necessary to achieve the key core objectives of ICM regulation, monitoring whether the objectives are achieved, and taking enforcement or other appropriate action when there is a violation or lack of compliance with regulatory requirements within the context of their own legal and regulatory framework. Regulators also should be required to implement the regulatory framework responsibly, fairly and effectively.

2.1.2 Scope

82. The assessor should obtain a comprehensive overview of a given jurisdiction's regulatory system, including the Sharīʿah governance system in place. As the responsibility for ICM regulation can be shared by more than one competent authority, the assessor should obtain information that reflects each authority's structure, powers, scope of responsibility and operations. For example, in some jurisdictions, market intermediaries other than securities firms (e.g. banking or credit institutions; insurance providers; and retirement, pension and

superannuation funds) may engage in the securities activities listed above, but may be subject to a different regulatory authority, for all or certain of their activities.

83. Where more than one authority is responsible, the assessor should obtain a description of the division of responsibility with respect to each of the functional areas of regulation identified above and the details of cooperative arrangements among the authorities.

84. The sharing of tasks in the regulatory system should also be considered when assessing CPICM 6 and 7. With regard to CPICM 8, the assessor should determine whether the regulator has identified and assessed the degree to which the conflicts exist and the degree to which regulation may be necessary to ensure the conflicts are avoided, eliminated, disclosed or otherwise managed.

2.1.3 CPICM 1 through 8

CPICM 1: The responsibilities of the Regulator should be clear and objectively stated. (IOSCO 1)

85. Unless the regulator's responsibilities are clearly and objectively stated, investors and market participants may be uncertain about the degree to which the regulator is able to protect the market's integrity through fair and effective oversight. This is also applicable with regards to the regulator's responsibilities in relation to products and services claimed as Sharī'ah-compliant. Where this uncertainty exists, concerns about the market's integrity may become a self-fulfilling prophecy, to the detriment of all market participants. The capacity of the regulator to act responsibly, fairly and effectively, therefore, is assisted by a clear definition of responsibilities, preferably set out in law; and strong cooperation among responsible regulators, through appropriate channels.

86. The desirable attributes of a regulator include an organisational structure and powers that permit it to achieve the basic objectives of regulation. In assessing this Principle, the assessor should consider whether, and how, the legal provisions that authorise and provide for the operation of the regulator demonstrate that the regulator can perform its duties, according to procedures and objectives predefined by the relevant regulatory framework. The assessor also should assess whether the arrangements in place demonstrate the ability of the regulatory framework to create and implement a system intended to protect investors, provide fair, efficient and transparent markets, and reduce systemic risk.

87. The packaging of products and services may be such that a single product or service exhibits characteristics traditionally associated with at least two of the following: capital markets, banking and insurance. Specific to ICM, there is also a need for clear demarcation between the responsibilities of the regulator and the centralised Sharī'ah board where there is a centralised model for Sharī'ah governance. Legislation should be designed to ensure that any division of responsibility among financial sector regulators avoids gaps or inequities. Where there is a division of regulatory responsibilities, similar types of conduct or products should be subject to similar regulatory requirements regardless of how responsibility is divided among regulators. Where, as in some jurisdictions, there is a centralised Sharī'ah board separate from the regulator, the respective responsibilities of the two should be clearly distinguished.

Key Issues

1. Responsibilities of the regulator should be clear and objectively set out, preferably in law.

2. Legislation should be designed to ensure that any division of responsibility among regulators avoids gaps or inequities. Where there is a division of regulatory responsibilities, substantially the same type of conduct and product generally should be subject to consistent regulatory requirements.

3. There should be effective cooperation among responsible regulators, through appropriate channels.[10]

Key Questions

1.

   a. Are the regulator's responsibilities, powers and authority[11] clearly defined and objectively set out, preferably in law, and, in the case of powers and authority, enforceable?

   b. If the regulator can interpret its authority, are the criteria for interpretation clear and transparent?

   c. Is the interpretative process transparent enough to preclude situations in which an abuse of discretion can occur?

2. When more than one regulator is responsible for securities regulation:

   a. Where responsibility is divided among regulators, is legislation designed to avoid regulatory differences or gaps?

   b. Is substantially the same type of conduct and product generally subject to consistent regulatory requirements?

[10] See also CPICM 14 and 15.

[11] Regulatory discretion may be necessary to meet regulatory objectives in a rapidly evolving market, but how the scope of such discretion is determined and how the manner of its exercise is subject to review is relevant to the regulator's ability to act responsibly, fairly and consistently.

c. Are responsible regulators required to cooperate and communicate in areas of shared responsibility?

d. Are there arrangements for cooperation and communication between responsible regulators through appropriate channels, and are cooperation and communication occurring between responsible regulators without significant limitations?[12]

Explanatory Notes

88. Where the responsibilities for ICM regulation are shared by more than one regulator and there are differences in the responsibilities and powers of those regulators, the assessment should identify each of the relevant responsible regulators and consider whether the responsibilities and powers of the regulators taken in combination are sufficient to address each component of the CPICM and the Key Questions and Key Issues thereunder. This will require an explanation of how powers and responsibilities considered relevant in the Standard are distributed and executed in a jurisdiction, or where and how regulatory powers are distributed – for example, by function, security, service or entity.

89. In this respect, the CPICM are neutral as to whether ICM regulation can be distinguished by security, function, service, entity and/or type of transaction. What is important is to determine, and to consider, how regulation applies to the financial markets, participants, intermediaries, securities and services that characterise the jurisdiction being assessed.

90. Gaps should be construed to mean gaps in coverage (not in performance) of areas of the basic elements (functions and objectives) of ICM regulation (e.g. ICIS, issuers, auditors, credit rating agencies, and other information service providers, market intermediaries, secondary and other markets, enforcement) which are applicable to, but are not covered by, the system being assessed. The assessor should draw the views of the jurisdiction being assessed regarding gaps and inequities. More specific functional gaps or deficiencies should be treated under the specific CPICM related to each element of ICM regulation. Evidence should be provided as to how all areas addressed by the CPICM are covered, and, that effective arrangements exist for cooperation where there are divisions of authority.

91. Where legislation does not satisfactorily address gaps or inequities and an amendment is not possible in the short term, potential gaps or inequities may be addressed by procedures intended to ensure their avoidance as a result of any division of responsibilities, such as

[12] Measures to protect the confidentiality of non-public information consistent with permitted uses should not be considered significant limitations. See also CPICM 15.

protocols or arrangements with other responsible authorities to assure appropriate and equitable coverage of the functions and objectives of securities regulation.

Benchmarks

Fully Implemented

92. Requires affirmative responses to all applicable questions except Question 2, where it is not applicable as there is a single regulator responsible for securities regulation in the jurisdiction.

Broadly Implemented

93. Requires affirmative responses to all applicable Questions except to Questions 2(b) and 2(d), provided that different responsible regulators do not supervise the same entity – for example, where prudential and conduct of business supervision of the same entity is performed by different responsible regulators.

Partly Implemented

94. Requires affirmative responses to all applicable Questions except to Questions 1(c), 2(b) and 2(d) if more than one responsible regulator supervises the same entity.

Not Implemented

95. Inability to respond affirmatively to one or both of Questions 1(a) and 1(b) and, if applicable, one or more of Questions 2(a) or 2(c).

CPICM 2: The Regulator should be operationally independent and accountable in the exercise of its functions and powers. (IOSCO 2)

96. While the regulator should be accountable under a jurisdiction's legal and governing structure, the regulator should also be operationally independent from external political or commercial interference. Without such independence, investors and other market participants may come to doubt the regulator's objectivity and fairness, with deleterious effects on the market's integrity. Generally, the regulator's independence will be enhanced by a stable source of funding. It also means that the regulator should remain independent from the market participants that it supervises.

97. The functions and powers of the regulator, and resulting accountability, vis-à-vis any centralised Sharīʻah board[13] should be explicitly stated, particularly in cases where the regulator requires consultation with, or approval by, the centralised Sharīʻah board. In the latter case, where approval authority is with the centralised Sharīʻah board, the accountability of the regulator will be in line with its responsibilities spelt out under CPICM 1.

98. In some jurisdictions, particular matters of regulatory policy require consultation with, or even approval by, a government minister or other legislative authority. The circumstances in which such consultation or approval is required or permitted should be clear and the process sufficiently transparent or subject to review to safeguard its integrity. Generally, it is not appropriate for these circumstances to include decision making on day-to-day technical matters.

99. Independence implies:

- a regulator that operates independently of sectoral interest; and
- the ability to undertake regulatory measures and enforcement actions without external (political or commercial) interference.

100. Accountability implies that the regulator is subject to appropriate scrutiny and review, including:

- periodic public reporting by the regulator on its performance;

[13] Whether the centralised Sharīʻah board exists within the capital market authority or separate from it.

- transparency in the regulator's process and conduct; and

- a system permitting judicial review of licensing-, authorising- or enforcement-related final decisions of the regulator.

101. The confidential and commercially sensitive nature of much of the information in the possession of the regulator must be respected. Safeguards must be in place to protect such information from inappropriate use or disclosure.

102. The capacity of the regulator to act independently will be enhanced by adequate legal protection for the regulator and its staff when acting in the bona fide discharge of their functions and powers.

Key Issues

Independence

1. The regulator should be operationally independent from external political interference,[14] and from commercial or other sectoral interests, in the exercise of its functions and powers.

2. Consultation with or approval by a government minister or other authority[15] should not include operational decisions.

3. In jurisdictions where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority, the circumstances in which such consultation or approval is required or permitted should be clear and the process of consultation and criteria for action sufficiently transparent or subject to review to safeguard its integrity.

4. The regulator should have a stable source of funding sufficient to exercise its powers and responsibilities.

[14] The term "interference" means a formal or informal level and method of contact that affects day-to-day decision making and is unsusceptible to review or scrutiny.

[15] The phrase "or other authority" as used in this CPICM should be understood to include a centralised Sharī'ah board where one exists either embedded within the capital market authority or separate from it. This should not, however, be taken to preclude the regulator from seeking Sharī'ah advice on a particular operational situation.

5. There should be adequate legal protection for the regulator and its staff acting in the bona fide discharge of their functions and powers.

Accountability

6. The regulator should be publicly accountable in the use of its powers and resources, including on matters of Sharīʿah governance, to ensure that the regulator maintains its integrity and credibility.

7. If a Sharīʿah board is embedded within it, the regulator should be accountable for ensuring that the Sharīʿah board is adequately resourced and serviced; is competent by way of having the relevant skills and expertise; and measures are in place to address any potential conflicts of interest of the Sharīʿah board members.

8. There should be a system permitting judicial review of final decisions of the regulator.

9. Where accountability is through the government or some other external agency, the confidential and commercially sensitive nature of information in the possession of the regulator must be respected. Safeguards should be in place to protect such information from inappropriate use or disclosure.

Key Questions

Independence

1. Does the regulator have the ability to operate on a day-to-day basis without:

   a. External political interference; or

   b. Interference from commercial or other sectoral interests?[16]

2. Where particular matters of regulatory policy require consultation with, or even approval by, a government minister or other authority:[17]

   a. Is the consultation process established by law?

[16] CPICM 3. Administrative actions, such as licensing or commencement of inspections or investigations ordinarily should be particularly scrutinised for freedom from inappropriate influence.
[17] See footnote 14.

b. Do the circumstances in which consultation is required exclude decision making on day-to-day technical matters?

c. Are the circumstances in which such consultation or approval is required or permitted clear, and the process sufficiently transparent, or the failure to observe procedures and the regulatory decision or outcome subject to sufficient review, to safeguard its integrity?

3. Does the regulator have a stable and continuous source of funding sufficient to meet its regulatory and operational needs?

4. Are the regulator, the head and members of the governing body of the regulator, and its staff accorded adequate legal protection for the bona fide discharge of their governmental, regulatory and administrative functions and powers?[18]

5. Are the head and governing board of the regulator subject to mechanisms intended to protect independence, such as: procedures for appointment; terms of office; and criteria for removal?

Accountability

6. With reference to the system of accountability for the regulator's use of its powers and resources:

   a. Is the regulator accountable to the legislature or another government body on an ongoing basis, including on matters of Sharīʿah governance where the regulator has functional responsibility and power in relation to this?

   b. Is the regulator required to be transparent[19] in its way of operating and use of resources, and to make public its actions that affect users of the market and regulated entities, excluding confidential or commercially sensitive information?

   c. Is the regulator's receipt and use of funds subject to review or audit?

7. If a Sharīʿah board is embedded within it, does the regulator demonstrate that it has:

[18] CPICM 5.

[19] The regulator must be accountable as a matter of law. The regulator may be considered to be *required* to be transparent if, as a general principle of administrative law, procedure or practice, its use of its powers and resources generally is transparent.

a. Established criteria on what may be considered a competent Sharīʿah board?

b. Provisions in place to ensure that the Sharīʿah board acts in an independent and transparent manner and that any conflicts of interest are managed appropriately?

c. Provisions in place to ensure that the Sharīʿah board is adequately resourced and serviced?

8. Are there means for natural or legal persons adversely affected by a regulator's decisions or exercise of administrative authority ultimately to seek review in a court? Specifically:

a. Does the regulator have to provide written reasons for its material decisions?[20]

b. Does the decision-making process for such decisions include sufficient procedural protections to be meaningful?

c. Are affected persons permitted to make representations prior to such a decision being taken by a regulator in appropriate cases?[21]

d. Are all such decisions taken by the regulator subject to a sufficient, independent review process, ultimately including judicial review?

9. Where accountability is through the government or some other external agency, is confidential and commercially sensitive information subject to appropriate safeguards to prevent inappropriate use or disclosure?

Explanatory Notes

103. The balance between independence and accountability is delicate. The CPICM take no position on the location of the regulator within the governmental structure. Nevertheless, in different circumstances, the safeguarding of independence must be particularly scrutinised. Not only should the allocation of regulatory responsibilities, the framework for accountability and procedures, or other mechanisms in place to achieve independence be considered, but also the actual operation of the relationship between the regulator and any governmental

[20] The regulator need not be required by legislation to give written reasons, provided that it has formal written procedures as to when it will do so.
[21] For example, a warning letter may not be subject to additional process.

overseer should be considered. If possible, the effect of such interrelationship should be reviewed in specific cases. For example, in some jurisdictions, rules or policies may require approval by a government minister or other authority, or other important regulatory matters may require consultation with or approval by a government minister or other authority. Also, sometimes matters are reviewed within the government for compliance with applicable law. The circumstances in which such consultation or approval is required or permitted should be clear, and the process sufficiently transparent or subject to review as to safeguard its integrity.

104. Independence or accountability is not necessarily compromised just because the regulator is part of the government and/or the top officials of the regulator are political appointments, including appointees that previously served in the government.

105. Criteria for decision making also can insulate the process from inappropriate political interference. For example, the ability to reverse licensing decisions at the ministerial level without clear criteria both for the refusal to license and related decision-making process would inappropriately infringe independence. A stable source of funding is critical because operational independence can be compromised if funding can be curtailed by external action. The assessor may inquire of the assessed jurisdiction as to whether the source of funds can adversely affect its accessibility.

106. Forms of funding may vary for each regulator and include cases where the regulator is funded by the government's budget.

107. As this Principle tests independence, the ability to protect sensitive information passed to other decision-making authorities should be part of the regulatory framework to prevent undue interference with the regulatory authorities' operations. The safeguards in place must be part of the system.

108. In assessing implementation of Key Question 1, the assessor should determine whether, practically speaking, the regulator is in fact operationally independent from external political interference, and from commercial or other sectoral interests, in the exercise of its functions and powers.

109. A positive response to Key Question 1(a) in relation to independence from external political interference will generally require the assessor to be satisfied – taking into account the legal, regulatory and political environment in which the regulator operates – that:

- the legal and regulatory framework does not have structural features which could significantly impact the independence of the regulator; and

- there is no evidence of actual interference in day-to-day operational decisions or other evidence pointing to a deficit in independence; in the assessment process, the assessor should also consider information based on discussions with market participants or other reliable sources related to whether or not market participants in their entirety perceive the regulator to be de facto independent.

110. One example of adequate legal protection for regulators acting in bona fide performance of regulatory functions would be qualified immunity from personal liability for actions taken in good faith within the scope of the regulator's authority. Other arrangements may also be possible. The adequacy and type of legal protection for regulators acting in bona fide performance of their regulatory functions must be evaluated according to the legal system applicable in the assessed jurisdiction.

111. Formal consultation with commercial interests, including those subject to regulation, as contemplated under Principle 4, does not impair independence.

Benchmarks

Fully Implemented

112. Requires affirmative responses to all applicable Questions.

Broadly Implemented

113. Requires affirmative responses to all applicable Questions except to Question 6(b)**.**

Partly Implemented

114. Requires affirmative responses to all applicable Questions except to either Questions 2(b) or 2(c), and to Questions 4, 5, 6(b) and 8(c).

Not Implemented

115. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), both 2(b) and 2(c), 3, 6(a), 6(c), 7(a), 7(b), 7(c), 8(a), 8(b), 8(d) or 9.

CPICM 3: The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. (IOSCO 3)

116. The regulator should have adequate powers, proper resources (including adequate funding), and the capacity to perform its functions and exercise its powers, both in regular and in emergency situations. What this means in practical terms is the subject of elaboration in this section. It includes powers of licensing, supervision, inspection, investigation and enforcement. It also includes the capacity and resources to attract and retain appropriately trained, qualified and skilled staff to perform its functions and exercise its powers, while being able to provide ongoing training to its staff.

117. The regulator must ensure that its staff receives ongoing training as required.

118. If the regulator has responsibility for matters of Sharī'ah compliance or Sharī'ah governance, the regulator should possess adequate powers, resources and competence to discharge its responsibilities.

119. The powers and resources of the regulator should be consistent with the size, complexity, and type of the markets that it oversees and its need to meet the functions contained in these CPICM. The assessor should determine after assessing all the CPICM and the effectiveness of the jurisdiction's regulatory programme if there is a substantial basis for concluding that the powers, resources, and capacity of the regulator are sufficient.

120. This CPICM is relevant for the work of the regulator taking into account that the Principle makes sure the appropriate performing of the regulator's functions and the effective exercise of its powers, which is fundamental in terms of achieving both: 1) successful preventative measures (surveillance, inspection, investigation); and 2) credible and effective corrective measures (detect, deter, enforce, sanction, redress and correct violations of securities laws). Any circumstance that impedes or challenges the appropriate and effective exercise of the functions and powers of the regulator is detrimental to the objectives behind these CPICM. In this way, this would be consistent and in compliance with CPICM for the Enforcement of Securities Regulation (CPICM 11 to 13) and CPICM for Cooperation in Regulation (14 to 16), and the other way around, taking into account that they are inter-related.

121. The regulator should play an active role in the education of investors. Investor education may enhance investors' understanding of the role of the regulator and provide investors with the tools to assess the risks associated with particular investments and to protect themselves against fraud (and other abuses). Investor education and financial literacy

programmes can also be useful tools for the securities regulators in supporting their regulation and supervision. For example, investor education programmes can complement regulations that enforce conduct standards, require financial institutions to provide clients with appropriate information, strengthen legal protections for consumers, or provide for redress. IOSCO recognises that there is no one-size-fits-all model for investor education and financial literacy programmes.

Key Issues[22]

1. The regulator should have powers of licensing, supervision, inspection, investigation and enforcement.

2. The regulator should have adequate funding to exercise its powers and responsibilities.

3. Where the regulator has functional responsibility and accountability in relation to Sharī'ah compliance or Sharī'ah governance, the regulator should possess adequate powers, resources and competence to discharge its responsibilities.

4. The level of resources should recognise the difficulty of attracting and retaining experienced and skilled staff.

5. The regulator should ensure that its staff receives adequate, ongoing training.

6. The regulator should have policies and governance practices in place to perform its mandate adequately.

7. Regulators should play an active role in promoting the education of investors and other market participants.

[22] See also Key Questions on enforcement and cooperation under CPICM 12, 13, 15 and 17 and Key Questions on regulatory powers related to issuers, market intermediaries, collective investment schemes and secondary and other markets.

Key Questions[23]

1. Are the powers and authorities of the regulator sufficient, taking into account the nature of a jurisdiction's markets and a full assessment of these CPICM to meet the responsibilities of the regulator(s) to which they are assigned?

2. With regard to funding:

    a. Is the regulator's funding adequate to permit it to fulfil its responsibilities, taking into account the size, complexity and types of functions subject to its regulation, supervision or oversight?

    b. Can the regulator affect the operational allocation of resources once funded?

3. Does the level of resources recognise the difficulty of attracting and retaining experienced and skilled staff?

4. Does the regulator ensure that its staff receives adequate ongoing training?

5. Does the regulator have policies and governance practices to perform its functions and exercise its powers effectively?

6. Does the regulator play an active role in promoting education in the interest of protecting investors?

7. Are the powers, resources and competence of the regulator sufficient to discharge its responsibilities where the regulator has functional responsibility and accountability in relation to Sharī'ah compliance or Sharī'ah governance?

Explanatory Notes

122. The powers granted to the regulator should be commensurate to the functions committed to the regulator. Where there is more than one responsible authority, the powers required for implementation may be distributed among them. The powers granted, taken together, should be sufficient to provide the ability to achieve implementation of the other CPICM set forth in this Standard. The assessor may wish to review this Principle after the full assessment is complete.

[23] The answers to these questions should be consistent with powers and authorities discussed in other Sections.

123. An assessment of governance should go beyond the framework of rules and practices by which the regulator ensures accountability, fairness, and transparency. It needs to go into the ability of the regulator to formulate its strategic direction and deliver its mandate. This could include, but is not limited to, governance practices for developing priorities and responsive strategies.

124. In complex markets, technology may be necessary to assure efficient discharge of regulatory functions. An appropriate programme of investor education in a jurisdiction may also assist the regulator in carrying out its responsibilities.

125. The regulator should be given an opportunity to demonstrate to the assessor that its powers and funding are adequate and, in particular, how they are deployed to achieve its objectives and legal and regulatory responsibilities (e.g., how the regulator measures effectiveness, promptness of action, level of coverage and ability to meet its priorities).

126. Turnover of staff may be an indication of inability to attract and retain experienced and skilled staff. The assessor should inquire further about the reasons.

127. The regulator should also be invited to explain what sorts of investor education activities or programmes are promoted by the regulator within the assessed jurisdiction.

Benchmarks

Fully Implemented

128. Requires affirmative responses to all applicable Questions.

Broadly Implemented[24]

129. Requires affirmative responses to all applicable Questions except to Question 3.

Partly Implemented

130. Requires affirmative responses to all applicable Questions except to Questions 2(b), 3, 4, 5, and 6.

[24] For *Broadly* and *Partly*, the availability and sufficiency of resources in fact may need to be evaluated along the spectrum of *Fully* to *Partly* with guidance from the assessed jurisdiction.

Not Implemented

131. Inability to respond affirmatively to one or more of Questions 1, 2(a) and 7.

CPICM 4: The Regulator should adopt clear and consistent regulatory processes. (IOSCO 4)

132. Clear, consistent, transparent procedures and processes are part of fundamental fairness and of a framework for developing regulatory decisions and for undertaking regulatory actions that assure accountability. Transparency of policies must, however, balance the rights of individuals to confidentiality, and regulators' enforcement and surveillance needs, with the objective of fair, equitable and open regulatory processes.[25]

133. In exercising its powers and discharging its functions, the regulator should adopt processes that are:

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

134. In the formulation of policy, the regulator should:

- have a process for consulting with the public, including those who may be affected by the policy;
- publicly disclose its policies in important operational areas;[26]
- observe standards of procedural fairness; and
- have regard to the cost of compliance with the regulation.

135. Many regulators have authority to publish reports on the outcome of investigations or inquiries, particularly where publication would provide useful guidance to market participants and their advisers. Any publication of a report must be consistent with the rights of an individual

[25] Matters related to Sharī'ah compliance and Sharī'ah governance are not to be assessed under this CPICM; they are considered and covered in CPICM 10 in this standard.

[26] In some operational areas, and in some cases, particularly in the areas of surveillance and enforcement, consultation and disclosure may be unnecessary or inappropriate as it may compromise the effective implementation of the policy.

to a fair hearing and the protection of personal data – factors that will often preclude publicity when a matter is still the subject of investigation.

Key Issues

Clear and Equitable Procedures with Consistent Application

1. In exercising its powers and discharging its functions, the regulator should adopt processes that are:

    a. consistently applied;

    b. comprehensible;

    c. transparent to the public; and

    d. fair and equitable.

2. In the formulation of policy, subject to enforcement and surveillance concerns, the regulator should:

    a. have a process for consulting with the public, including those who may be affected by the policy;

    b. publicly disclose its policies in important operational areas;[27] and

    c. have regard to the cost of compliance with regulation.

3. The regulator should observe standards of procedural fairness.

Transparency and Confidentiality

4. Transparency practices, such as publication of reports on the outcome of investigations or inquiries, where permitted, should be consistent with the rights of an individual to a fair hearing and the protection of personal data – factors that will often preclude publicity when a matter is still the subject of investigation.

[27] That is, policies with respect to issuers, ICIS, market intermediaries, and secondary and other markets.

Key Questions

Clear and Equitable Procedures

1. Is the regulator subject to reasonable procedural rules and regulations?

2. Does the regulator adhere to the following:

    a. Does it have a process for consulting with the public, or a section of the public, including those who may be affected by a rule or policy – for example, by publishing proposed rules for public comment, circulating exposure drafts, or using advisory committees or informal contacts?

    b. Does it publicly disclose and explain its rules and regulatory policies, not including enforcement and surveillance policies, in important operational areas, such as through interpretations of regulatory actions, setting of standards, or issuance of decisions, stating the reasons for regulatory actions?

    c. Does it publicly disclose changes and reasons for changes in rules or policies?

    d. Does it have regard to the costs of compliance with regulation?

    e. Are all its rules and regulations available to the public?[28]

    f. Are its rule-making procedures readily available to the public?[29]

3. In assessing procedural fairness:

    a. Are there rules in place for dealing with the regulator that are intended to ensure procedural fairness?

    b. Is the regulator required[30] to give reasons in writing for its decisions that affect the rights or interests of others?

    c. Are all material decisions of the regulator in applying its rules subject to review?

[28] For example, on its website or through readily accessible reports. See also CPICM 1.
[29] See also CPICM 2.
[30] The regulator need not be required by legislation to provide reasons, provided that it has written procedures as to when it will do so.

d. Are such decisions subject to judicial review where they adversely affect legal or natural persons?

e. Are the general criteria for granting, denying or revoking a licence made public, and are those individuals affected by the licensing process entitled to a hearing with respect to the regulator's decision to grant, deny or revoke a licence?

Transparency and Confidentiality

4. If applicable, are procedures for making reports on investigations public consistent with the rights of individuals, including confidentiality and data protection?

Consistent Application

5. Does the regulator exercise its powers and discharge its functions consistently?

Explanatory Notes

136. The assessor should establish whether there are specific laws, rules or procedures that govern the administrative structure and whether these rules are clear, accessible and transparent. Such rules would assist in assuring that procedures are: consistently applied; comprehensible; transparent to the public; and fair and equitable.

137. In some operational areas, and in some cases, particularly in areas of surveillance and enforcement, consultation and disclosure may be unnecessary or inappropriate as they may compromise the effective implementation of regulatory policy.

138. There may be different levels of, or procedures for, review for different types of regulatory actions. For example, rule making may be subject to different review procedures than actions with respect to granting licences or taking enforcement action. This is not inconsistent with the CPICM if the review procedures are transparent and equitably applied.[31]

139. An effective consultation process may be responsive to the need to take into account the impact of regulation and to have regard to the costs of compliance with regulation. The regulator should be able generally to assess the use of its resources. A regulator is not

[31] See also CPICM 2, Key Question 7.

required to conduct a specific cost/benefit analysis in order to be found to have regard for the cost of compliance when framing regulatory policy.

140. Interviews with affected parties and other documentation may be necessary to confirm whether procedures are, in fact, consistently applied, fair and equitable, and the market is open to fair competition practices.

Benchmarks

Fully Implemented

141. Requires affirmative responses to all applicable Questions.[32]

Broadly Implemented

142. Requires affirmative responses to all applicable Questions except to Question 2(d).

Partly Implemented

143. Requires affirmative responses to all applicable Questions except to Questions 2(b), 2(d), 2(f) and 5.

Not Implemented

144. Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(c), 2(e), 3(a), 3(b), 3(c), 3(d), 3(e), or 4.

[32] CPICM 2. If there is no power to make reports public, then there would be no need to protect confidentiality.

CPICM 5: The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality. (IOSCO 5)

145. This Principle refers to the integrity and the means for achieving and demonstrating the integrity of the regulator and its staff. In the context of this Principle, the term "staff" is intended to include the head of the regulator, as well as its members. Only the highest professional standards of conduct are appropriate to achieving the objectives of regulation.

Key Issues

1. The staff of the regulator should observe the highest professional standards and be required to follow clear guidance on matters of conduct, including:

   a. the avoidance of conflicts of interest (including the conditions under which staff may trade in securities);

   b. the appropriate use of information obtained in the course of the exercise of powers and the discharge of duties;

   c. the proper observance of confidentiality and privacy provisions and the protection of personal data; and

   d. the observance of procedural fairness standards.

2. Failure to meet standards of professional integrity should be subject to sanctions.

Key Questions

1. Are the staff of the regulator required to observe requirements or a "Code of Conduct" or other written guidance, pertaining to:

   a. The avoidance of conflicts of interest?

   b. Restrictions on the holding or trading in securities subject to the jurisdiction of the regulator and/or requirements to disclose financial affairs or interests?

   c. Appropriate use of information obtained in the course of the exercise of powers and the discharge of duties?

d. Observance of confidentiality and privacy provisions and the protection of personal data?

e. Observance by staff of procedural fairness standards in the performance of their functions?

2. Are there:

a. Processes to investigate and resolve allegations of violations of the above standards?

b. Legal or administrative sanctions for failing to adhere to these standards?

Explanatory Notes

146. The Key Questions are intended to address requirements relating to maintenance of high professional standards. The assessor should obtain documentation of specific procedures and how they have been used in specific cases. The assessor should also look at documentation of confidentiality measures and arrangements to avoid conflicts of interest.[33] For example, guidance on conflicts of interest should address outside employment and holding of other positions, among other things.

147. Restrictions on trading could include, for example, pre-clearance of transactions or restrictions on transactions above a specified threshold.

Benchmarks

Fully Implemented

148. Requires affirmative responses to all applicable Questions.

Broadly Implemented

149. Requires affirmative responses to all applicable Questions except that there may not be active monitoring of matters under Questions 1(a) and 1(b).

[33] See also CPICM 4.

Partly Implemented

150. Requires affirmative responses to all applicable Questions except that, with respect to Questions 1(a) through (e), there may be minor shortcomings in observance of procedures, including no active monitoring under Questions 1(a) and 1(b).

Not Implemented

151. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d) or 1(e), subject to the departures from full compliance permitted under Partly Implemented, or failure to respond affirmatively to either of Questions 2(a) or 2(b).

CPICM 6: The Regulator should have or contribute to a process to identify, monitor, mitigate and manage systemic risk, appropriate to its mandate. (IOSCO 6)

Objective

152. Systemic risk refers to the potential that an event, action, or series of events or actions could have a widespread adverse effect on the financial system and, in consequence, on the economy. Securities regulators are concerned about systemic risk because of its potential widespread effects and potential to harm a large number of investors and market participants.

153. Reducing systemic risk is one of the three core objectives of regulation. CPICM 6 recognises that securities regulators have an important and unique role to play in identifying, monitoring, mitigating, and managing systemic risk. Systemic risk in the securities markets in most cases is not the result of sudden adverse events, but instead the result of slow and prolonged build-up of risk over a longer time frame. It may also take the form of a more gradual erosion of market trust, for example, as a result of widespread market misconduct. Implementing many of the other CPICM (e.g. CPICM 10 and CPICM 20) will be important in mitigating risks to market trust. In particular, strong investor protection standards, transparency offered by extensive disclosure requirements, risk monitoring, research and analytics, vigorous enforcement, robust resolution regimes, and other factors are important elements of how the regulator can mitigate and manage risks against a gradual erosion of market trust.

154. Promoting financial stability is a shared responsibility amongst the financial sector regulatory community. Securities regulators, prudential regulators and central banks all have important roles to play and come equipped with different tools at their disposal. The nature of the risk identified will, to a large extent, dictate which set of tools may be most effective in addressing the risk. The tools available to securities regulators to reduce systemic risk generally consist of strong investor protection standards and enforcement measures, disclosure and transparency requirements, business conduct regulation, and resolution regimes for market intermediaries. This Principle explicitly recognises that securities regulators may not have the appropriate tools to address certain forms of systemic risk and, therefore, it is important that they cooperate with other regulators.

155. Effective securities regulation is predicated on preserving market integrity, financial stability and investor protection. This approach recognises that the market is composed of an interconnected network where the activities of one or more participants can have spill-over effects on all. Systemic risk arising in one part of the financial system may also be spread to other parts of the financial system through the markets and the economy. Consequently,

securities regulators need to work with other relevant regulators and authorities to understand the interconnections between market participants, markets and market infrastructures.

156. Securities markets are characterised by rapid changes and financial innovation. Innovation should be encouraged and facilitated where it has the potential to improve the functioning of the markets and to provide investors with greater choice. However, innovation may not always be beneficial, particularly when it leads to opacity or is associated with poor risk management, which could eventually lead to the build-up of risks. Regulators should be aware of new and evolving products, business models and participants, and the potential risks they may pose to the financial system as a whole. Regulators need to strive to stay in step with and understand the potential risks associated with financial innovation and develop approaches that permit beneficial innovation while preserving investor protection. Risk monitoring, research and analytics should include monitoring of innovation and new technologies.

157. Securities regulators should develop key risk metrics relevant to measuring systemic risks arising within securities markets, intermediaries and regulated activities, and improve their understanding and application of tangible steps that can be taken to mitigate such risks. Securities regulators may be able to leverage work done by other supervisors but it will be important to develop their own risk indicators through the use of qualitative and quantitative data.

158. The identification, monitoring, mitigation and management of systemic risk should be integrated into an organised and documented risk management framework through formalised processes and arrangements.

Key Issues

1. The regulator should have or contribute to regulatory processes through formalised arrangements, which may be cross-sectoral, to identify, monitor, mitigate, and appropriately manage systemic risk based on clear responsibilities in relation to systemic risks. The process can vary with the complexity of the market.

2. Given the central role of markets in the overall financial system and their capability to generate and/or transmit risks, securities regulators should:

a. work with other supervisors to improve the overall understanding of the economics of the securities markets, their vulnerabilities and the interconnections with the broader financial sector and the real economy; and

b. have or develop formal systems and processes to permit the sharing of information and knowledge as an essential component for the delivery of an effective regulatory response to systemic risk.

3. The regulator should have appropriately skilled human and adequate technical resources to support effective risk arrangements.

Key Questions

1.

a. Does the regulator have clear responsibilities in:

i. identifying, monitoring, mitigating and appropriately managing systemic risks related to securities markets; and

ii. contributing to processes in relation to other financial markets?

b. Is there a clear definition of systemic risk within the jurisdiction?

2. Does the regulator have, or contribute to, a regulatory process (which may be focused on the securities market or be cross-sectoral) through formalised arrangements to identify, monitor, mitigate and appropriately manage systemic risk, according to the complexity of the regulator's market consistent with its mandate and authority?

a. Is there an effective information-sharing framework in place with other regulators and supervisors within the jurisdiction covering systemic risks, which is supported by formal cooperation or institutional arrangements?

b. Does the regulator communicate information and data about identified systemic risk(s) with regulators in other jurisdictions under established procedures or arrangements and/or supported by bilateral and/or multilateral memoranda of understanding (MoUs)?

3. Does the regulator have appropriately skilled human and adequate technical resources to support effective risk arrangements?

Explanatory Notes

159. Disclosure and transparency are critical to identifying and understanding the development of systemic risk and arming regulators with the information needed to take the appropriate action. Transparency in markets and products is also crucial to allow market participants to better price risk. Regulators have a particular responsibility and interest in, promoting transparency at the market level, as well as adequate disclosure at the product and market participant level.

160. Regulators also have a particular responsibility for establishing organisational requirements, business conduct regulation and resolution regimes for market intermediaries, which are important elements in mitigating and managing systemic risk. Robust oversight of organisational requirements and business conduct is essential to managing the build-up of undesirable incentive structures, which can become an important source of risk in the financial system.

161. Reducing systemic risk needs to be considered within the context of the regulator's broader mandate. A number of other principles also contribute to the regulator's efforts to identify, mitigate and manage systemic risk. These include, in particular, Principles relating to the perimeter of regulation (CPICM 7), conflicts of interest (CPICM 8), cooperation and information-sharing with other regulators (CPICM 14–16), oversight of credit rating agencies (CPICM 24) and procedures for dealing with the failure of a market intermediary (CPICM 33). The Principles for Financial Market Infrastructures[34] will also be relevant to the management of systemic risk in relation to clearing and settlement systems.

162. When assessing Key Question 1, the key aspect is whether the regulator exercises a role, which does not necessarily have to be backed by legal framework, in relation to systemic risk.

163. When assessing Key Question 2, the assessor should consider whether the regulator has or contributes to a regulatory process (which may be focused on the securities market or be cross-sectoral) with respect to systemic risk posed by entities within the scope of its

[34] These are currently not assessed as part of IOSCO's Principles and Objectives; however they do have relevance for management of systemic risk.

regulation (e.g. with respect to market intermediaries, hedge funds or central counterparties which are themselves systemically important in the relevant securities market).

164. Flexibility of approach and being open to new insights will be important as securities regulators learn more about systemic risk. The formalised arrangements referred in Key Question 2 would include general and systemic risk arrangements as indicated below.[35]

165. General Arrangements. The arrangements to identify, monitor, mitigate and adequately manage systemic risk should include components which:

- entail a holistic and systematic analysis of entities, products, markets, market infrastructures and activities across securities markets that could be the source of systemic risk;

- involve the systematic and robust analysis of accessible, reliable and good-quality data (including microeconomic and macroeconomic data and market intelligence) either collected by the securities regulator or sourced from other agencies or parties (including other relevant supervisors);

- include mechanisms to assist in understanding the evolving functioning of securities markets;

- involve engagement with market participants to better understand emerging risks, systemic and otherwise. This engagement may take the form of surveys, formal consultations, informal roundtables, individual meetings, etc.;

- include documentation about the work performed in assessing potential systemic risks at each stage of the assessment process, and documentation about the status of steps taken to mitigate identified risks;

- allow for periodic reassessment of procedures and outcomes; and

- provide for policy and/or regulatory actions, where appropriate in the context of the regulatory mandate, based on the assessments conducted.

[35] See *Thematic Review of the Implementation of Principles 6 and 7 of the IOSCO Objectives and Principles of Securities Regulation*, Final Report. Report of the Board of IOSCO, September 2013, pp. 6–10, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD424.pdf.

166. Systemic Risk Arrangements. These arrangements, in addition to the general arrangements set out above, should include components which:

- provide a broad understanding of the financial markets environment in which securities regulators operate and on which assessments of systemic risk can be made. It should also take into account the interconnections between different products, markets, market infrastructures and activities across securities markets;

- complement reviews undertaken by other relevant regulators, where appropriate, by incorporating analysis of the operation of securities markets and the interplay between various markets and participants; and

- include the development and use of indicators to calibrate systemic risk emerging from (or affecting) securities markets.

167. Organisational Culture. To achieve the above, securities regulators should build an organisational culture that supports and serves as a foundation to processes in relation to systemic risk. This would include:

- furthering a culture for a methodological, collaborative and integrated approach within the regulator towards the identification, monitoring, mitigation and management of systemic risk;

- promoting "professional scepticism" contributing to early identification of systemic risk; and

- ensuring organisational awareness of the culture, frameworks and approaches for identification, monitoring, mitigation and management of systemic risk, and commitment to the effective and meaningful operation thereof.

Benchmarks

Fully implemented

168. Requires affirmative responses to all applicable Questions.

Broadly implemented

169. Inability to respond affirmatively to either Questions 1(b), 3(b) or 4.

Partly Implemented

170. Inability to respond affirmatively to either Question 1(a) or 3(a).

Not Implemented

171. Inability to respond affirmatively to Question 2.

CPICM 7:	**The Regulator should have or contribute to a process to review the perimeter of regulation regularly. (IOSCO 7)**

Objective

172. Regular review of the perimeter of regulation promotes a regulatory framework that supports investor protection, fair, efficient and transparent markets, and the reduction of systemic risk.

173. Depending on the structure of the markets and the legal system that underpins them, not all market activities or market participants may be subject to direct regulation or oversight. The decision whether to regulate a specific product, market, market participant or activity is ultimately a policy judgment made by the relevant authorities in each jurisdiction based on an assessment (to which regulators should contribute) of the jurisdiction's particular circumstances. Therefore, the regulator should have or contribute to a process to regularly review whether its current regulatory requirements and framework adequately addresses risks posed to investor protection, and to fair, efficient and transparent markets, as well as to the reduction of systemic risks.

174. A regular review of the perimeter of regulation will also consider the effectiveness of existing regulations and the need to modify them or adopt new regulations in light of new market developments. In particular, that review will need to address the risk of regulatory arbitrage arising from changes to the intensity of regulation across the financial sector.

175. The review of the regulatory perimeter should be integrated into securities regulators' risk management frameworks through formalised processes and arrangements.

176. CPICM 6 and 7 are interrelated in nature and similar processes might be applied by the regulator for both CPICM 6 and 7. However, while CPICM 6 has a particular focus on systemic risk and is limited to the regulator's mandate, CPICM 7 is broader in scope (including systemic risks and other risks) and is not limited to the regulator's mandate.

Key Issues

1. The regulator should:

    a. Adopt or adapt its own process, or participate in a process with other regulators and/or government policy-makers, for conducting a regular review of products, markets, market participants and activities so as to identify and assess possible

risks to investor protection and market fairness, efficiency and transparency or other risks to the financial system; and

b. Have formalised arrangements and/or processes to regularly review the perimeter of regulation in order to promote the identification and assessment of these risks.

2. Such review should include consideration of:

a. Whether developments in products, markets, market participants and activities have an effect on the scope of securities regulation; and

b. Whether the policy approach underlying the existing statutory or discretionary exemptions, continues to be valid.

3. The process should focus on determining whether the regulator's existing powers, operational structure, and regulations are sufficient to meet emerging risks.

4. The process should also allow for any changes to the existing perimeter of regulation to be made in a timely manner in response to an identified emerging risk. Such a necessary change may include the regulator seeking changes to legislation.

Key Questions

1. Does the regulator have or participate in a process, to identify and assess whether its regulatory requirements and framework adequately addresses risks posed by products, markets, market participants and activities to investor protection, fair, efficient and transparent markets and the reduction of systemic risk?

2. Does the regulator have formalised arrangement and/or a process to review, when there is evidence of changing circumstances, its past regulatory policy decisions on products, markets, entities, market participants or activities, especially decisions to exempt, and take measures as appropriate?

3. Does the regulator participate in a process (with other financial system supervisors and regulators if appropriate) which reviews unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage,

in order to promote investor protection and fair, efficient and transparent markets and reduce systemic risks?

4. Does the regulator seek legislative or other changes when it identifies a regulatory weakness or risk to investor protection, market fairness, efficiency, and transparency that requires legislative or other changes?

Explanatory Notes

177. Assessors should recognise that each regulator may have its own unique process in reviewing the perimeter of regulation and deference should be given to regulatory prerogative.

178. Examples of such processes could include:

- A team, group or division within the organisation to identify risks, regulatory gaps or conflicts;
- The regulator being party to a formal or informal group of financial regulators that share information and discuss the regulatory perimeter;
- *Ad hoc* groups to identify and assess risks in response to a crisis or on a periodic basis; or
- Other formal or informal means of surveying or assessing the perimeter of regulation.

179. The responsibilities of the securities regulator within jurisdictional arrangements to review the regulatory perimeter should be clear. These arrangements should allow for identification of risks posed by unregulated products, markets, market participants and activities, including those resulting from innovation and technology.[36]

180. These arrangements, in addition to the general arrangements set out in CPICM 6 (Explanatory Notes), should include components which:

- involve securities regulators systematically identifying, prioritising and determining the scale and scope of emerging risks from different entities, activities, markets

[36] See *Thematic Review of the Implementation of Principles 6 and 7 of the IOSCO Objectives and Principles of Securities Regulation*, Final Report. Report of the Board of IOSCO, September 2013, pp. 6–10, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD424.pdf.

and products in financial markets that could serve as the basis for deciding whether and what type of regulatory action or intervention is warranted;

- build on existing risk identification frameworks by requiring securities regulators to proactively go beyond existing regulatory boundaries to identify potential risks; and

- recognise that different approaches may be required to discern and assess different types of risks.

181. Further, securities regulators should also seek to build an organisational culture that supports and serves as a foundation to processes in relation to reviewing the regulatory perimeter. This would include:

- furthering a culture for a methodological, collaborative and integrated approach within the regulator towards reviewing the regulatory perimeter; and

- ensuring organisational awareness of the culture, frameworks and approaches for reviewing the regulatory perimeter and commitment to the effective and meaningful operation thereof.

182. When assessing implementation of this Principle, the assessor should consider particular instances where the perimeter of regulation has been reviewed. The assessor could, for example, consider if regulators have assessed whether the current regulatory requirements and framework adequately address risks that may be posed by the use of financial benchmarks – for example, to investors or to fair, efficient and transparent markets.

Benchmarks

Fully Implemented

183. Requires affirmative responses to all applicable Questions.

Broadly Implemented

184. There is no *Broadly Implemented* rating for this Principle.

Partly Implemented

185. Inability to respond affirmatively to Questions 2 or 4.

Not Implemented

186. Inability to respond affirmatively to Question 1 or 3.

CPICM 8:	**The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. (IOSCO 8)**

Objective

187. This Principle is an overarching Principle which sets out the role ICM regulators should have in focusing on conflicts of interest and the misalignment of incentives.

Conflicts of Interest

188. A recurring concern of ICM regulators has to do with what economists call "agency problems", where market participants entrusted to act in the interests of others use their position, power or information to advance their own interests instead.

189. Such conflicts of interest are common problems in many financial markets and are often the focus of securities regulation. They arise for a range of reasons including compensation programmes in firms. Conflicts should be and are the focus of securities regulation because they can undermine investor protection and the fair, efficient and transparent operation of markets, or present a systemic risk. This focus on conflicts of interest is reflected in references to conflicts of interest in a number of CPICM (i.e., 5, 9, 24, 25, 26, 30 and 32).

190. Where conflicts of interest may exist that pit the interests of a market participant against those it has been entrusted to advance, the regulator should identify and assess the degree to which the conflicts exist and determine the degree to which regulation may be necessary to ensure the conflicts are avoided, eliminated, disclosed or otherwise managed.

Misalignment of Incentives in Securitisation[37]

191. This Principle also sets out the role the regulatory system should have where the incentives and interests of those engaged in bringing financial products to market are not aligned with the interests of investors.

192. This is a particular issue where different firms are responsible for the design, manufacture and distribution of a financial product. Even where each firm engaged in bringing a product to market avoids, eliminates, discloses or otherwise manages conflicts of interest with, and meets its obligations to, direct counterparties and clients, incentives may exist for it

[37] It is important to note that securitisation exposures are of two types: securitised exposures that are based on tangible assets or usufruct which are tradable and securitised exposures that are based on financial assets (cash and receivables), which are only tradable at par.

to act in a way which is not in the best interests of the end consumer or investor. Firms in these circumstances may owe no duty to the end consumer or investor but their actions may not always be in the interests of the end consumer or investor.

193. The years preceding the 2008 global financial crisis provide an example of what is called a "lack of alignment of incentives" or "misalignment of incentives", particularly in relation to certain conventional securities backed by financial assets such as mortgages.[38] Originators, sponsors, issuers and underwriters during this period, while meeting contractual obligations and managing direct conflicts of interest to their immediate client or counterparty, had no additional incentive to perform appropriate levels of due diligence on the asset pools backing the security or to employ robust underwriting standards. Originators and brokers may have focused on the origination of securitised products without due regard to longer-term performance of the products encouraged by short-term incentive remuneration structures.[39] The quality of the underlying assets suffered, resulting in diminished returns (and losses) to end investors.

194. Where a jurisdiction has an active securitisation market and identifies that the incentives of investors and securitisers along the value chain (including the originator, issuer, sponsor, underwriter or other entities) are misaligned, the regulatory system should evaluate, formulate and implement approaches to align incentives, taking into account local market conditions. Where appropriate, these approaches might include mandating retention of risk in securitisation products. The approach to incentive alignment should be disclosed for each transaction.

Key Issues

Conflicts of Interest

1. The regulator should identify and evaluate potential and actual conflicts of interests regarding regulated entities.

2. The regulator should take steps so that conflicts of interest among regulated entities are avoided, eliminated, disclosed or otherwise managed. Disclosure of

[38] *Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, pp. 15–21, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf.
[39] Ibid, p. 16, paras. 52–53.

potential or actual conflicts of interest should be made to or accessible by investors and/or other users of the services or products.

Misalignment of Incentives in Securitisation

3. For jurisdictions with active securitisation markets, the regulatory system should evaluate, formulate and implement approaches to aligning incentives, including where appropriate, through mandating retention of risk in securitisation products.

4. The regulatory system should require that the method chosen for compliance with the incentive alignment approach, including any mandated risk retention requirements, is clearly disclosed.

Key Questions

Conflicts of Interest

1. Does the regulator have in place a process designed to identify and evaluate potential and actual conflicts of interest regarding regulated entities?

2. Where the regulator identifies significant conflicts of interest among regulated entities, does it take steps so that these conflicts of interest are avoided, eliminated, disclosed or otherwise managed?

3. Where the regulator requires conflicts of interest to be disclosed, are the disclosures mandated in such a way that they are accessible by investors and/or the users of the services or products?

Misalignment of Incentives in Securitisation[40]

4. In jurisdictions with active securitisation markets, has the regulatory system evaluated, formulated and implemented approaches to align incentives, including mandatory risk retention, wherever appropriate, taking into account local market conditions?

[40] See *Global Developments in Securitization Regulation*, Report of the Board of IOSCO, November 2012, p. 48, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf.

5. Does the regulatory system require that the method chosen for compliance with the incentive alignment approach, including any mandated risk retention requirements, is clearly disclosed?

Explanatory Notes

195. Decisions on which regulatory tools to use to address particular conflicts of interest among regulated entities (e.g. prohibitions, disclosures, use of information barriers, etc.) will necessarily entail policy decisions reflecting legal and market structures and regulatory philosophies. The critical issue from an assessment perspective is that the process by which the regulator monitors conflicts of interest in the market may affect investor protection and market fairness, efficiency and transparency, or pose a systemic risk.

196. Examples of conflicts of interest and misaligned incentives from a conventional capital market perspective commonly highlighted in past financial crises involve:

- mortgage brokers hired by financial institutions to assess the quality of loan applications but who were compensated based on the volume and size of applications processed (giving rise to an incentive to exaggerate the quality of the loan applications);

- credit rating agencies hired by issuers, arrangers and/or investors to publicly or widely opine on the creditworthiness of a security in which the issuer, arranger or investor has an interest (and, therefore, a willingness to compensate the credit rating agency according to whether the rating aligns with the issuer's, arranger's or investor's interest); and

- the judgment of audit firms being affected by the provision of non-audit services to audit clients.

197. Not all of the entities are always regulated by securities regulators. Therefore, the above examples should not be read as conflicts of interest or misaligned incentives that all regulators should seek to address, unless noted in other CPICM. For example, mortgage brokers often fall under banking regulation. However, securities regulators should work together with other relevant regulators so as to formulate consistent approaches to address identified misaligned incentives.

198. Examples of approaches where the regulator has identified, evaluated and taken steps to avoid conflicts of interests and the misalignment of incentives in areas highlighted in the 2008 crisis might include:

- imposing risk retention requirements for originators, sponsors, original lenders and/or issuers of securitised products; and

- requiring the independence of service providers engaged by, or on behalf of, an issuer, where an opinion or service provided by those service providers may influence an investor's decision to acquire a securitised product.

199. Securitisation market participants and their activities might be regulated by securities regulators and other relevant regulators. In assessing implementation of this Principle, the assessor should consider all relevant parts of the regulatory framework (including requirements which might be imposed by non-securities regulators).

200. The most common example of how misaligned incentives could be addressed in the securitisation value chain is to require risk retention. Risk retention, or "skin in the game", requirements have been a key focus of regulatory responses since the crisis. These requirements have been and are being developed as a means of addressing misaligned incentives that may be embedded in the "originate to distribute" model of some securitisation products with a view to encouraging prudent behaviour by issuers and sponsors. Where risk retention is mandated, the applicable legislation, regulation and/or policy guidance should address the following elements:

- the party on which obligations are imposed (i.e. direct and/or indirect regime, based on an assessment of the most efficient and effective way of achieving risk retention);

- permitted forms of risk retention requirements (e.g. vertical, horizontal, etc.); and

- exceptions or exemptions from the risk retention requirements.

201. Market circumstances may, however, warrant other approaches being taken.

Benchmarks

Fully Implemented

202. Requires affirmative responses to all applicable Questions.

Broadly Implemented

203. Requires affirmative responses to all Questions except Questions 3 and 5.

Partly Implemented

204. There is no *Partly Implemented* rating for this Principle.

Not Implemented

205. Inability to respond affirmatively to Questions 1, 2, or 4.

BIBLIOGRAPHY FOR PRINCIPLES RELATING TO THE REGULATOR

	Document	CPICM	Other CPICM
1	*Sound Practices for Investment Risk Education*, Report of the Board of IOSCO, September 2015, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD505.pdf	3	
2	*Strategic Framework for Investor Education and Financial Literacy*, Report of the Board of IOSCO, October 2014, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD462.pdf	3	
3	*Thematic Review of the Implementation of Principles 6 and 7 of the IOSCO Objectives and Principles of Securities Regulation*, Report of the Board of IOSCO, September 2013, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD424.pdf	6 7	
4	*Principles for Financial Benchmarks*, Report of the Board of IOSCO, July 2013, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf	7	36
5	*Global Developments in Securitization Regulation*, Report of the Board of IOSCO, November 2012, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf	8	
6	*Unregulated Financial Markets and Products*, Final Report, Report of the Technical Committee of IOSCO, September 2009, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf	8	16

2.2 Principle Relating to Self-Regulation

2.2.1 Preamble

206. Self-Regulatory Organisations (SROs) can be a valuable complement to the regulator in achieving the objectives of capital markets regulation.

207. Various models of self-regulation exist and the extent to which self-regulation is used varies. The common characteristics of SROs in most jurisdictions are a separation from the regulator (although government oversight and authorisation generally exist), and the participation of business, industry and, if appropriate, investors in the operations of the SRO.

208. There can be substantial benefits from self-regulation:

- SROs may require the observance of ethical and business conduct standards which go beyond government regulations.
- SROs may have broader ability to compel the production of information than government regulators.
- SROs may offer considerable depth and expertise regarding market operations and practices, and may be able to respond more quickly and flexibly than the government authority to changing market conditions.
- SROs often build and maintain technology infrastructure to undertake their own, and the regulator's regulatory functions, with this infrastructure being funded entirely by regulated persons, not taxpayers.

209. SROs should undertake those regulatory responsibilities which they have expertise to perform most efficiently. The actions of SROs will often be limited by applicable contracts and rules.

2.2.2 Scope

210. This Principle applies if an entity has one or several of the key features of an SRO. The understanding of what constitutes an SRO is further specified in the following guidance. Self-regulation may encompass the authority to create, amend, implement and enforce rules of trading, business conduct and/or qualification regimes with respect to the persons (i.e. legal and natural persons) subject to the SRO's jurisdiction and to resolve disputes through arbitration or other appropriate dispute resolution mechanisms. This authority may be derived

from a statutory delegation of power to a non-governmental entity or through a contract between an SRO and its members as is authorised or recognised by the regulator. In some jurisdictions, SROs may not cover all the functions mentioned above.

211. An organisation should be classified as an SRO (and subject to assessment under CPICM 9) if it has been given the power or responsibility to regulate and its rules are subject to meaningful sanctions regarding any part of the securities market or industry. One typical feature of an SRO is that the organisation establishes rules relevant for a certain industry – for example, on eligibility of individuals/firms, on (market) conduct or qualifications of staff or disciplinary rules – that could trigger sanctions in case of infringements. Another typical feature of SROs is that the organisation also enforces such rules.

212. There may be SROs, particularly in the form of exchanges, which facilitate listing of Sharīʿah-compliant securities and/or provide Islamic stock indices. In some examples, the SROs are required to follow Sharīʿah-screening guidelines and other relevant regulations provided by the regulator. However, there are also instances when such guidelines are not directly provided by the regulator and the exchanges have their own criteria. Critical here in all instances is when the responsibility for determining the Sharīʿah compliance of products on an ongoing basis rests at the level of the SRO.

213. In summary, SROs are organisations that:

- establish rules of eligibility that must be satisfied in order for individuals or firms to participate in any significant securities activity; or

- establish and enforce binding rules of trading, business conduct and qualification for individuals and/or firms engaging in securities activities; or

- establish disciplinary rules and/or conduct disciplinary proceedings, which would enable the SRO to impose appropriate sanctions for non-compliance of its rules.

214. If self-regulation is used, the SRO should be subject to appropriate oversight by the regulator.

2.2.3 CPICM 9

CPICM 9	**Where the regulatory system makes use of Self-Regulatory Organisations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. (IOSCO 9)**

215. The CPICM recognise the value that a properly regulated SRO can play and set out general recommendations for the proper authorisation and oversight of SROs. However, the use of SROs is a discretionary policy option and, therefore, the absence of SROs in a jurisdiction should have no assessment implication.

216. The "appropriate use" of an SRO is related to:

i. The SRO's capacity to carry out the purposes of relevant governing laws, regulations, including the development and implementation of SRO rules as well as the monitoring and enforcement of compliance by its members and associated persons with those laws, regulations and rules as reflected in the SRO's regulatory authorisation requirements and oversight programme.

ii. The adequacy of the regulator's oversight.

iii. The augmentation of regulatory resources by utilising the SRO's expertise, its proximity to the market and its flexibility in addressing issues that arise in the changing market environment.

iv. Adequate standards of corporate governance, to effectively manage the conflicts of interest inherent to the activity of self-regulation.

217. "Inappropriate use" of an SRO by extension might include the exercise of SRO functions by an unauthorised entity or without regulatory oversight, designation of private-sector institutions that demonstrate an insufficient capability to meet standards of authorisation, delegation or enforcement to perform SRO functions, evidence of misuse of quasi-governmental powers, or insufficient performance of the functions of self-regulation.

218. The regulator should require an SRO to meet appropriate standards before allowing the organisation to exercise its authority. These standards must include, inter alia, the ability to:

- Enact rules that prohibit fraudulent and manipulative practices.

- Maintain the organisation and capacity to monitor compliance, and have a disciplinary mechanism to enforce rules, *inter alia*, expulsion; suspension; limitation of activities, functions, and operations; fine; censure and suspend or bar.

219. Oversight of the SRO should be ongoing.

220. Moreover, once the SRO is operating, the regulator should assure itself that the exercise of this power is in the public interest and protects investors, and results in fair, effective and consistent enforcement of applicable securities laws, regulations and appropriate SRO rules.

221. The regulator should have oversight of any Sharī'ah governance mechanism in place within the SRO, particularly those SROs that exercise responsibility for determining the Sharī'ah compliance status of Islamic securities. To undertake such oversight, the regulator would also need to have in place regulations to ensure that the SRO has the necessary resources, skills and competencies for oversight and assessment of Sharī'ah compliance issues.

222. The effectiveness of an SRO may be compromised by conflicts of interest. The regulator should monitor and address the potential that may arise for conflicts of interest. The regulator must ensure that no conflicts of interest arise because of the SRO's access to valuable information about market participants (whether or not they are members of the SRO itself). The risk of conflicts arising may be acute when the SRO (e.g., an exchange) is responsible both for the supervision of its members and the regulation of a market sector.

223. Regardless of the extent to which self-regulation is used, the regulator should retain the authority to inquire into matters affecting investors or the market. Where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct, or where a conflict of interest necessitates it, the regulator should take over the responsibility for an inquiry from an SRO. It is important, therefore, to ensure that the information provided by the SRO to the regulator allows these matters to be identified at an early stage.

224. SROs should follow similar professional standards of behaviour on matters such as confidentiality and procedural fairness as would be expected of the regulator.[41]

[41] SROs are generally non-governmental agencies and so will not always be subject to the same standards as apply to a government agency.

225. In assessing this Principle, the assessor should consider whether an SRO's powers and levels of oversight are consistent with its functions and responsibilities. Like a regulatory authority, an SRO's processes should be fair and consistent; its decisions should be subject to regulatory review; it should protect the confidentiality of its data; and it is the professional responsibility of its staff that their conduct should be similar to that expected of regulator staff. The regulator should have full authority to oversee effectively any SRO.

Key Issues

Authorisation

1. As a condition of authorisation, the legislation or the regulator should require an SRO to demonstrate that it:

    a. Has the capacity to carry out the purposes of relevant governing laws, regulations and SRO rules and to enforce compliance by its members and associated persons subject to those laws, regulations, and rules.

    b. Treats all members of the SRO and applicants for membership in a fair and consistent manner.

    c. Develops rules that are designed to set standards of behaviour for its members and to promote investor protection and market integrity.

    d. Submits to the regulator its rules for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy requirements established by the regulator.

    e. Cooperates with the regulator and other SROs to investigate and enforce applicable laws and regulations.

2. The SRO should have:

    a. Statutory delegation or other formal recognition from the regulator; and

    b. MoUs or other arrangements in place to secure cooperation between it and the regulator.

c. Its own rules, which are enforced and whose non-compliance is appropriately sanctioned.

3. It should also:

a. Assure a fair representation of members in selection of its directors and administration of its affairs.

b. Avoid rules that may create anti-competitive situations.

c. Avoid using the oversight role to allow any market participant unfairly to gain advantage in the market.

Oversight

4. Oversight should be ongoing to ensure that:

a. An SRO meets the conditions of its authorisation on an ongoing basis.

b. The government regulator retains the authority to inquire into matters affecting investors or the market.

c. Where the powers of an SRO are inadequate to investigate, or otherwise to address, alleged misconduct, or where the SRO has a conflict of interest that cannot be appropriately managed, the regulator conducts any necessary investigation, rather than the SRO; and

d. An SRO provides information to the regulator that allows matters requiring regulatory intervention to be identified at an early stage.

Professional Standards

5. The SRO should adopt standards of confidentiality for its staff and standards of procedural fairness applicable to its members comparable to those for the regulator.

Conflicts of Interest

6. The SRO should have procedures in place to address potential conflicts of interest.

Key Questions

Authorisation or Delegation Subject to Oversight

1. As a condition to authorisation, does the legislation or the regulator require the SRO to demonstrate that it:[42]

    a. Has the capacity to carry out the purposes of its governing laws, regulations and SRO rules consistent with the responsibility of the SRO, and to enforce compliance by its members and associated persons subject to its laws, regulations and rules?

    b. Treats all members of the SRO, applicants for membership and similarly situated market participants subject to its rules in a fair and consistent manner?

    c. Develops rules that are designed to set standards for its members and to promote investor protection?

    d. Submits to the regulator its rules and any amendments thereto, for review and/or approval, as the regulator deems appropriate, and ensures that the rules of the SRO are consistent with the public policy requirements established by the regulator?

    e. Cooperates with the regulator and other domestic SROs to investigate and enforce applicable laws, regulations and rules?

2. Does the SRO:

    a. Have statutory delegation or other formal recognition from the regulator?

    b. Have MoUs or other arrangements in place to secure cooperation between it and the regulator?

    c. Have its own rules which are enforced and whose non-compliance is appropriately sanctioned?

[42] In the case of a newly operational SRO, the applicant should demonstrate that it has programmes and procedures in place to meet the conditions of authorisation, and ongoing and effective execution of such programmes or procedures should be considered a condition of authorisation.

d. Where applicable, e.g., a mutualised organisation, assures a fair representation of members in selection of its board of directors and administration of its affairs?

e. Avoid rules that may create anti-competitive situations as defined in the Explanatory Note?

f. Avoid using the oversight role to allow any market participant unfairly to gain an advantage in the market?

Oversight

3. Does the regulator:

   a. Have in place an effective ongoing oversight programme of the SRO, which may include:

      i. inspection of the SRO;

      ii. periodic reviews;

      iii. reporting requirements;

      iv. review and revocation of SRO governing laws, regulations and rules; and

      v. the monitoring of continuing compliance with the conditions of authorisation or delegation.

   b. Retain full authority to inquire into matters affecting the investors or the market?

   c. Take over or support an SRO's responsibilities where the powers of an SRO are inadequate for inquiring into or addressing particular misconduct or allegations of misconduct, or where a conflict of interest necessitates it?

   d. Have oversight of any Sharī'ah governance mechanism in place within the SRO, particularly those SROs that exercise responsibility for determining the Sharī'ah compliance status of Islamic securities?

Professional Standards Similar to those Expected of a Regulator

4. Does the regulator, the law or other applicable regulation require the SRO to follow similar professional standards of behaviour as would be expected of a regulator:

a. On matters relating to confidentiality and procedural fairness?

b. On the appropriate use of information obtained in the course of the SRO's exercise of its powers and discharge of its responsibilities?

Conflicts of Interest

5. Does the regulator, the law or other applicable regulation assure that potential conflicts of interest at the SRO are avoided or appropriately managed?

Explanatory Notes

226. Use of properly overseen SROs can expand regulatory resources in financial markets.[43]

227. The level and extent of regulatory oversight and the types of necessary powers and protections may be affected by the structure of the SRO. For example, there may be more concern for conflicts of interest, or appropriate use of self-regulatory resources, in the case of for-profit, demutualised markets. Furthermore, in some markets, certain very specific functions are delegated to the SRO and others are not. Assessors must sensibly apply the Benchmarks in this case, only requiring oversight of the functions performed and not testing powers or attributes not performed by the SRO. In addition, if an entity performs certain SRO functions, for example an exchange, those SRO functions should be tested against CPICM 9 as applicable even though the exchange is authorised under CPICM 34. If, under consideration of the criteria in the scope section, an SRO-function is performed, this activity will be captured by CPICM 9. The assessments for CPICM 34 and CPICM 9 in this case should be consistent. Reference also may be made to other relevant CPICM for testing the adequacy of performance of regulatory functions by SROs where such functions are delegated to the SRO.

228. Anti-competitive situations may include situations where the SRO acts in an exclusionary, unfair or inequitable manner when governing access to the SRO, or when taking action with respect to the enforcement, or promulgation or interpretation, of SRO rules and procedures in a way that is not fair and equitable to similarly situated market participants. Among other things, regulatory oversight should be directed to the SRO undertaking its responsibilities in a way that unreasonably prevents access to the market or that unreasonably

[43] See also CPICM 3.

creates barriers to entry in the business of providing investment services that are unrelated to oversight of the market or prudential concerns.

229. SROs that are public companies also should be subject to the governance provisions applicable to other issuers. (See CPICM 17 through 19.)

Benchmarks

Fully Implemented

230. Requires affirmative responses to all applicable Questions.

Broadly Implemented

231. Requires affirmative responses to all applicable Questions, except, in the case of Questions 2(d) and 2(e), the regulator does not have the power to require that the SRO:

a. assures a fair representation of members in the selection of its board of directors and the administration of its affairs; or

b. avoids rules that may create anti-competitive situations;

provided that the SRO has relevant rules and procedures and/or there is a general law that addresses these issues and there is not a *record* of substantial complaint.

Partly Implemented

232. Requires affirmative responses to all applicable Questions except to Questions 2(d), 2(e) and 5, provided that in the case of Question 5, the regulator can take over actions undertaken by the SRO where these matters are at risk and there is no evidence of obvious abuses.

233. Additionally, although the SRO may not have the power to assist in investigation of compliance with applicable laws and regulations, the regulator requires the SRO, as a condition of authorisation and on an ongoing basis, to make all relevant information available to the regulator in regard to Question 1 (e).

Not Implemented

234. Inability to demonstrate that the regulator can require an SRO to meet standards, or failure to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d), 2(c), 2(f), 3(a), 3(b), 3(c), 3(d), 4(a) or 4(b), or to Questions 1(e) or 5, absent the qualifications under *Partly Implemented*, and/or a finding that the exercise of SRO functions in practice occurs without oversight or there is demonstrable evidence of abuse or insufficient performance of SRO functions.

BIBLIOGRAPHY FOR PRINCIPLE RELATING TO SELF-REGULATION

	Document	CPICM	Other CPICM
1	*Issues Paper on Exchange Demutualization*, Report of the Technical Committee of IOSCO, June 2000, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD119.pdf	9	
2	*Model for Effective Self-Regulation*, Report of the SRO Consultative Committee of IOSCO, May 2000, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD110.pdf	9	
3	*Principles of Effective Market Oversight*, Council of Securities Regulators of the Americas, May 1995, http://www.cvm.gov.br/ingl/inter/cosra/inter.asp	9	

2.3 Principle Relating to Sharī'ah Governance

2.3.1 Preamble

235. Sharī'ah defines a set of rules and principles governing the overall Islamic financial system. Compliance with these rules and principles is the most important factor differentiating the ICM from the conventional securities market. Hence, an essential feature of ICM activities is the requirement to comply with Sharī'ah rules and principles, and this requires the services of a competent Sharī'ah board (comprising, in line with IFSB-10, three or more Sharī'ah scholars, an external Sharī'ah consultancy firm or an individual scholar). Accordingly, "Sharī'ah governance system" [44] refers to the set of institutional and organisational arrangements that is required to ensure there is effective and independent oversight of Sharī'ah compliance through a number of structures and processes that may include one or more of the following:

a. the issuance of relevant Sharī'ah pronouncements or resolutions;

b. the dissemination of information on such Sharī'ah pronouncements or resolutions to the operative personnel who monitor day-to-day Sharī'ah compliance;

c. an internal Sharī'ah compliance review or audit to verify that the Sharī'ah-compliance requirements have been satisfied, during which any non-compliance is recorded, reported and, to the extent possible, addressed and rectified, or, imposing the consequence of invalidation on it where it cannot be rectified.[45]

d. an external annual Sharī'ah compliance review or audit to verify that the aforementioned internal audit or review has been carried out properly and the findings have been duly noted by the Sharī'ah board.

236. Securities and operations in the ICM are required to adhere to Sharī'ah[46] on an ongoing basis and at all stages of products and activities (for e.g. point of sale, ex-post sale,

[44] IFSB–10: *Guiding Principles on Sharī'ah Governance* covers the relationship between Sharī'ah governance in individual institutions and whatever Sharī'ah governance arrangements may exist for a jurisdiction as a whole. It recognises that Sharī'ah governance may take several forms, and that jurisdictions have adopted diverse approaches to it. The standard has been prepared within that context and accommodates whatever Sharī'ah governance arrangements consistent with IFSB-10 that may apply in an institution or jurisdiction. http://www.ifsb.org/standard/IFSB-10%20Shariah%20 Governance.pdf

[45] The assertion "to the extent possible" recognises instances when an underlying security has moved away from being Sharī'ah-compliant and the transition to non-compliance is irreversible – for instance, due to invalidation of the contracts used to structure the security, or when the issuer of the security no longer wishes to claim Sharī'ah compliance.

[46] The Sharī'ah principles essentially require investments to be free from *ribā* (interest), *gharar* (excessive uncertainty), *maysir* (gambling), and involvement with prohibited businesses (liquor, pork, conventional insurance, etc.) while further complying with various detailed tenets of the Islamic law of contracts.

etc.). In this regard, a typical process of identifying and structuring Sharī'ah-compliant alternatives to conventional capital market instruments involves a competent entity [47] screening the underlying structures and activities of proposed investments to ensure they are compliant.

237. There are, however, differing practices in the marketplace in terms of the regulatory environment for the ICM. These practices include the following:

a. A jurisdiction may provide specific recognition and treatment to ICM products either in the form of separate ICM regulations or by dealing with them specifically within a single capital market framework.

b. A jurisdiction may possess a single capital market framework that sets out guidance in general terms but allows the application of supervisory discretion for specific treatment pertaining to ICM products, where needed.

c. A jurisdiction may possess a single capital market framework that does not recognise ICM products as distinct and hence no different treatment is accorded.

238. The requirements for a board comprised of Sharī'ah scholars to review and supervise the products and instruments also vary. For instance:

a. A jurisdiction may put in place a centralised Sharī'ah board/committee that provides guidance and/or sets regulatory and Sharī'ah parameters for ICM products being offered in the market.

b. A jurisdiction may place responsibility on the issuer to obtain approval from an appropriate Sharī'ah board, or to disclose if it has received approval from a Sharī'ah board.

c. A combination of (a) and (b) may apply.

239. While the ICM is generally not segregated from conventional capital markets in terms of market infrastructure – for example, Islamic capital market instruments are listed on the same exchanges as conventional securities – a claim that an instrument is Sharī'ah-compliant is an important one for transparency and fairness to investors.

[47] This may be either a Sharī'ah board, comprised of two or more scholars and experts (and either internal or external to an entity in the ICM), or a single Sharī'ah scholar/consultant to the entity.

240. Hence, in order to achieve the objectives of ICM regulation, the regulator should ensure there is an appropriate Sharī'ah approval process for ICM products and services, along with ongoing monitoring post-product launch/issuance. This includes adequate disclosure on processes and activities to avoid any misleading claims of Sharī'ah compliance while further ensuring clarity on the general rights, responsibilities and exposures of investors based on the underlying Sharī'ah-compliant contracts supporting the products.

241. An additional dimension that needs to be considered in ICM is with respect to Sharī'ah scholars, particularly when an individual scholar may sit on multiple Sharī'ah boards of competing IIFS within the marketplace. The issue is also exacerbated where there is a centralised Sharī'ah board operating within the regulatory authority, and Sharī'ah scholars may sit on both the central Sharī'ah board and those in the marketplace.[48]

2.3.2 Scope

242. The principle applies to regulators in jurisdictions where players in the ICM, including issuers, fund managers and market intermediaries, explicitly claim the Sharī'ah compliance of their offerings.

243. The scope also includes all relevant aspects of Sharī'ah governance for ICM operations and products, including those pertaining to Sharī'ah boards, their competencies, composition and independence, as well as Sharī'ah-related disclosure requirements.

[48] IFSB-10, on Sharī'ah governance, discusses this issue in detail in paragraphs 13, 19, 25 and 44. Appendix 3 of IFSB-10 also sets out the "basic professional ethics and conduct for members of the Sharī'ah board.

2.3.3 CPICM 10

CPICM 10: The Regulator[49] should require that Sharī'ah governance is upheld for all products, activities, services and/or institutions implicitly or explicitly claiming Sharī'ah compliance in the Islamic capital market.[50] (No IOSCO equivalent)

244. The CPICM recognise the sensitivity of claims to Sharī'ah compliance for ICM products and services, given that this is important to religious and/or ethically sensitive investors – both individual and institutional.[51] IFSB-10 provides Principles for Sharī'ah governance in Islamic financial institutions, which will apply to ICM financial institutions. However, capital markets regulation also addresses products and non-financial institutions (such as issuers). In these areas, the approaches of IFSB-10 may be applicable by analogy.

Key Issues

1. The regulator should seek to ensure that products claiming to be Sharī'ah-compliant in the ICM have undergone a sound screening and approval process by a competent Sharī'ah board (whether the board is comprised, in line with IFSB-10, of three or more Sharī'ah scholars, an external Sharī'ah consultancy firm or an individual scholar) and/or are in conformance with the jurisdiction's centralised Sharī'ah standards (if applicable and available).

2. The regulator should require the Sharī'ah board to be competent by way of having the relevant skills and expertise, and ensure that measures are in place to address any misaligned incentives and conflicts of interest of the board, including the role of Sharī'ah scholars.

3. The regulator should require marketers[52] of products claimed to be Sharī'ah-compliant in the ICM to make appropriate disclosures should any material changes affecting the Sharī'ah compliance of the product occur.

[49] Here and elsewhere in CPICM 10, it is recognised that some jurisdictions may have multiple regulators with different scopes of authority on matters related to Sharī'ah governance. Hence, the assessment is to be based on the relevant scope of authority of the regulator being assessed.
[50] In some jurisdictions, other terms (e.g. "participatory finance") may be used to imply compliance with Sharī'ah.
[51] There are institutional investors that seek purely Sharī'ah-compliant investments – for example, Islamic pension funds, Islamic banks, Islamic endowment (*waqf*) authorities, etc.
[52] These may be the originators themselves or, alternatively, market intermediaries that market and distribute products from third-party originators.

4. The regulator must clearly specify regulatory measures and remedial actions to be undertaken in the event of a change in status to Sharīʿah non-compliant of a previously compliant product.

5. The regulator must also be transparent and consistent in its approach to dealing with matters of Sharīʿah governance in the ICM.

6. The regulator must have cooperation arrangements in place to manage cross-border activities in ICM in the light of differing Sharīʿah interpretations.

Key Questions

1. As a condition to a product claiming Sharīʿah compliance in the ICM, does the legislation or the regulator demonstrate that it has:

    a. Required the offering party in the market to comply with the jurisdiction's centralised Sharīʿah standards (if applicable and available)?

    b. Required the offering party to avail itself of the services of, and to comply with the opinions of, a Sharīʿah board?

    c. Duly required the offering party to transparently disclose the basis for its claim of Sharīʿah compliance for its product or service?

2. In relation to a Sharīʿah board referred to in Key Question 1, does the legislation or the regulator demonstrate that it:

    a. Has established appropriate processes and procedures for assessing the competence and recognising the resolutions/judgments of a Sharīʿah board in its jurisdiction?

    b. Has provisions in place that require the Sharīʿah board, where it is within the jurisdiction of the regulator, to act in an independent and transparent manner and to manage appropriately any conflicts of interest?

    c. Requires the offering party to maintain records of the process undertaken in obtaining Sharīʿah approval of its products?

3. In relation to the spirit of transparency and market discipline, does the legislation or the regulator demonstrate that it requires the offering party to provide adequate disclosures of the ICM product and services on an ongoing basis, including any material disclosures that may affect the Sharīʿah compliance status of an offering?

4. To safeguard sound Sharīʿah non-compliance risk management and to uphold Sharīʿah governance, does the legislation or the regulator demonstrate that it has steps for corrective action in place in the event of a change in status to Sharīʿah non-compliant of a previously compliant product?

5. Does the legislation or the regulator demonstrate that it:

    a. Documents and publicly discloses the basis for material shifts (if any) in jurisdiction-wide frameworks relating to Sharīʿah governance?

    b. Applies the framework in a consistent manner in the marketplace without any inequities or differences in implementation?

6. To establish the Sharīʿah compliance of products and services offered by foreign entities, does the regulator demonstrate that it:

    a. Requires the foreign offering party to comply with relevant host regulations[53] for claiming Sharīʿah compliance of the product in its jurisdiction?

    b. Has arrangements in place with foreign counterparts to seek additional information to ascertain if an appropriate Sharīʿah compliance process has been followed for the product or service, in case a need arises?[54]

Explanatory Notes

245. A number of issues under CPICM 10 are closely related to many other Principles, including, for instance: clarity on the regulator's responsibility for the ICM (under CPICM 1); public accountability of the regulator in relation to the ICM (under CPICM 2); the authority and competence of the regulator on matters related to Sharīʿah compliance in the ICM (under CPICM 3); oversight and monitoring of SROs – in particular, when they have responsibility at their level to monitor the Sharīʿah compliance of ICM products (under CPICM 9); adequate surveillance mechanisms of Sharīʿah compliance and an effective enforcement programme in

[53] These regulations may in some circumstances provide for recognition of another jurisdiction's provisions for claiming Sharīʿah compliance.

[54] If RSAs are signatories to the IOSCO Multilateral MoU the provisions for mutual information sharing would enable them to achieve this.

the event of Sharīʿah compliance failure by the regulator (under CPICM 13); cooperation on Sharīʿah governance matters with domestic and foreign counterparts (under CPICM 14 and 16); and adequate disclosures on ICM and Sharīʿah issues (under CPICM 17, 20 and 26).

246. Sharīʿah scholars may be required to follow certain behavioural standards, particularly in regard to the protection of confidential information, as well as other measures such as abiding by, where available and at the discretion of the regulator, specific codes of conduct, governance standards, and restrictions in place on the number and types of Sharīʿah boards they may sit on concurrently.

247. While the specifics of the various issues are duly raised in each of the respective CPICM, they may have relevance to key issues and key questions grouped under CPICM 10. Hence, a failure in any of the issues in other CPICM will directly impact the implementation of CPICM 10 from a Sharīʿah governance perspective.

248. There may be instances when certain ICM products are marketed in jurisdictions using terminologies that signal an implicit Sharīʿah compliance of the product in question – for instance, referring to a fund as an "Amānah Fund". Where the regulator detects such sorts of implicit Sharīʿah compliance claim signals, the product in question is to be regulated under the scope of regulations covering ICM products and, hence, the various key issues and key questions of CPICM 10 are also applicable.

Benchmarks

Fully Implemented

249. Requires affirmative responses to all applicable Questions.

Broadly Implemented

250. Requires affirmative responses to all applicable Questions except Questions 5(a) and 6(b).

Partly Implemented

251. Requires affirmative responses to all applicable Questions except Questions 1(c), 2(a), 2(b), 2(c), 4, 5(a) and 6(b).

Not Implemented

252. Failure to respond affirmatively to one or more of Questions 1(a), 1(b), 3, 5(b) or 6(a).

BIBLIOGRAPHY FOR PRINCIPLE RELATING TO SHARĪʿAH GOVERNANCE

	Document	CPICM	Other CPICM
1	IFSB-1: *Guiding Principles of Risk Management,* http://www.ifsb.org/standard/ifsb1.pdf	10	
2	IFSB-10: *Guiding Principles on Sharīʿah Governance Systems,* http://www.ifsb.org/standard/IFSB-10%20Shariah%20Governance.pdf	10	
3	IFSB-6: *Guiding Principles on Governance for Islamic Collective Investment Schemes,* http://www.ifsb.org/standard/ifsb6.pdf	10	26 27 28 29
4	IFSB-19: *Guiding Principles on Disclosure Requirements for Islamic Capital Market Products,* http://www.ifsb.org/standard/IFSB%2019%20-%20Guiding%20Principles%20on%20Disclosure%20of%20ICM%20Products%20(final).pdf	10	17 20 26

2.4 Principles Relating to Enforcement

2.4.1 Preamble

253. Strong and rigorous enforcement of securities laws is fundamental to help foster investor confidence and maintain fair and efficient markets. Under the Principles, the term "enforcement" should be interpreted broadly enough to encompass powers of inspection, investigation and surveillance such that the regulator should be expected to have the ability, the means, and a variety of measures to detect, deter, enforce, sanction, redress and correct violations of securities laws.

254. Broadly interpreted, "enforcement" can be considered to take place across a continuum that includes a range of activities and processes, such as:

- routine, risk-based and *ad hoc* inspections of regulated entities, including collecting information from regulated entities necessary to establish and assess compliance, and inspections prompted by tips and complaints from investors;
- surveillance of trading on organised platforms and gathering market intelligence more generally;
- investigations in respect of regulated or unregulated entities, which may be prompted by suspicion of misconduct; and
- taking action against non-compliance and misconduct, which may include enforcement proceedings and seeking appropriate remedies and sanctions.

255. This list is not intended to be prescriptive or exhaustive. Different regulators will have differing values, goals and legal systems underlying their enforcement programmes. Accordingly, not all of the activities and processes described above will be relevant to all regulators.

256. Regulators should also demonstrate adequate surveillance mechanisms and an effective enforcement programme to identify and respond to failure to comply with their Sharī'ah compliance requirements.

257. While CPICM 11 and 12 are intended to establish the nature and extent of the regulator's powers, CPICM 13 is designed to measure the ability of the regulator to use these powers, and how effectively and credibly it exercises them. Together they seek to determine a regulator's ability to monitor the entities subject to its supervision, to collect information on a

routine and *ad hoc* basis, and to take enforcement action or otherwise effect corrective action by regulated entities to ensure that persons and entities comply with relevant securities laws or are sanctioned for non-compliance.

258. The assessment under these Principles requires a careful consideration of the legal system in which the regulator operates. The Principles contemplate both civil law and common law systems and do not prescribe any specific enforcement model to be followed. There are several enforcement models that have been shown to be effective. These include models in which enforcement responsibilities are shared between several government or quasi-government agencies, or in which responsibilities are shared with SROs.

259. It is important that not only are the legal mechanisms in place for ensuring inspection, investigation, surveillance and enforcement powers, but that the authority has the ability to carry out effective programmes in each of these areas. This includes ensuring that adequate resources are devoted to enforcement because only through effective enforcement will regulators most effectively deter future misconduct. Enforcement of securities regulatory requirements across the range of entities and products in the capital markets is also of key importance. CPICM 11, 12 and 13 are therefore highly interrelated with the specific regulatory functions and responsibilities described under the Principles for Issuers, Islamic Collective Investment Schemes, Market Intermediaries and Secondary and Other Markets. Assessors should ensure that the evaluation of CPICM 11, 12 and 13 is consistent with the assessments of the other Principles from an enforcement perspective in the assessed jurisdiction.

260. Under this framework, these Principles are relevant to the work of the regulator on the basis that they ensure the appropriate performance of the regulator's functions and the effective exercise of its enforcement and supervisory powers.

2.4.2 Scope

261. Mechanisms for ensuring enforcement of securities laws should be in force in all jurisdictions. It is not necessary, however, that the responsibility for all aspects of enforcement of securities laws be given to a single body.

262. Where enforcement is undertaken by an authority other than the regulator, or where enforcement is shared between the regulator and another authority, cooperation among such bodies is critical and the ability to do so in a timely and effective manner should be particularly scrutinised.

2.4.3 CPICM 11 through 13

CPICM 11:	**The Regulator should have comprehensive inspection, investigation and surveillance powers. (IOSCO 10)**

263. CPICM 11 is designed to address whether a regulator has comprehensive powers to conduct inspections, investigations, and surveillance in relation to regulated entities in order to monitor and assess compliance with relevant ICM laws. It covers the circumstances where, and methods by which, the regulator may obtain information from regulated entities. CPICM 11 also addresses the regulator's authority to conduct ongoing oversight and supervision of regulated entities as a preventative measure.

264. The concept of inspection generally includes the routine activities that a regulator may undertake in overseeing and supervising regulated entities in order to monitor compliance with regulatory requirements, detect and deter non-compliance, and identify risks and potential issues. These activities may vary among jurisdictions, and may include reviews of books, records, continuous disclosure and other regulatory filings and other information in response to an inquiry or as part of a reporting cycle. They may also include on-site inspection or desk-based reviews. For powers of inspection to be meaningful, regulated entities should be required to make and keep records of their transactions and activities. The regulator should also have the power to carry out inspections of regulated entities on their premises without prior notice, when it believes it is appropriate to verify compliance with regulatory requirements.

265. The suspicion of a breach of law should not be necessary to enable the regulator to require information from or conduct inspections of regulated entities. A regulator may choose to determine when and how often to conduct routine or more focused inspections of particular regulated entities by fixing a schedule, considering risk assessments and/or using other risk-based methods to set inspection priorities.

266. The concept of investigation generally includes activities that the regulator may undertake to obtain information, records or statements. An investigation may be prompted by findings from an inspection, or by suspicion of a breach of securities law, with a view to determining if further enforcement proceedings should be commenced.

267. Powers of inspection and investigation may be supported with the ability of the regulator or other competent authority to take actions to ensure compliance with these powers, for example, by seeking a court or judicial order to enforce the request to provide information to the regulator.

268. The main focus of surveillance is usually on monitoring trading activity of listed securities on authorised exchanges and regulated trading platforms. However, surveillance can take different forms and be conducted using a range of tools and technologies. The regulator should take advantage of the forms of surveillance that it considers appropriate for its market, which may expand to include tracing connections and conducting more targeted monitoring of particular persons subject to a regulator's supervision (for example, individuals associated with past misconduct) and having systems in place to alert the regulator when unusual or suspicious trading patterns occur so that further inspections and investigations can take place.

269. In circumstances where inspection, investigation, surveillance or other regulatory enforcement authority has been delegated to or is otherwise exercised by third parties, regulators should maintain some level of oversight or involvement in order to avoid undue gaps.

Key Issues

1. The regulator should have the power to require the provision of information in the ordinary course of business, in response to an inquiry or as part of a reporting cycle, or to carry out inspections of regulated entities' business operations[55] whenever it believes it is appropriate to verify compliance with relevant standards.

    a. The suspicion of a breach of law should not be necessary to enable the regulator to conduct inspections or require information of regulated entities.

    b. The regulator should be able to conduct on-site inspections of regulated entities.

2. The regulator should be able to require the provision of all information reasonably needed to examine compliance with relevant standards, including books, records, documents, communications and statements.

3. The regulator should have the power to conduct or supervise surveillance of trading activity on its authorised exchanges and regulated trading platforms.

[55] See, generally, *Outsourcing in Financial Services,* Report of the Joint Forum, February 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf.

4. Where regulatory enforcement responsibilities are delegated to a third party, including an SRO, the third party should be subject to disclosure and confidentiality requirements that are as stringent as those applicable to the regulator.

Key Questions[56]

1. Does the regulator have the power to inspect a regulated entity's business operations,[57] including its books and records:

   a. Without giving prior notice?

   b. On-site?

2. Does the regulator have the power to obtain books and records and request data or information from regulated entities without judicial action, even in the absence of suspected misconduct:

   a. In response to a particular inquiry?

   b. On a routine basis?

3. Does the regulator have the power to conduct or supervise surveillance of trading activity on its authorised exchanges and regulated trading platforms?

4. Does the regulatory system have recordkeeping and record retention requirements for regulated entities?[58]

5. Are regulated entities required:[59]

[56] Questions for CPICM 11 are generally taken from the *Resolution on Principles for Record Keeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws,* Resolution of the Presidents' Committee of IOSCO, November 1997, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES15.pdf ("Resolution on Record Keeping") and confirmed by the *Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information,* Report of IOSCO, May 2002 (version revised May 2012), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf (the "IOSCO MMoU").

[57] "Regulated entity" includes authorised or licensed entities or persons. These regulated entities remain accountable to the regulator for any delegated activity.

[58] The FAQs to the IOSCO MMoU consider five years as the norm for maintenance of records (see FAQ #41). See also, CPICM 30-33 for Market Intermediaries.

[59] Key Question 4 is testing if a jurisdiction does have record keeping requirements and if there are retention requirements for those records for regulated entities. Key Question 5 is testing if a jurisdiction has specific categories of documents that should be maintained by regulated entities. These requirements can be found in securities, banking, anti-money laundering or other laws of the jurisdiction, and assessors should review all relevant laws of the jurisdiction for these requirements.

a. To maintain records concerning client identity?[60]

b. To maintain records that permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions?

6. Does the regulator have the authority to determine or have access to the identity of all clients of regulated entities?[61]

7. Where a regulator[62] outsources or otherwise grants, or where legislation grants, inspection or other regulatory enforcement authority to a third party, including an SRO:

   a. Does the regulator supervise the outsourced functions of the third party?

   b. Does the regulator have full access to information maintained or obtained by the third party?

   c. Can the regulator cause changes/improvements to be made in the third parties' processes?

   d. Is the third party subject to disclosure and confidentiality requirements that are no less stringent than those applicable to the regulator?

Explanatory Notes

270. Full access to information maintained or obtained by the third party includes access to information being outsourced by the third party, taking into account that the SRO might use some outsourced services for its surveillance and inspection activities.[63]

[60] See *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, p. 10, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf. See also *Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism*, Report of the Joint Forum, June 2003, p. 7, available at http://www.iosco.org/library/pubdocs/pdf/ IOSCOPD146.pdf.
[61] See Principles on Client Identification and Beneficial Ownership for the Securities Industry, supra.
[62] In the case of an SRO, the regulator should have these powers as a condition of continuing authorisation. See CPICM 9. For this question, see generally *Outsourcing in Financial Services*, supra.
[63] This footnote refers to Key Question 7(b).

Benchmarks

Fully Implemented

271. Requires affirmative responses to all applicable Questions.

Broadly Implemented

272. Requires affirmative responses to all applicable Questions, except to Question 7(c).

Partly Implemented

273. Requires affirmative responses to all applicable Questions, except to Questions 7(c) and 7(d).

Not Implemented

274. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), 2(b), 3, 4, 5(a), 5(b), 6, 7(a) or 7(b).

CPICM 12:	The Regulator should have comprehensive enforcement powers. (IOSCO 11)

275. While CPICM 11 is limited to regulated entities, CPICM 12 is intended to have wider application to also include unregulated entities. CPICM 12 deals with courses of action, including investigations and proceedings, available to the regulator where a breach of relevant securities laws by any person is suspected or identified.[64]

276. The regulator or other competent authority should, therefore, be provided with comprehensive investigatory and enforcement powers. Such powers may vary from jurisdiction to jurisdiction and, for example, may include the powers described in the preamble to CPICM 11, as well as the power to:

- obtain information, records and statements from any entity or any persons involved (whether regulated or unregulated), directly or indirectly, or who may possess information relevant to an investigation;

- commence actions and lay charges against persons suspected of misconduct or breach of securities laws, and/or seek orders from courts or tribunals and/or to refer matters for civil and/or criminal actions;

- seek or impose a range of effective, proportional and dissuasive administrative sanctions where a breach is found, and to seek to enforce such sanctions where necessary;

- make or seek temporary orders (for example, the suspension of trading) while an investigation is, or proceedings are, taking place against the person suspected of breaching securities laws;

- compel the attendance, statement or testimony of individuals or representatives of entities who have been charged or asked to provide evidence;

- allow for outcomes arrived at through alternative resolution mechanisms (for example, through settlement, mediation or arbitration processes that may or may not be binding on parties);

[64] See *Resolution on Enforcement Powers*, Resolution of the Presidents' Committee of IOSCO, November 1997, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf; and *Resolution on Record Keeping*, supra.

- appeal decisions and/or allow for appeals to be made.

277. It is not necessary that the responsibility for all aspects of enforcement of the securities law be given to a single body. There are several enforcement models that have been shown to be effective. These include models in which enforcement responsibilities are shared between several government or quasi-government agencies or in which responsibilities are shared with SROs.

278. The international nature of securities markets and the fact that, frequently, misconduct may occur across several jurisdictions give rise to a number of particular issues.

279. Legislation and the enforcement powers of the regulator should be sufficient to ensure that it can be effective in cases of cross-border misconduct.

280. Details about the powers that an enforcement authority should have are described more specifically in the *IOSCO Multilateral Memorandum of Understanding* concerning *Consultation and Cooperation and the Exchange of Information* (the "IOSCO MMoU").[65]

281. The general topic of international cooperation and its importance to effective regulation is addressed in the Principles relating to Cooperation.

Key Issues

1. The regulator or other competent authority should have comprehensive investigative and enforcement powers including the power: to seek court or judicial orders, or to take action to enforce regulatory, administrative, or investigative requirements or decisions; or to seek or impose effective sanctions; or to initiate criminal proceedings or refer matters to the criminal authorities.

2. The regulator or other competent authority should be able to obtain data, information, documents, books and records, and to take at least voluntary statements or testimony from any person, including third party entities and individuals (whether regulated or unregulated), that are either involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation.

[65] See Article 7 of the IOSCO MMoU, supra.

3. Enforcement powers should not compromise private rights of action. Private persons should be able to seek their own remedies (including, for example, for compensation, damages or specific performance of an obligation).

4. Where the exercise of enforcement powers requires the action of more than one regulator or other competent authority, prompt cooperation, including information sharing between them, should be possible for investigative and enforcement purposes.[66]

Key Questions

1. Does the regulator or other competent authority have the investigative and enforcement power to enforce compliance with the laws and regulations relating to securities activities?

2. Does the regulator or other competent authority have the following powers:

   a. Power to seek court or judicial orders, to refer matters for civil proceedings or to take other action to ensure compliance with regulatory, administrative, and investigative requirements or decisions?

   b. Power to impose effective, proportionate and dissuasive administrative sanctions?[67]

   c. Power to initiate criminal proceedings or to refer matters for criminal prosecution?

   d. Power to order the suspension of trading in securities or to take other appropriate actions?[68]

3. Does the regulator or other competent authority have the investigative and enforcement power to require and to obtain from any person, including third party

[66] See CPICM 1 and 14.
[67] CPICM 11, Key Questions. See also the *Resolution on Record Keeping*, supra.
[68] Other actions include the imposition of trading restrictions or requirements on individual market participants, e.g., position limits on Sharī'ah-compliant trades, reporting requirements, liquidation-only trading, special margin requirements or other corrective actions. Some jurisdictions also can seek compensatory remedies. The specific actions listed in Key Question 2(d), and in this footnote, are exemplary and are not necessary to receive a *Fully Implemented* assessment provided the regulator can demonstrate that available sanctions are proportionate, dissuasive and effective.

entities and individuals (whether regulated or unregulated), that are either involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation:[69]

a. Contemporaneous records sufficient to reconstruct all transactions in securities and Sharīʿah-compliant hedging instruments including records of all funds and assets transferred into and out of bank and brokerage accounts relating to those transactions?

b. Records for transactions in securities and Sharīʿah-compliant hedging instruments that identify:

   i. The client:

      1. Name of the account holder?

      2. Person authorised to transact business?

   ii. The amount purchased or sold?

   iii. The time of the transaction?

   iv. The price of the transaction?

   v. The individual and the bank or broker and brokerage house that handled the transaction?

c. Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organised in its jurisdiction?

d. Statements or testimony?[70]

e. Any other information including documents and bank records?

4. Can private persons seek their own remedies for misconduct relating to the securities laws?[71]

[69] *Resolution on Record Keeping*, supra and the IOSCO MMoU, supra. This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart. See also CPICM 11 and CPICM 14, Key Question 1.

[70] A regulator should be enabled to obtain at least voluntary statements.

[71] Such actions need not be taken directly under the securities laws, but could be under provisions within the general law.

5. Where an authority other than the regulator must take enforcement or other corrective action, can the regulator share information obtained through its regulatory or investigation activities with that authority?

6. Where the regulator is unable to obtain information in its jurisdiction necessary to an investigation is there another authority that can obtain the information?[72]

7. If yes: Are there respective arrangements between the regulator and the other domestic authority with regard to the respective exchange of information in place?[73]

Explanatory Notes

282. The assessor must determine how the jurisdiction's enforcement programme is designed to use the powers accorded.[74] The sufficiency of the powers may depend on the ability to demonstrate that they are exercised effectively. The scope of the investigative and enforcement powers conferred on the regulator and/or on other authorities, including public prosecuting authorities, depends on the conduct under investigation and the legal system applicable in the jurisdiction. The assessor should inquire whether the system, as such, is able effectively to detect, investigate and prosecute violations of the securities laws.

283. Regulators and other competent authorities should recognise in applying their investigative and enforcement powers that securities fraud or other securities misconduct often takes unusual, complex or new forms. They should be prepared to apply their laws to such unusual forms of fraud and to contribute actively to develop their respective legislation, and surveillance/inspection and investigation methodologies, where necessary.

284. The assessor also should inquire of the regulatory authority as to its view of the adequacy of available sanctioning powers and powers to take corrective action.

285. Examples of measures used to enforce securities regulatory requirements and to deter and sanction securities violations include: fines; disqualification; suspension and revocation of authority to do business; injunctions or cease and desist orders, directly or through court order; asset freezes, directly or through court order; action against unlicensed persons in conducting securities transactions or referral of such activities to the criminal authorities;[75] measures to

[72] See CPICM 16, Key Question 8.
[73] A respective arrangement could be an undertaking or an MOU.
[74] CPICM 13.
[75] "Enforcement programme" may be broadly understood as all the measures that are taken by a regulator in order to use its powers.

enforce disclosure and financial reporting requirements for issuers; measures to enforce conduct of business, capital requirements and other prudential rules; and measures to enforce recordkeeping and reporting by market intermediaries,[76] operators of authorised exchanges, regulated trading systems and ICIS, and other regulated securities entities.

286. Such sanctions are examples only, and the regulator must demonstrate that there is a spectrum of sanctions available that are proportionate, dissuasive, effective and sufficient to cover the spectrum of securities violations.

Benchmarks

Fully Implemented

287. Requires affirmative responses to all applicable Questions and, where cooperation among another authority and the regulator is necessary to take action, that such action is responsive to the priorities of the securities regulator and timely.

Broadly Implemented

288. There is no *Broadly Implemented* rating for this Principle.[77]

Partly Implemented

289. Requires affirmative responses to all applicable Questions except to Question 4.

Not Implemented

290. Inability to withdraw or suspend a licence, or inability to respond affirmatively to one or more of Question 1, 2(a), 2(b), 2(c), 2(d), 3(a), 3(b), 3(c), 3(d), 3(e), 5, 6, or 7 or demonstrated failures in cooperation arrangements.

[76] An example of a measure to enforce reporting requirements would be the power to require an amended financial report or disclosure statement.
[77] Nevertheless, the grade *Broadly Implemented* could be applied on the basis of the "Assessment Measures" described in the Introduction to this Methodology.

CPICM 13:	**The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme. (IOSCO 12)**

291. CPICM 13 requires the regulator to demonstrate how the regulatory system in place, and its own organisation, provides for an effective and credible use of inspection, investigation, surveillance and enforcement powers and compliance programmes. In particular, the regulator should be able to demonstrate that there is a system to take effective inspection, investigation, surveillance and enforcement actions and that, where appropriate, actions have been undertaken to address misconduct or abuses. For the specific case of ICM, this should include effective and credible use of powers to redress any violations related to Sharī'ah-governance requirements that may be imposed by a jurisdiction for ICM operations/institutions and products. An effective programme, for example, could combine various means to identify, detect, deter and sanction such misconduct. A wide range of possible sanctions could meet the standards according to the nature of the legal system assessed. The regulator, however, should be able to provide documentation that demonstrates that sanctions available (whatever their nature) are effective, proportionate and dissuasive. Sections of the Principles that address specific functions also address possible sanctions.

292. The regulator should be able to demonstrate that an effective and credible use of inspection, investigation, surveillance and enforcement powers has been made and will be made in the future. The effective and credible use of powers depends on adequate powers, proper resources and the capacity to perform its functions and exercise its powers. Whereas CPICM 11 and 12 establish the nature and extent of the regulator's enforcement powers, and CPICM 3 addresses resources in general, CPICM 13 covers the use of the resources by the regulator in the performance of its functions and exercise of its enforcement powers.

293. In particular, the regulator should be able to demonstrate and explain how its powers are exercised by:

- The regulatory actions undertaken in the jurisdiction. This may include the manner in which concerns raised through inspections, surveillance or compliance reviews may lead to investigation and enforcement proceedings.

- The compliance programmes that it requires regulated entities to have in place to prevent, detect and correct securities law violations. For example, a compliance programme may include establishing internal controls, day-to-day supervision, and monitoring of activities within the entity and a requirement for written policies and

procedures to be communicated to employees of the entity. The regulator should monitor the entity's compliance with policies and procedures.

- The type of ongoing and *ad hoc* inspections performed in the jurisdiction (see CPICM 11 for a description of the term "inspections"). For example, the regulator may have a method for determining the frequency and scope of inspections of regulated entities, or may have a risk-based process for setting inspection priorities and scope.

- The investigation and enforcement actions undertaken in the jurisdiction. This may include the regulators' ability to detect and gather the information necessary to exercise these actions, which may involve partners such as other regulators, SROs and law enforcement agencies.

- The sanctions imposed, or other corrective action effected, with respect to misconduct detected within the jurisdiction. Regulators may have and use a range of regulatory responses and sanctions to deter potential misconduct, which will allow the regulator to seek remedies that are effective, proportional and dissuasive.

Key Issues

1. In order to have an effective and credible enforcement system, it is not sufficient for a regulator simply to have the statutory powers set out in the CPICM. The regulator should be able to:

    a. Detect suspected breaches of the law in an effective and timely manner.

    b. Gather the relevant information necessary for investigating such potential breaches.

    c. Be able to use such information to take action where a breach of the law is identified.

    d. Demonstrate that it has programmes in place and utilises its resources in order to effectively exercise activities according to Key Issues 1(a) to (c).

2. In addition, the regulator should require a compliance system to be in place for regulated entities aimed at preventing, detecting and correcting securities law violations, which includes:

a. Inspections or self-reviews using methodologies and techniques which are adequate, but which may vary from jurisdiction to jurisdiction.

b. Other monitoring or surveillance techniques.

Key Questions

Detecting Breaches

1. Is there an effective system of inspection in place whereby the regulator carries out inspections:

   a. On a routine periodic basis?

   b. Based upon a risk assessment?

   c. On a non-periodic basis in response to intelligence received (e.g. investor complaints, and tips and complaints from other sources)?

2. Is there an automated system which identifies unusual transactions on authorised exchanges and regulated trading systems?

3. Can the regulator demonstrate adequate mechanisms and procedures to detect and investigate:

   a. Market and/or price manipulation?

   b. Insider trading?

   c. Misrepresentations of material information or other fraudulent or manipulative practices relating to securities and Sharīʿah-compliant hedging instruments?

   d. Failure of compliance with other regulatory requirements, for example: conduct of business, capital adequacy, disclosure, or segregation of client assets?

4. Does the regulator have an adequate system to receive and respond to the intelligence that it receives?

Compliance System

5. Does the regulator require regulated entities to have in place supervisory and compliance procedures reasonably designed to prevent securities law violations?

6. Does the regulator monitor how compliance procedures are executed and communicated to employees of such entities?

7. Can the regulator take measures against or discipline or sanction regulated entities for failure to supervise reasonably subordinate personnel whose activities violate the securities laws?

8. Does the regulator require market surveillance mechanisms that permit an audit of the execution and trading of all transactions on authorised exchanges and regulated trading systems?[78]

Effectiveness

9. Based on articulated criteria, does the regulator or other competent authority have an effective enforcement programme in place in order to enforce securities laws?

Explanatory Notes

294. In assessing this Principle, the assessor also should refer to CPICM 11 and 12 with respect to powers, CPICM 14 and 16 with respect to cooperation and CPICM 2 and 3 with respect to adequacy of resources, procedures and accountability of regulators.

295. The assessor should assess whether there is evidence of an effective system in place to detect breaches, gather and use information, promote compliance and sanction non-compliance, using inspection, investigation, surveillance, and enforcement powers. There should be effective and credible use of these powers in respect of the various areas of securities regulation.

296. The regulator or third party, including an SRO, should be able to demonstrate to the assessor records and other material evidence that describe enforcement activities, including

[78] Assessors must check whether auditing of transactions is provided for and in fact has been performed.

legislative provisions, published guidance, and illustrative press releases covering relevant enforcement cases, complaints and depositions, if public.

297. In assessing a risk-based inspection programme, the assessor should determine how priorities are set and how they are adjusted or updated – for example, by use of review of periodic financial reports or other mechanisms. It is sufficient that a system for the redress of complaints under the regulatory framework be addressed through an ombudsman, external dispute-resolution provision or other third-party scheme, or through oversight of individual firm arrangements.

298. In assessing the effectiveness of an enforcement programme, the assessor should assess whether the regulator uses the powers set forth in CPICM 12, Key Question 2(a) to 2(d).

299. The lack of skilled staff to operate an automated system referred to in Key Question 2 is a strong indicator that the respective Question should be answered in the negative.

300. There is a strong indication that Key Question 3(a) and 3(b) cannot be answered affirmatively, if Key Question 2 is answered negatively.

301. In relation to Key Question 9, assessors must articulate the metrics used to arrive at their conclusions about the effectiveness of an enforcement programme. These metrics could, but not need necessarily, include: (1) resources dedicated to an enforcement programme; (2) level of fines imposed per annum; (3) cost of capital in the jurisdiction as a proxy for investor confidence in the enforcement programme; (4) the number of cases filed per annum; and (5) number and type of investigations conducted per year.

Benchmarks

Fully Implemented

302. Requires affirmative responses to either 1(a) or 1(b) and to all other applicable Questions provided that, in the case of an affirmative response only to 1(b), there must be some means to identify changes in risk priorities or status of firms potentially subject to inspection and the ability to demonstrate effective coverage.

Broadly Implemented

303. Requires affirmative responses to either 1(a) or 1(b) and to all other applicable Questions except to Questions 2, 4 and 8 and/or an investigation, surveillance and enforcement system is in place but more resources need to be committed to ensure effective management, adjustments in operation of the system may be necessary, or certain desirable powers (see Principle 10) are necessary to augment the system to make it more effective.

Partly Implemented

304. Requires affirmative responses to either Question 1(a) or 1(b), and to Questions 1(c), 3(a), 3(b), 3(c), 3(d), 5, 6 and 7, and the regulator can demonstrate that it has an active enforcement and compliance programme, although there are some deficiencies in timeliness or coverage.

Not Implemented

305. Inability to respond affirmatively to both Question 1(a) and 1(b), or to one or more of Questions 1(c), 3(a), 3(b), 3(c), 3(d), 5, 6, 7 or 9.

BIBLIOGRAPHY FOR PRINCIPLES RELATING TO ENFORCEMENT

	Document	CPICM	Other CPICM
1	*Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information*, Report of IOSCO, May 2002 (version revised May 2012), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf "IOSCO MMoU"	11 12 13	14 15 16
2	*Outsourcing in Financial Services,* Report of the Joint Forum, February 2005, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf	11	19 31
3	*Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf	11	31
4	*Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf	12	14 17 31
5	*Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism*, Report of the Joint Forum, June 2003, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD146.pdf	11	31
6	*Securities Activity on the Internet II*, Report of the Technical Committee of IOSCO, June 2001, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf	12	17 33

	Document	CPICM	Other CPICM
7	*Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf	12	14 17 31 33
8	*Resolution on Principles for Record Keeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws*, Resolution of the Presidents' Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES15.pdf "*Resolution on Record Keeping*"	11 12	14 15 16
9	*Resolution on Enforcement Powers*, Resolution of the Presidents' Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf	12	14

2.5 Principles Relating to Cooperation

2.5.1 Preamble

306. CPICM 14, 15 and 16 address cooperation amongst regulators and their domestic and foreign counterparts for investigations, enforcement and for supervision and other regulatory purposes.[79]

307. The increasing internationalisation of financial activities and the globalisation of markets can put information beyond the immediate reach of one individual regulator. This puts an additional emphasis on the need for international cooperation and information sharing among regulators.

308. Fraud, market manipulation, insider trading and other illegal activities, such as the unauthorised provision of financial services that crosses jurisdictional boundaries, can and do occur in a global market aided by modern telecommunications. In addition, increasing numbers of market participants are conducting business and regulated activity in and across multiple jurisdictions.

309. Cooperation is vital to ensuring that compliance programmes, as well as investigations and enforcement actions are not impeded unnecessarily by jurisdictional boundaries.

310. Specific to ICM, issues may arise in relation to cross-border activities, such as the issuance of cross-border *ṣukūk*, which may require cooperation between regulators in terms, for example, of additional records of underlying assets to support *ṣukūk* structures, and to ensure compliance with respective laws and regulations, including on matters of Sharīʿah.[80]

311. Even within the same jurisdiction, there may be an important need to share information at a domestic level. Where there is more than one regulator or where the securities law overlaps with the general law of a jurisdiction, the need for domestic cooperation may extend beyond matters of enforcement and include information relevant to authorisation to act in a particular capacity and to the reduction of systemic risk, for example, where there are divisions in responsibility for the securities, banking and other financial sectors.[81] CPICM 14 measures

[79] Information sharing for supervision and other regulatory purposes may require, for example, among other things: routine sharing of information on questionable activities and proven frauds; information on any concern about an applicant in regard to licensing, authorisation or eligibility determinations; listing or registration of securities; information about the current circumstances of a licence holder or issuer; information that may be needed to minimise the adverse effects of market disruptions, including contingency plans, contact persons and structural measures to address market disruptions; and information on market conditions, such as actions taken by market authorities, prices, trading activities, market data, etc.

[80] See also CPICM 10 and 20. It is not uncommon to find some levels of difference in interpretation of Shari'ah across borders. This may, however, have an impact on the Shari'ah compliance status of securities.

[81] CPICM 1 and 3.

the extent of a regulator's ability to share information. CPICM 15 deals with whether the regulator has mechanisms in place to establish when and how the regulator will share information with its counterparts. CPICM 16 relates to the types of assistance that a regulator may provide to a counterpart.

312. IOSCO members are required to sign a Multilateral Memorandum of Understanding (MMoU), which is designed to facilitate, among other things, the implementation of the IOSCO-equivalent Principles to CPICM 14, 15 and 16. Accession to the IOSCO MMoU is a strong indicator that these Principles are fully implemented since the authority has the requisite legal authority to meet the international standards articulated in the IOSCO MMoU. However, accession to the IOSCO MMoU does not automatically lead to the conclusion that the Principles are fully implemented since, for example, the authority concerned may lack the resources and/or practical ability to assist properly at the time of the Principles' assessment. There is currently no equivalent IFSB MMoU.

313. International cooperation between regulators is also necessary for the effective regulation and supervision of domestic markets. The inability to provide regulatory and supervisory assistance can seriously compromise efforts towards effective securities regulation. Domestic laws need to remove impediments to international cooperation.[82]

2.5.2 Scope

314. The regulator should identify the agencies within the jurisdiction it needs to cooperate with, the types of arrangements required and the purposes for cooperating. For example, in some jurisdictions it may be necessary to obtain information from another authority within the jurisdiction, or to rely on another authority to bring or to initiate a compliance review, investigation or enforcement action. The regulator should be able to demonstrate the gateways or channels through which required information can be made available and that those channels work when needed. Additionally, the regulator should identify the laws of the jurisdiction such as blocking, bank secrecy, or other types of legislation or judicial decisions that can affect its ability to cooperate with others.

[82] *Report on the Self-Evaluation Conducted by IOSCO Members Pursuant to the 1994 IOSCO Resolution on "Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance"*, Report of IOSCO, November 1997, Parts C and D at pp. 8–9, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD76.pdf; *Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998 – in particular, Key Recommendations 21–24, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf.

315. The ability of a regulator to cooperate is closely related to its powers to obtain and keep confidential the information requested by its foreign counterparts, as provided in the CPICM Relating to the Regulator and CPICM for Self-Regulation, as well as in the IOSCO MMoU and other cooperative arrangements.

2.5.3 CPICM 14 through 16

CPICM 14:	**The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts. (IOSCO 13)**

316. This Principle addresses the power of the regulator(s) to share public and non-public information within its files, or available to it through inspection, investigation, and surveillance, without other external process. When sharing non-public information, care must be taken by the requested regulatory authority to ensure that the use of such information is consistent with the purpose for which it is shared and to preserve its confidentiality subject to such uses.

317. There may be an important need to share information at a domestic level with other domestic authorities. Cases of fraud or money laundering that involve dealings in securities may require close cooperation between two or more domestic agencies, including law enforcement, regulatory and judicial authorities. The need for domestic cooperation is also important in the context of supervision and will include information relevant to authorisation to act in a particular capacity and the reduction of systemic risk, especially where there are divisions in responsibility for the securities, banking and other financial sectors. If the jurisdiction in question has a centralised Sharī'ah board, external to the regulator, there will also be a need for cooperation with that board.

318. International cooperation between regulators is necessary for the effective regulation and supervision of domestic markets. The inability to provide regulatory and supervisory assistance can seriously compromise efforts towards effective securities regulation. Domestic laws need to remove impediments to international cooperation. In the context of the ICM, cross-border issuances and listing of securities may require international cooperation to gauge any differences in interpretation of Sharī'ah, which may impact the Sharī'ah compliance status of securities in the respective markets.

319. The removal of any "dual illegality" conditions to information sharing and regulatory cooperation is essential. As a transitional matter, while a jurisdiction moves towards the removal of dual illegality conditions, it is essential that any conditions be interpreted flexibly and in a manner that minimises impact on international cooperation.

320. While regulators have different supervisory approaches, each has a common interest in information-sharing and cooperation based on earned trust in each other's regulatory and supervisory systems.[83]

321. The form and content of the cooperation will vary from case to case.[84] It is essential that assistance can be provided not only for use in investigations but also for other types of inquiries, for example as part of a programme for the purpose of monitoring compliance or preventing illicit activities within the scope of securities regulation. Regulators may also assist each other in providing or sharing enforcement techniques.

322. Information that was provided to a regulator for investigation and enforcement purposes should be able to be shared directly or indirectly through authorities in their jurisdiction for use in investigation and prosecution (administrative, civil and criminal) of securities violation.

323. Cooperation in the context of supervision is also important. There is a need to exchange general and more specific information about matters of regulatory concern, including financial and other supervisory information, technical expertise and surveillance. The sharing of information related to systemic risks should also be central to cooperation between jurisdictions, as assessed in CPICM 6.

324. Globally active regulated entities, particularly with regard to their compliance culture, financial condition and risk exposure, must be subject to information sharing on an ad hoc basis and in a more organised and specific manner.

Key Issues[85]

1. A regulator should be able to share both public and non-public information with other domestic authorities.

[83] See Executive Summary to *Principles Regarding Cross-Border Supervisory Cooperation*, Final Report, Report of the Technical Committee of IOSCO, May 2010, pp. 3–6, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf.

[84] Cooperation may require: routine sharing of information on questionable activities and proven frauds; information on any concern about an applicant for licensing, listing or registration; information about the current circumstances of a licence holder or issuer; information that may be needed to minimise the adverse effects of market disruptions, including contingency plans, contact persons and structural measures to address market disruption; and information on market conditions such as actions taken by market authorities, prices, trading activities and market data: *Multi-Jurisdictional Information Sharing for Market Oversight*, Final Report, Report of the Technical Committee of IOSCO, April 2007, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf.

[85] *Resolution on Record Keeping*, supra, Parts C and D at p. 2. See also the IOSCO MMoU, supra, Parts 6, 7, 10 and 11.

2. A regulator should be able to share public and non-public information with its foreign counterparts.

3. Domestic laws should not impede international cooperation through sharing of information for regulatory, inspection, investigation, surveillance or enforcement purposes.

4. Where confidential information gathered by the regulator in the exercise of its functions or powers is shared with another competent authority, either domestically or internationally, the regulator should be able to ensure that the information is provided subject to conditions which, to the extent consistent with the purpose of the release, preserve the confidentiality of that information.

Key Questions

1. For each of the regulators identified,[86] does the regulator have authority to share with other domestic regulators and authorities information on:

    a. Matters of inspection, investigation and enforcement?

    b. Determinations in connection with authorisation, licensing or approvals?

    c. Surveillance?

    d. Market conditions and events?

    e. Client identification including persons who beneficially own or control non-natural persons organised in the regulator's jurisdiction?

    f. Regulated entities?

    g. Listed companies and companies that seek a listing of their securities?

[86] That is, the regulators which have responsibility for securities enforcement identified as part of the assessment process.

2. Can the regulator share the information described in Key Question 1 for regulatory and enforcement purposes with other domestic authorities without the need for external approval[87] such as from a relevant government minister or attorney?

3. Does the regulator have the authority to share information with foreign counterparts with respect to each of the matters listed in Key Question 1?[88]

    a. Matters of inspection, investigation and enforcement?

    b. Determinations in connection with authorisation, licensing or approvals?

    c. Surveillance?

    d. Market conditions and events?

    e. Client identification including persons who beneficially own or control non-natural persons organised in the regulator's jurisdiction?

    f. Regulated entities?

    g. Listed companies and companies that seek a listing of their securities?

4. Can the regulator share the information identified in Key Question 3 above for enforcement and regulatory purposes with foreign counterparts without the need for external approval,[89] such as from a relevant government minister or attorney?

5. Can the regulator provide information to other domestic and foreign authorities on an unsolicited basis?

6. Can the regulator share information with foreign counterparts even if the alleged conduct would not constitute a breach of the laws of the regulator's jurisdiction if conducted within that jurisdiction?

[87] If such approval is purely formalistic and occurs immediately, the regulator could receive a *Fully Implemented* assessment even though such approval is required. For example, in some jurisdictions, the Attorney General or similar official signs off on actions as the chief legal authority in the system. Ideally, in domestic circumstances some sharing would be pre-approved.

[88] This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart.

[89] If such approval is purely formalistic and occurs immediately, the regulator could receive a *Fully Implemented* assessment even though such approval is required. See previous example in footnote 87.

7. Can the regulator share with domestic and foreign counterparts information and records identifying the person or persons beneficially owning or controlling bank accounts related to transactions in securities and Sharī'ah-compliant hedging instruments, and brokerage accounts, as well as the necessary information to reconstruct a transaction, including bank records?[90]

8. Does the regulatory system provide enough assurance that the confidential information gathered by the regulator in the exercise of its functions or powers that is shared with another competent authority, either domestically or internationally, is subject to appropriate rules of confidentiality?

Explanatory Notes

325. An application for a licence may be received from a person known to be registered in another jurisdiction, or registration may be sought for the same offer documents in several jurisdictions. Similarly, threats to systemic stability are not confined to domestic factors and may include the behaviour of individual financial institutions in another jurisdiction.

326. Further, an increasing number of companies have securities listed in more than one jurisdiction and it is common for a significant part of an issuer's commercial activity to take place in a country other than the one in which its stock is listed. Investors frequently invest in foreign markets and securities, either directly or in managed funds. An increasing number of ICIS are marketed across jurisdictional boundaries. It is also common for scheme promoters, managers and custodians to be located in several different jurisdictions, and they may not be in the same jurisdiction as investors to whom the scheme is promoted.

327. Similar financial products may be traded on various markets in several countries.

328. Notwithstanding the obligation to cooperate domestically, when information is passed through an international channel, the uses of such information may be restricted to the uses specified in the information-sharing arrangement. For example, when information is obtained by a foreign counterpart under the IOSCO MMoU, it is not allowed to use this information outside the uses contemplated by the IOSCO MMoU. If there is a necessity to use this information in a way which is not covered by the IOSCO MMoU, the requesting authority must obtain the consent of the requested authority.

[90] IOSCO MMoU, supra, para. 7(b)(ii) at p. 4.

329. If there are bank secrecy, confidentiality or blocking statutes, the regulator should be able to demonstrate whether there are exceptions to these statutes that allow the regulator to obtain and share information with foreign counterparts.

330. Assessors should ask whether there have been court cases or other developments that cast doubt as to whether the powers granted to the regulator are in fact enforceable.

331. The Principles recognise that the regulator can legitimately impose conditions when it shares information, particularly non-public information, with its domestic and foreign counterparts. Conditions might include ensuring appropriate use of the information and ensuring the confidentiality of the information except pursuant to the uses permitted, such as in a public enforcement action for which the information was requested. See also CPICM 15, which addresses confidentiality safeguards more generally.

332. A request for assistance may be denied by a requested authority:

a. where the request would require the requested authority to act in a manner that would violate domestic laws;

b. on grounds of public interest or essential national interest;

c. where a criminal proceeding has already been initiated in the jurisdiction of the requested authority based upon the same facts and against the same persons, or the same persons have already been the subject of final punitive sanctions on the same charges by the competent authorities of the jurisdiction of the requested authority, unless the requesting authority can demonstrate that the relief or sanctions sought in any proceedings initiated by the requesting authority would not be of the same nature or duplicative of any relief or sanctions obtained in the jurisdiction of the requested authority; or

d. where the request is not made in accordance with the provisions of the IOSCO MMoU.

333. Where a request for assistance is denied, or where assistance is not available under domestic law, the requested authority will provide the reasons for not granting the assistance and consult with the requesting authority.

Benchmarks

Fully Implemented

334. Requires an affirmative response to all applicable Questions.

Broadly Implemented

335. Requires an affirmative response to all applicable Questions except to Questions 2 and 4, provided that information sharing still can occur in a timely fashion.

Partly Implemented

336. Requires an affirmative response to all applicable Questions except to Question 3(c) provided that information can be made available in specific cases, Questions 2 and 4 if the conditions for *Broadly Implemented* are not met, and Question 5.

Not Implemented

337. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d), 1(e), 1(f), 1(g), 3(a), 3(b), 3(c), 3(d), 3(e), 3(f), 3(g) or 6, 7, 8, or such a significant inability to act in a timely manner that the Principle cannot be regarded as implemented.

CPICM 15:	**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. (IOSCO 14)**

338. Securities regulators have long used MoUs to facilitate consultation, cooperation and the exchange of information in securities enforcement matters. These enforcement MoUs permit regulators who suspect there has been a violation of their laws and/or regulations to seek *ad hoc* assistance from their overseas counterparts when evidence of the possible violation may lie outside their jurisdictions. Most of these MoUs have been entered into on a bilateral basis; since 2005 the IOSCO MMoU has become the mandatory global minimum standard for enforcement cooperation among securities regulators.

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

340. MoUs facilitate the process of information exchange by establishing a more formalised mechanism or framework that makes clear permitted uses, confidentiality arrangements, and other operational procedures between the parties.

Key Issues[91]

1. The design of information-sharing mechanisms should take into account the following factors:

    a. Which market authority or regulator has access to and is able to provide the information or assistance.

[91] See *Principles Regarding Cross-Border Supervisory Cooperation*, supra, Chapter 8 (Mechanisms for Supervisory Cooperation) at pp. 31–37; *Principles for Memoranda of Understanding*, Report of the Technical Committee of IOSCO, September 1991, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf, supra, Part 2.

b. How such access can be obtained under applicable law.

c. Confidentiality under applicable law.

d. Permitted use under applicable law.

e. The form and timing of the assistance or information sharing.

f. The applicability of other arrangements, including MOUs between such authorities for sharing investigative and financial information.

2. Where confidential information gathered by the regulator in the exercise of its functions is shared with another authority, particular care must be taken to ensure that the information is provided subject to conditions, which, to the extent consistent with the purpose of its release, preserve the confidentiality of that information.

3. The regulator should be able to maintain the confidentiality of the request consistent with Article 11 of the IOSCO MMoU.

Key Questions

1. Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with other domestic authorities?

2. Does the regulator have the power, by legislation, rules or as a matter of administrative practice, to enter into information-sharing agreements (whether formal or informal) with foreign counterparts?

3. If the regulator is a member of IOSCO, is it a signatory to the IOSCO MMoU (in the affirmative, please skip Question 4(a))?

4. Has the relevant regulator developed information-sharing mechanisms to:

   a. Facilitate the detection and deterrence of cross-border misconduct?

b. Assist in the discharge of licensing, surveillance and enforcement responsibilities?[92]

5. Where warranted by the scope of cross-border activity and the ability to provide reciprocal assistance, does the regulator actively try to establish information-sharing arrangements with foreign regulators?

6. Are these arrangements documented in writing?

7. Does the regulator take steps to assure safeguards are in place to protect the confidentiality of information transmitted consistent with its uses?

8. Can the regulator maintain the confidentiality of the request for information received from a foreign regulator consistent with Article 11 of the IOSCO MMOU?

9. Can the regulator demonstrate that it shares information, where appropriate safeguards are in place, when it is requested by another domestic authority or foreign counterpart?

Explanatory Notes

341. This Principle can be satisfied through the use of a range of mechanisms for sharing entity-specific information and market-wide intelligence – each address different, albeit overlapping, types of information-sharing. Each mechanism also buttresses the others, making all of them more effective when used in conjunction as part of a single overarching supervisory cooperation strategy among IOSCO members. All of these different mechanisms, however, are likely to be useful to securities regulators for different purposes.

342. MoUs or other documented arrangements can help to add certainty, and in some cases, expedition, to the process of information exchange. Nonetheless, the mere formality of an arrangement is no substitute for a close and cooperative arrangement.

343. The assessor should be able to provide actual evidence of the usefulness of existing arrangements for cooperation. For example, the jurisdiction should be able to demonstrate that it can and does share information when requested to do so by another authority. If this is not possible, then the assessor should question the efficacy of either formal or informal

[92] When the person that is the subject of the inquiry is known to the requested authority.

arrangements. The assessment does not address whether the regulator obtains the information directly or indirectly.[93]

344. The regulator should identify responses to requests for assistance and should provide examples of successful and substantive responses. The regulator should provide a list of the number of requests for assistance received, the type of assistance requested for each request, and provide examples of successful and substantive responses by the regulator.[94] The regulator should also provide information if there are instances where cooperation was denied and provide the rationale for such denial. If practical cases have not occurred, the regulator should be able to demonstrate that there are internal processes in place that address the aforementioned issues.

345. In the context of the IOSCO MMoU, the regulator should be able to demonstrate its practical ability to share information required under the IOSCO MMoU and show actual instances in which information required under the IOSCO MMoU was shared with foreign counterparts.

346. Under the IOSCO MMoU, each authority will keep confidential requests made under the IOSCO MMoU, the contents of such request, and any matters arising under the IOSCO MMoU, including consultations between or among authorities, and unsolicited assistance. After consultation with the requesting authority, the requested authority may disclose the fact that the requesting authority has made the request if such disclosure is required to carry out the request. In this context, confidentiality with regard to requests and information received from another authority is very important. In accordance with Article 11(b) of the IOSCO MMoU, the authority that has made a request will keep confidential non-public documents and information received under the MMoU, except as contemplated by Article 10(a) of the IOSCO MMoU or in response to a legally enforceable demand. In the latter case, the requesting authority should notify the requested authority prior to complying with the demand and assert such appropriate legal exemptions or privileges with respect to the information concerned as may be available.

347. The assessor should assess the extent to which the regulator has to comply with demands for disclosure of other domestic authorities; see Articles 10 and 11 of the IOSCO MMoU.

[93] This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart.

[94] Consistent with confidentiality obligations (including Article 11 of the IOSCO MMoU), the regulator, in providing examples of successful and substantive responses, should consider masking references that identify its counterpart and any individuals or firms.

348. Although the regulator may not be a signatory to the IOSCO MMoU, the assessor should seek to assess the extent to which the regulator can still facilitate the detection and deterrence of cross-border misconduct.

Benchmarks

Fully Implemented

349. Requires an affirmative response to all applicable Questions.

Broadly Implemented

350. Requires an affirmative response to all applicable Questions except to Question 6.

Partly Implemented

351. Requires an affirmative response to all applicable Questions except to Question 6 and that an affirmative response to one or more of Questions 4(a), 4(b) and 5 is not required if the regulator's jurisdiction does not do substantial cross-border business and the need for information sharing is infrequent and *ad hoc*.

Not Implemented

352. Inability to respond affirmatively to one or more of Questions 1, 2, 3, 7, 8 or 9, or Questions 4(a), 4(b) or 5 if the regulator's jurisdiction does more than an insubstantial cross-border business, or there is evidence that information cannot be, and is not being, shared in appropriate cases in a timely manner.

CPICM 16:	**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. (IOSCO 15)**

353. Effective regulation and supervision can be compromised when necessary information is located in another jurisdiction and is not available or accessible. Thus, a regulator should be empowered to assist and provide information necessary to foreign regulators in the discharge of their mandate and mission. Without this ability, information gathering powers would be insufficient to ensure proper regulation, supervision and enforcement of markets.

354. Fraud, market manipulation, insider trading and other illegal conduct that crosses jurisdictional boundaries can and do occur in a global market aided by modern telecommunications.

355. The IOSCO MMoU was put in place with the goal of ensuring that a cooperative mechanism exists among IOSCO members at the international level to facilitate the detection and deterrence of cross-border misconduct. The IOSCO MMoU is considered to be the minimum standard for international enforcement and cooperation. It is therefore essential for IOSCO members to have the legal authority to meet this minimum standard. The IOSCO MMoU is a benchmark for international cooperation, but should not be considered as limiting the ability of members to sign other agreements that may go beyond what is prescribed in the IOSCO MMoU.

356. Assistance in taking substantive action may also be necessary. When it is within their powers,[95] regulators can more effectively enforce securities laws when they are able to prevent the concealment of the proceeds of fraud or other misconduct, thus facilitating the return of money to injured investors.[96]

357. Supervisory assistance and cooperation is also essential in the context of activities of regulated entities and issuers on markets across the world. In 2010, IOSCO published a set of principles to guide IOSCO members in developing cross-border cooperative supervisory

[95] Regulators are encouraged by the *Resolution on Cross-Border Cooperation to Freeze Assets Derived from Securities Violations*, Resolution of the IOSCO Presidents' Committee, June 2006, available at https://www.iosco.org/library/resolutions/pdf/IOSCORES25.pdf, to examine the legal framework under which they operate and strive to develop, through law reform or otherwise, mechanisms by which they or another authority within their jurisdiction could, on behalf of a foreign regulator, freeze assets derived from suspected and established cross-border securities violations and thereby deny wrongdoers the benefit of their ill-gotten gains.

[96] See, generally, *Measures Available on a Cross-Border Basis to Protect Interests and Assets of Defrauded Investors*, Report of the Technical Committee of IOSCO, July 1996, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD55.pdf.

arrangements,[97] as well as a sample MoU that could assist IOSCO members in designing supervisory cooperation MoUs. Since then, a number of regulators have used these principles and the sample MoU to promote information sharing for supervisory purposes.

Key Issues[98]

1. A domestic regulator should be able to provide effective assistance to foreign regulators who need to make inquiries under their competence, with respect to matters related to securities and Sharīʿah-compliant hedging instruments, including bank and brokerage records and client identification information, regardless of whether the domestic regulator has an independent interest in the matter.

2. Assistance, including compulsory assistance, in obtaining records should be provided to foreign regulators in securing compliance with securities laws.

3. Regulators should be able to provide assistance, including obtaining court orders, to the full extent of their powers.

4. Regulators should be able to provide information on financial conglomerates subject to their supervision.

5. Regulators should be able to share information and provide assistance for effective regulation and supervision of markets and market participants.

Key Questions[99]

1. Is the domestic regulator able to offer effective and timely assistance to foreign regulators in obtaining the following:[100]

    a. Contemporaneous records sufficient to reconstruct all transactions in securities and Sharīʿah-compliant hedging instruments, including records of all funds and

[97] See Principles Regarding Cross-Border Supervisory Cooperation, supra, which includes at Annex A an Annotated Sample Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Regulated Entities.
[98] See generally *Principles for Memoranda of Understanding*, supra. See also IOSCO MMoU, supra.
[99] For these questions, see generally *Principles for Memoranda of Understanding*, supra; *Resolution on Record Keeping*, supra; and IOSCO MMoU, supra.
[100] This question may be answered in the affirmative if one competent authority has the authority to share all required information, including information originally in the possession of another competent domestic authority, with its foreign counterpart. See also CPICM 14.

assets transferred into and out of bank and brokerage accounts relating to those transactions?

b. Records for ICM transactions that identify:

i. The client:

1. Name of the account holder?

2. Person authorised to transact business?

ii. The amount purchased or sold?

iii. The time of the transaction?

iv. The price of the transaction?

v. The individual and the bank or broker and brokerage house that handled the transaction?

c. Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organised in its jurisdiction?

d. Reports from a competent Sharīʿah board/authority as to whether the asset/project backing a security sold/listed/issued cross-border is Sharīʿah-compliant?[101]

2. Is the domestic regulator able to offer effective and timely assistance to foreign regulators in securing compliance with laws and regulations related to:

a. Insider dealing, market manipulation, misrepresentation of material information and other fraudulent or manipulative practices relating to securities and Sharīʿah-compliant hedging instruments, including solicitation practices, handling of investor funds and customer orders?

b. The registration, issuance, offer or sale of securities and Sharīʿah-compliant hedging instruments, and reporting requirements related thereto?

[101] In most cases, this will be the report initially produced when the security was issued. However, there may be occasions when a new opinion is required - for example if the parameters of a project appear to have changed. If a new opinion is required, it is reasonable for the requesting authority to bear the costs. See also CPICM 10 and CPICM 20.

c. Market intermediaries, including investment and trading advisers who are required to be licensed or registered, Islamic collective investment schemes, brokers, dealers and transfer agents?

d. Markets, exchanges and clearing and settlement entities?

3. Is the domestic regulator able, according to its domestic laws and regulations, to provide effective and timely assistance to foreign regulators regardless of whether the domestic regulator has an independent interest in the matter?

4. Is the domestic regulator able to offer effective and timely assistance to foreign regulators in obtaining information on the regulatory processes[102] in its jurisdiction?

5. Is the domestic regulator able to offer effective and timely assistance to foreign regulators in requiring or requesting:

   a. The production of documents?

   b. Taking a person's statement or, where permissible, formal testimony recognised by law?

6. Is the domestic regulator able to offer effective and timely assistance to foreign regulators in obtaining court orders, if permitted, for example, urgent injunctions?[103]

7. Is the domestic regulator able to provide effective and timely assistance to foreign regulators regarding information about financial conglomerates subject to its supervision and more precisely assistance in relation, for example, to:

   a. The structure of financial conglomerates?

   b. The capital requirements in conglomerate groups?

   c. Investments in companies within the same group?

   d. Intra-group exposures and group-wide exposures?

   e. Relationships with shareholders?

[102] "Regulatory processes" refer to formal processes, such as licensing procedures or audit procedures, which could be relevant to enforcement.
[103] The regulator should be able to compel the production of documents.

f. Management responsibility and the control of regulated entities?

8. If the regulator cannot directly obtain the information set out in Key Question 1, can the regulator obtain that information from another domestic authority and share that information with the requesting regulator?

9. May the requesting authority use the information furnished by the domestic authority for the purposes set forth under Article 10(a) of the IOSCO MMoU?

Explanatory Notes

358. In assessing this Principle, the assessor should refer to CPICM 11, 12 and 13 to assess if the regulator has the appropriate power to gather information needed by the foreign regulator.

359. With respect to injunctions or other remedies, such as asset freezes, where permitted, it is understood that the regulator may need the assistance of another authority. Although the power to assist in obtaining such court orders is not required for a *Fully Implemented* rating if such assistance is not permitted, where such assistance is in fact permitted, the failure to cooperate could result in a *Partly Implemented* rating.

360. The regulator should be able to demonstrate the timeliness of assistance or cooperative effort by providing records, logs or other supporting evidence.

361. The regulator should also provide evidence of the type of requests for assistance received, the type of assistance requested for each request, and provide examples of successful and substantive responses by the regulator. The regulator should also provide information if there are instances where cooperation was denied and provide the rationale for such denial.

362. The form of international assistance may include:[104]

- Assistance in obtaining public or non-public information, for example, about a licence holder, listed company, shareholder, beneficial owner or a person

[104] See, generally, *Report on Issues Raised for Securities and Futures Regulators by Under-Regulated and Uncooperative Jurisdictions*, Report of the Technical Committee of IOSCO, October 1994, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD41.pdf and *Principles Regarding Cross-Border Supervisory Cooperation*, supra.

exercising control over a licence holder or company.

- Assistance in obtaining banking, brokerage or other records.
- Assistance in obtaining voluntary cooperation from those who may have information about the subject of an inquiry.
- Assistance by providing examination reports.
- Assistance by providing risk analysis assessments and information to support the identification, assessment and mitigation of hidden risks to markets and investors.
- Assistance in inspection of market participants, including visits.
- Assistance in obtaining information or in the compulsion of documents and at least voluntary testimony or statements.
- Assistance in providing information on the regulatory processes in a jurisdiction, or in obtaining court orders, for example, urgent injunctions.

363. The particular procedures used for the supervision of financial conglomerates must reflect the domestic law of the places in which they operate and must take account of the possibility that relevant regulatory responsibility may continue to be shared between agencies. It is nevertheless possible to identify some general issues that should be considered as matters requiring close supervisory cooperation:

- structure of financial conglomerates;
- capital requirements in conglomerate groups;[105]
- investments in companies within the same group;
- intragroup exposures and group-wide exposures;[106]
- relationships with shareholders;

[105] See, generally, *Risk Concentration Principles*, Report of the Joint Forum, December 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD102.pdf.

[106] See, generally, *Intra-Group Transactions and Exposures Principles*, Report of the Joint Forum, December 1999, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD101.pdf.

- management responsibility and the control of regulated entities.

364. In the case where there is not power to provide specific assistance, the assessor also should inquire as to whether the regulator is making efforts to seek further powers or taking other steps to enhance its capacity to cooperate. In circumstances where the authorities require a court order to obtain certain information (e.g. bank records), an inability to obtain court orders for that purpose in a timely fashion may indicate that the authority is unable to cooperate.

Benchmarks

Fully Implemented

365. Requires an affirmative response to all applicable questions.

Broadly Implemented

366. Requires affirmative responses to all Questions except to Questions 7(a), 7(b), 7(c), 7(d), 7(e) and 7(f).

367. The regulator can only provide some of the types of information listed and this limitation does not affect its ability to provide information on the entity subject to its supervision or oversight, and provided, however, that the authority takes steps to provide assistance within its powers and such assistance is not so untimely as to be tantamount to being denied.

Partly Implemented

368. Requires affirmative responses to all Questions except Questions 6, 7(a), 7(b), 7(c), 7(d), 7(e) and 7(f), provided, however, that the authority takes steps to provide assistance within its powers and such assistance is not so untimely as to be tantamount to being denied.

Not Implemented

369. Inability to respond affirmatively to one or more of Questions 1(a), 1(b)(i), 1(b)(ii), 1(b)(iii), 1(b)(iv), 1(b)(v), 1(c), 1(d), 2(a), 2(b), 2(c), 2(d), 3, 4 or 5(a), 5(b), 8 and 9 or assistance does not occur or is so untimely as to be tantamount to being denied.

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2	*Principles Regarding Cross-Border Supervisory Cooperation*, Final Report, Report of the Technical Committee of IOSCO, May 2010, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf	14 15 16	33 34
3	*Multi-Jurisdictional Information Sharing for Market Oversight*, Final Report, Report of the Technical Committee of IOSCO, April 2007, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf	14	33 34 36
4	*Resolution on Cross-Border Cooperation to Freeze Assets Derived from Securities and Derivatives Violations*, Resolution of the IOSCO Presidents' Committee, June 2006, https://www.iosco.org/library/resolutions/pdf/IOSCORES25.pdf,	16	
5	*Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf	14	12 17 31

	Document	CPICM	Other CPICM
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7	*Intra-Group Transactions and Exposures Principles*, Report of the Joint Forum, December 1999, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD101.pdf	16	
8	*Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf	14	12 17 31 33
9	*Guidance on Information Sharing*, Report of the Technical Committee of IOSCO, March 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD86.pdf	14 16	
10	*Report on the Self-Evaluation Conducted by IOSCO Members Pursuant to the 1994 IOSCO Resolution on "Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance"*, Report of IOSCO, November 1997, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD76.pdf	14	
11	*Resolution on Principles for Record Keeping, Collection of Information, Enforcement Powers and Mutual Cooperation to Improve the Enforcement of Securities and Futures Laws*, Resolution of the Presidents' Committee of IOSCO, November 1997,	14 15 16	11 12

	Document	CPICM	Other CPICM
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12	*Resolution on Enforcement Powers*, Resolution of the Presidents' Committee of IOSCO, November 1997, http://www.iosco.org/library/resolutions/pdf/IOSCORES14.pdf	14	12
13	*Measures Available on a Cross-Border Basis to Protect Interests and Assets of Defrauded Investors,* Report of the Technical Committee of IOSCO, July 1996, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD55.pdf	16	
14	*Recommendation on the Recognition of Bilateral Netting Agreements in the Calculation of Capital Requirements for Securities Firms,* Resolution of the Technical Committee of IOSCO, March 1996, http://www.iosco.org/library/resolutions/pdf/IOSCORES38.pdf	17	
15	*Resolution Concerning Cross-Border Transactions*, Resolution of the Presidents' Committee of IOSCO, July 1995, http://www.iosco.org/library/resolutions/pdf/IOSCORES12.pdf	16	
16	*Report on Issues Raised for Securities and Futures Regulators by Under-Regulated and Uncooperative Jurisdictions*, Report of the Technical Committee of IOSCO, October 1994, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD41.pdf	16	
17	*Resolution on Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation*	16	

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	and Assistance (Self-Evaluation), Resolution of the Presidents' Committee of IOSCO, October 1994, https://www.iosco.org/library/resolutions/pdf/IOSCORES11.pdf		
18	*Resolution on Transnational Securities and Futures Fraud*, Resolution of the Presidents' Committee of IOSCO, October 1993, http://www.iosco.org/library/resolutions/pdf/IOSCORES8.pdf	16	
19	*Resolution on Money Laundering*, Resolution of the Presidents' Committee of IOSCO, October 1992, http://www.iosco.org/library/resolutions/pdf/IOSCORES5.pdf	16	
20	*Resolution on Principles for Memoranda of Understanding*, Resolution of the Presidents' Committee of IOSCO, September 1991, http://www.iosco.org/library/resolutions/pdf/IOSCORES42.pdf	16	
21	*Principles for Memoranda of Understanding*, Report of the Technical Committee of IOSCO, September 1991, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf	14 15 16	
22	*Resolution on Information Sharing between SROs*, Resolution of the SRO Consultative Committee of IOSCO, November 1990, http://www.iosco.org/library/resolutions/pdf/IOSCORES40.pdf	16	

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23	*Resolution on International Equity Offers*, Presidents' Committee of IOSCO, September 1989, http://www.iosco.org/library/resolutions/pdf/IOSCORES41.pdf	14 16	
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2.6 Principles for Issuers

2.6.1 Preamble

370. These CPICM are about the information that issuers should disclose to investors when they invest in securities and on an ongoing basis.

371. The Principles seek to support core objectives of ICM regulation in the following ways:

- they enhance investor protection by requiring issuers to provide investors with information about the issuer, the risks of investing in its securities, and other matters to support better investment decisions;

- they support the operation of fair, orderly, efficient and transparent markets by providing investors and therefore the markets with accurate and relevant information; and

- they support the reduction of systemic risk as it may be affected by investor confidence by enhancing transparency in the market.

372. CPICM 17, 18 and 19 are closely interrelated. While CPICM 17 focuses primarily on full, timely and accurate disclosure of financial and non-financial information, these same qualities of disclosure are essential for the purposes of CPICM 18 and 19. For example, it should be impossible to conclude under CPICM 18 that holders of securities are treated in a fair and equitable manner if they are not provided with full, timely and accurate disclosure in connection with the voting decisions and change of control transactions addressed in that Principle. Similarly, it should be impossible to conclude under CPICM 19 that accounting standards are of a high and internationally acceptable quality if full and accurate disclosure would not be reflected in the financial statements to which such standards have been applied. It also should be impossible to conclude that audited financial statements required in prospectuses, listing documents and annual reports reflect full, timely, and accurate disclosure under CPICM 17 or full disclosure to shareholders under CPICM 18, if accounting standards of a high and internationally acceptable quality have not been applied to such financial statements.

373. To determine whether CPICM 17, 18 and 19 are implemented in a manner that achieves the objectives of investor protection, fair, orderly, efficient and transparent markets, and reducing systemic risk, it may also be necessary to consider a jurisdiction's general legal framework and laws that complement ICM regulation.

374. Finally, an assessment of implementation of CPICM 17, 18 and 19 is also essential for purposes of assessing implementation of CPICM 28 regarding Islamic collective investment schemes.

2.6.2 Scope

375. CPICM 17 and 19 are intended to apply to issuers making "public offerings" of securities and also to issuers whose securities are "listed and/or publicly traded".[107] CPICM 18 is intended to apply to companies whose securities are listed, publicly offered or traded.

376. Most jurisdictions separately regulate public offerings, thereby ensuring general protection of the public while reducing the regulatory burden in the case of non-public undertakings. The definition of what amounts to an offer to the public varies, as does the threshold for what constitutes public trading.

377. The term "issuer" should be understood broadly to include all entities and persons who offer or sell their own securities. The CPICM do not apply to the issuing of debt by government or entities created by statute, which perform a public function or deliver a public service pursuant to a statutory mandate provided that they are backed by the guarantee of the government.

378. In assessing implementation of these CPICM, however, the assessor should bear in mind that the terms "publicly traded" and "public offerings" are not defined in the CPICM. Accordingly, the universe of issuers and transactions to which these three CPICM apply may be expected to vary among jurisdictions. The assessor should not attempt to substitute his or her judgment in lieu of the law of the jurisdiction as to what constitutes a public offering, but should indicate what public offerings are covered by the law. This may affect the extent to which these CPICM are applicable.[108]

379. With respect to what constitutes "publicly traded" securities to which the CPICM should apply, the CPICM relating to Secondary and Other Markets[109] provide useful guidance. Those CPICM indicate that the concept of a secondary or other market is not limited to traditional organized exchanges, but is also intended to include various regulated forms of "off-exchange" market systems that trade equities and *ṣukūk*[110]. That Section, however, is directed principally at authorised exchanges and regulated trading systems as defined therein. Regulation

[107] These CPICM do not apply to private offerings, except where the offering is made through a private placement and the investor then resells to the public.
[108] See CPICM 1.
[109] Refer to CPICM 34–38.
[110] See CPICM 20.

appropriate to a particular secondary or other market will depend upon the nature of the market and its participants.[111]

380. Bearing in mind that CPICM 17, 18 and 19 set forth requirements for disclosure and reporting primarily by issuers, that the objective of these CPICM is investor protection, and that the objective of authorised exchanges and regulated trading systems[112] is fairness,[113] efficiency and transparency,[114] the assessor should determine the exchanges and trading systems within a jurisdiction that are deemed to be exchanges and trading systems subject to regulation under CPICM 34 to 38 and which provide trading services in corporate equity and debt securities for retail investors. Implementation of CPICM 17, 18 and 19 should be assessed with respect to issuers whose securities are listed and/or traded on those authorised exchanges and regulated trading systems.[115]

381. Even with this guidance, an assessor may have to exercise judgment in assessing whether CPICM 17, 18 and 19 have been implemented with respect to publicly traded securities in a particular market.

382. For greater clarification, these CPICMs apply to the following types of securities in the following ways:[116]

- CPICM 17 and 19 apply to the issuing of equity securities and of *ṣukūk* (other than *ṣukūk* issued by government or entities created by statute, which perform a public function or deliver a public service to a statutory mandate) including publicly traded asset-backed securities[117] and structured financial products. They do not apply to the issue of sovereign *ṣukūk*.

- CPICM 18 applies only to equity securities.

[111] Refer to CPICM on market intermediaries, CPICM 30–33.
[112] See CPICM 34.
[113] See CPICM 35.
[114] See CPICM 36.
[115] References to listing documents in CPICM 17–19 apply only where the securities are listed on an authorised exchange or, where relevant, a regulated trading system.
[116] The list of securities to which these principles apply is not intended to be exhaustive.
[117] *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, Final Report, Report of the Technical Committee of IOSCO, April 2010, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf and *Principles for Ongoing Disclosure for Asset-Backed Securities*, Final Report, Report of the Board of IOSCO, November 2012, available at http://www.iosco.org/library/pubdocs/pdf/ IOSCOPD395.pdf, define asset-backed securities (at pp. 4 and 2, respectively) as "those securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets that by their terms convert into cash within a finite period of time, such as RMBS (residential mortgage-backed securities) and CMBS (commercial mortgage-backed securities), among others". These principles are not intended to apply to "securities backed by asset pools that are actively managed (such as some securities issued by investment companies), or that contain assets that do not by their terms convert to cash (such as collateralised debt obligations)".

- CPICM 17 and 19 also apply to rights issues to existing security holders.[118]

383. The CPICM also apply to structured financial products that are securities (which may be described as highly complex and, in current practice, there are Sharī'ah compliance issues for many structured products). Adequate disclosure of the risks that the underlying assets of these securities face, and of the possible effect that these risks may have on the security itself, is particularly important. The issuer's disclosure should also include checks, assessments, duties and risk practices performed by underwriters, sponsors and originators; asset pool performance; and reports on Sharī'ah compliance from a competent Sharī'ah entity[119] for any structured financial product being claimed as Sharī'ah-compliant.

384. In assessing the regulatory framework for issuers that make "public offerings", the assessor should consider the requirements with respect to content of advertising, and information about issuers, offerings, listing, periodic reports and reports of material events, bids, or the change in control or change of interest associated with the holding of a publicly offered or traded security.

385. In assessing implementation of CPICM 17, 18 and 19, the assessor also should recognise that the source of disclosure and reporting requirements will not necessarily be limited to securities law and regulations. For example, in some jurisdictions, timely disclosure and other requirements are imposed by marketplace listing rules. In such circumstances, there should be appropriate oversight by the regulator. In assessing implementation of these CPICM, the assessor should also recognise that regulatory requirements may be tailored based on the nature of the issuing entity, the securities issued or the initial investor.

386. Finally, the assessor should determine the extent to which a jurisdiction's secondary market and publicly traded issues are subject to, or are realistic candidates for, cross-border listing and/or trading activity, since this may affect the importance of some of the Key Questions.[120]

387. In general, the appropriate framework for issuer regulation includes adequate company, accounting, commercial and contract law. While the assessor should be informed about the legal framework, in general, the specific objectives of non-securities-specific law are addressed explicitly in the Key Issues, Key Questions, and Benchmarks to this Section.

[118] See *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuer*, Report of IOSCO, September 1998, pp. 9–10, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf.

[119] This may either be a Sharī'ah board, comprised of two or more scholars and experts (and either internal or external to an entity in the ICM) or a single Sharī'ah scholar/consultant to the entity.

[120] CPICM 17, Key Question 9. See also CPICM 18, Key Question 6; and CPICM 19, Key Question 7.

2.6.3 CPICM 17 through 20

CPICM 17:	**There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions. (IOSCO 16)**

388. Issuers should disclose to investors current and reliable information necessary to make informed investment decisions on an ongoing basis. The Principle of full, timely and accurate disclosure of current and reliable information material to investment decisions is directly related to the objectives of investor protection and fair, efficient and transparent markets.[121]

389. This CPICM requires consideration of the adequacy, accuracy and timeliness of both financial and non-financial disclosures as well as disclosure of risks that are material to investors' decisions. These disclosures may pertain to specified transactions, periodic reports and ongoing disclosure and reporting of material developments.

390. This CPICM applies to issuers of securities, as defined in the Scope to these CPICM.

391. Disclosure requirements set out in this CPICM may extend beyond the issuing entity itself to include others, such as directors and senior officers of the company, participating underwriters, material shareholders and other parties playing a material role in issuing securities.[122] It will be apparent from the text where others have a relevant obligation.

392. Specific to the ICM, disclosures should also reflect the economic substance and risk profile of the security, consistent with its substance. For example, in the case of *ṣukūk*, relevant information focusing on the originator should be disclosed, as should information on the rights, obligations and responsibilities of the *ṣukūk* holders. Sufficient disclosures should also be made about Sharīʻah aspects of the security to allow an informed judgment as to initial and ongoing Sharīʻah compliance. In relation to this, IFSB-19[123] was released in April 2017 and outlines disclosure requirements for *ṣukūk* and ICIS.

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[121] For example, see generally *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf; *Principles for Ongoing Disclosure for Asset-Backed Securities*, supra; and *Insider Trading – How Jurisdictions Regulate It*, Report of the Emerging Markets Committee of IOSCO, May 2003, available at https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD145.pdf.

[122] See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, Principle III at p. 9. See also, generally, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra; and *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, Final Report, Report of the Technical Committee of IOSCO, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

[123] IFSB-19: *Guiding Principles for Disclosure Requirements for Islamic Capital Market Products (Ṣukūk and Islamic Collective Investment Schemes).* http://www.ifsb.org/standard/IFSB%2019%20-%20Guiding%20Principles%20on%20Disclosure%20of%20ICM%20Products%20(final).pdf.

Key Issues

Full Disclosure

1. The regulatory framework should ensure full, timely and accurate disclosure of risks, financial results and other information that is material to investors making informed investment decisions on an ongoing basis.

2. Disclosure rules should include rules about the following (with the list being illustrative):

    a. The conditions applicable to an offering of securities for public sale.

    b. The content and distribution of prospectuses, listing particulars documents or other offering documents.

    c. Supplementary documents prepared in the offering.

    d. Advertising in connection with the offering of securities.

    e. Information about those who have a significant interest in an issuer.[124]

    f. Information about those who seek control of an issuer (discussed in greater detail below).

    g. Information material to the price, or value, of a security.[125]

    h. Periodic reports.

[124] See *Principles for Periodic Disclosure by Listed Entities*, Final Report, Report of the Technical Committee of IOSCO, February 2010, pp. 16–17, available at https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD317.pdf; see also *Protection of Minority Shareholders in Listed Issuers*, Final Report, Report of the Technical Committee of IOSCO in consultation with the OECD, June 2009, pp. 10–14, available at https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD295.pdf; see also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra, Item VII at pp. 18–19; *Disclosure Principles for Public Offerings and Listings of Asset-backed Securities*, supra, Principle III at pp. 10–12; and *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers,* Final Report, Report of the Technical Committee of IOSCO, March 2007, Item XI at pp. 23–24, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf.

[125] If there are classes of shares or other structural features that would affect share price, these should be disclosed. This information also would include the release of price-sensitive information. Note that any division of shares into classes or other structural features that would result in establishing a priority in receiving dividends or priority in liquidation will not be considered Sharī'ah-compliant.

i. Shareholder voting decisions.

j. Material related party transactions and transactions including transactions involving directors and senior managers of the issuer.[126]

k. Periodic disclosure of information about director and senior management compensation and risk management practices.[127]

l. The most significant risks material to the offering.[128]

General Disclosure

3. Specific disclosure requirements should be augmented by a general disclosure requirement.

Sufficiency, Accuracy, Timeliness and Accountability for Disclosure

4. Disclosure should be accurate, sufficiently clear and comprehensive, and reasonably specific and timely.[129]

5. Regulation should ensure that proper responsibility is taken for the content of information and, depending on the circumstances, those persons who take liability for such disclosures may include the issuer, underwriters, promoters, directors, authorising officers of the issuer, experts and advisers who consent to be named in the documentation or provide advice.

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[126] See *Principles for Periodic Disclosure by Listed Entities*, supra, p. 11.

[127] The reference to "risk management practices" is in the context of disclosure on compensation. The information about director and senior management compensation and risk management practices is important to investors so that they can assess the incentives created by this use of the issuer's resources, whether the incentives of the compensation are aligned with investors' interests, and how performance may be oriented to the returns generated for shareholders. This assessment can be facilitated by disclosure of, among other things, the most important design characteristics of the compensation system, including how those characteristics may be tied to performance and, where appropriate, risk. See *Principles for Periodic Disclosure by Listed Entities*, supra, pp. 11–13.

[128] See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, Principle XI at p. 32; see also *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra, Item III.D at p. 12; and *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, supra, Item III at p. 12.

[129] See *International Equity Offers,* Report of IOSCO, September 1989, pp. 7–8, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD2.pdf; and *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra, pp. 5–6. See also, generally, *Securities Activity on the Internet*, supra – in particular, Key Recommendation 5 and text; *Securities Activity on the Internet II*, Report of the Technical Committee of IOSCO, June 2001, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf; *Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf; *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, supra, pp. 3–4; see IOSCO Public Document No. 318 and *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, p. 5.

Derogations

6. The circumstances under which derogation from full and timely disclosure is permitted should be limited and the safeguards that apply in such circumstance should be clear.

Key Questions

Full Disclosure

1. Does the regulatory framework have clear, comprehensive and reasonably specific disclosure requirements that apply to:

    a. Public offerings, including the conditions applicable to an offering of securities for public sale, the content and distribution of prospectuses and other offering documents (and, where relevant, short form profile or introductory documents) and supplementary documents prepared in the offering?[130]

    b. Annual reports?

    c. Other periodic reports?

    d. Shareholder voting decisions?

    e. Advertising of public offerings outside the prospectus?

2. Does the regulatory framework require accurate, sufficiently clear and comprehensive, and reasonably specific and timely disclosure of:

    a. events that are material to the price or value of securities;

    b. the most significant risks of investing in the security; and

    c. important relevant information about the issuer and its activities?

3. Does the regulatory framework require:

[130] The term "conditions" refers to both any restrictions, or any stipulations, with respect to an offer and the transaction terms.

a. Financial information and other required disclosure in prospectuses, listing documents, annual and other periodic reports, and, where applicable, in connection with shareholder voting decisions, to be of sufficient timeliness to be useful to investors?

b. Periodic information about financial position and results of operations (which may be in summary form) to be made publicly available to investors?

c. Appropriate measures to be taken (for example, provision of more recent unaudited financial information) when the audited financial statements included in a prospectus for public offerings are not current?

General Disclosure

4. In addition to specific disclosure requirements, is there a general requirement to disclose either all material information or all information necessary to keep the disclosures made from being misleading?

Sufficiency, Accuracy, Timeliness and Accountability for Disclosure

5. Are there measures available to the regulator (e.g. review, certification,[131] supporting documentation, sanctions) to address concerns with the sufficiency, accuracy and timeliness of the required disclosures?

6. Does regulation ensure that issuers and others involved in the issuing process, which may include underwriters, directors, authorising officers, promoters, experts and advisers, are liable for the content of disclosures they make?

Derogations

7. Are the circumstances where disclosures may be omitted or delayed limited to trade secrets, similar proprietary information, or other valid business purposes, such as incomplete negotiations?

8. Where there are derogations from disclosure, is regulation sufficient to provide for fulfilment of the objective of full and timely disclosure by allowing for:[132]

[131] "Certification" is generally used in conjunction with internal audits of financial statements, but the list is intended to be exemplary and certification could also refer to other certifications.
[132] In the case of price-sensitive information.

a. Temporary suspensions of trading?

b. Restrictions on, or sanctions regarding, the trading activities of persons with superior information?

Cross-Border Matters

9. If public offerings or listings by foreign issuers are significant within the jurisdiction, are the jurisdiction's disclosure requirements for such offerings or listings of equity by foreign issuers consistent with IOSCO's *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*; and in the case of *ṣukūk* by foreign issuers consistent with IFSB-19's[133] *Guiding Principles on Disclosure Requirements* – specifically, Principles S1 to S4 for *ṣukūk*?

Explanatory Notes

393. With respect to a jurisdiction's disclosure framework, the Key Questions envision that the assessor should take into consideration not only whether the information required to be disclosed is sufficiently clear, comprehensive, reasonably timely, and specific, but also whether the disclosure is made available under circumstances that encourage investors to use this information to make investment and voting decisions. For example, the assessor should take into consideration whether the regulatory regime addresses sales practices, such as "touting" advertising outside of the required disclosure documents that may detract from investors' reliance upon the required disclosure documents.

394. With respect to what may constitute full disclosure in Key Question 2, specific disclosures would be expected to be included for material pieces of information relevant to investors being able to make informed investment decisions. This information should address the most significant risks of investing in the security.[134] Important information about the issuer should include information about:

- those who have a significant interest in an issuer, including certain significant

[133] IFSB-19: *Guiding Principles for Disclosure Requirements for Islamic Capital Market Products (Ṣukūk and Islamic Collective Investment Schemes)*: http://www.ifsb.org/standard/IFSB%2019%20-%20Guiding%20Principles%20on%20Disclosure%20of%20ICM%20Products%20(final).pdf

[134] See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, Principle XI at p. 33; see *also International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra, Item III.D. at p. 12; *International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities by Foreign Issuers*, supra, Item III at p. 12.

security holders of the issuer;

- those who seek control of an issuer;

- material-related party transactions, including transactions involving directors and senior managers of the issuer; and

- director and senior management compensation and risk management practices.

395. With respect to what may constitute comprehensive and specific disclosure requirements for public offerings and listings of asset-backed securities[135] for Key Question 2, assessors should consider whether issuers (or service providers where specified below) are required to do the following:

- Disclose the identities of all parties involved in the transaction and the functions and responsibilities of significant parties.[136]

- Disclose all checks and assessments that have been performed or risk assurance practices that have been undertaken by the underwriter, sponsor and/or originator in respect of the underlying asset pool.[137]

- Service providers revisit and maintain reports over the life of the product.[138]

- Provide initial and ongoing information about underlying asset pool performance;[139] the composition and characteristics of the asset pool; [140] details regarding significant obligors of pool assets;[141] and the creditworthiness of the person(s) with direct or indirect liability to the issuer.[142]

[135] Asset-backed securities in the sense in which the term is used in conventional finance generally involve: (a) underlying financial assets that generate the cash flow supporting the securities; (b) absolute transfer of the financial assets such that the securities can withstand insolvency of the originator; (c) recourse only to the underlying financial assets (rather than the originator); and (d) a credit analysis focused on the financial assets (rather than the originator). The fact that they are dependent on financial assets (e.g. mortgages) makes them very different from most *ṣukūk*. *Ṣukūk* in essence are entirely different from conventional bonds in terms of their Sharīʿah basis and rulings, including in relation to their underlying assets/projects, structuring principles, clauses on risk and returns and so on, as compared to conventional bonds that represent only debt with no right of ownership in any assets. See also footnote 37 on the types of securitised exposures that are tradable and not tradable.
[136] See also CPICM 2 and 3.
[137] See *Unregulated Financial Markets and Products*, supra, Recommendation 1.2.
[138] Id, Recommendation 1.4
[139] Id, Recommendation 2.1; and *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, CPICM 4.
[140] See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, CPICM 5.
[141] Id, CPICM 6.
[142] See *Unregulated Financial Markets and Products*, supra, Recommendation 2.1.

- Disclose the structure of the transaction,[143] credit enhancements,[144] and the use of Sharīʿah-compliant hedging instruments.[145]

- Disclose all exchanges or regulated markets on which the security is, or is intended to be, traded.[146]

396. Assessors should also consider whether there are requirements for continuous disclosure of material developments in respect of public asset-backed securities.[147] These requirements may incorporate some or all of the disclosure topics highlighted in the *Principles for Ongoing Disclosure for Asset-Backed Securities* that are considered appropriate by the regulator taking into account the characteristics of their specific regulatory framework, the characteristics of the issuing entity or the characteristics of the securities involved.[148]

397. With respect to what may constitute "timely disclosure" for purposes of Key Question 2, the IOSCO *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, complemented by IFSB-19: "2.1.3 Principle G.3: Timely Information", provide that the listed entity shall disclose ongoing information on a timely basis, which could require disclosure on an immediate basis for disclosure of material developments, where such a term could be defined to mean "as soon as possible", promptly or prescribed as a maximum of specified days.[149]

398. These principles also indicate under the general ongoing obligation approach, disclosure may be subject to delay, which may be granted in some jurisdictions by the competent authority, if the information:

- is confidential under legislation; and

- concerns an incomplete proposal or negotiations, or the disclosure of particular information is such as to prejudice the legitimate interests of the entity's investors; in such cases the listed entity must ensure that the information is kept strictly confidential.[150]

[143] See *Disclosure Principles for Public Offerings and Listings of Asset-Backed Securities*, supra, CPICM 8.
[144] Id, CPICM 9.
[145] Id, Principle X.
[146] Id, Principle XII.
[147] Refer to footnote 135.
[148] See *Principles for Ongoing Disclosure for Asset-Backed Securities*, supra, p. 2.
[149] *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, supra, pp. 4–5 and IFSB-19: "2.1.3 Principle G.3: Timely Information", p. 7.
[150] Id.

399. Finally, in referring to disclosures required on a periodic basis prescribed by law or listing rules, such as quarterly or annual reports, these principles note that "[t]he disclosure obligation may require disclosure of relevant information on an immediate basis even when it belongs to periodic reporting".[151]

400. With respect to what may constitute appropriate delivery of periodic financial information in Key Question 3(b), practices vary among jurisdictions as to the frequency and timing of disclosure of periodic financial information. An affirmative response to Key Question 3(b) is warranted if the periodic financial information is made available on at least a semi-annual basis.

401. With respect to what may constitute general disclosure in Key Question 4, a general disclosure requirement will provide that all material information relevant to a particular security or issuer is required to be disclosed. Another approach for such a general disclosure requirement is that disclosure is required of all material information that is necessary to keep disclosures made from being misleading.[152]

402. With respect to assessing Key Question 6, and depending on the circumstances, persons taking responsibility may include the issuer, underwriters, directors, authorising officers, promoters, and experts and advisers consenting to be named as such.[153]

403. With respect to what may constitute derogations in Key Questions 7 and 8, assessors should recognise that there are circumstances in which it may be necessary to the proper functioning of the market to allow something less than full disclosure – for example, of trade secrets or incomplete negotiations. In the limited circumstances where the market requires some derogation from the objective of full and timely disclosure, there may need to be temporary suspensions from trading or restrictions on the trading activities of those who possess more complete information. In such circumstances, trading should be prohibited in the absence of full disclosure.

[151] Id.

[152] Reference should also be made to so-called merit-based regulation in which the regulator takes some responsibility for assessing the quality of a proposed offering. This approach is generally associated with developing markets and may be of particular benefit where a market lacks a group of analysts and advisers who could analyse information if it were made publicly available. It is therefore generally regarded as transitional and not necessary in a fully developed market.

[153] For more guidance about the internal control mechanisms that could be implemented by an issuer, see *Issuer Internal Control Requirements – A Survey*, Report of the Technical Committee and the Emerging Markets Committee of IOSCO, December 2006, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD229.pdf.

Benchmarks

Fully Implemented

404. Requires affirmative responses to all applicable Questions. If there are no derogations to disclosure, then Questions 7, 8(a) and 8(b) can be considered inapplicable.

Broadly Implemented

405. Requires affirmative responses to all applicable Questions except to Questions 1(e) and 3(c).

Partly Implemented

406. Requires affirmative responses to all applicable Questions except to Questions 1(c), 1(e), 3(c), 7 (where derogations are provided for) and 9.

Not Implemented

407. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(d), 2(a), 2(b), 2(c), 3(a), 3(b), 4, 5, 6, 8(a) or 8(b) (where derogations are provided for).

CPICM 18:	**Holders of securities in a company should be treated in a fair and equitable manner. (IOSCO 17)**

408. By seeking to safeguard the fair and equitable treatment of shareholders (particularly in connection with voting decisions and change of control transactions), this CPICM supports investor protection and fair, efficient and transparent markets.

409. This CPICM requires an assessment as to whether the basic rights of shareholders are protected and whether shareholders within a class[154] are treated equitably.

410. CPICM 18 addresses many of the same issues that are covered by Principles I and II of the *Principles of Corporate Governance of the Organization for Economic Co-operation and Development* (OECD) regarding the rights and equitable treatment of shareholders, particularly in connection with voting decisions, takeover bids, and other transactions that may result in a change in control or that may consolidate control.[155]

411. Regulation which safeguards the fair and equitable treatment of shareholders should require disclosure of the security holdings of management and of those persons who hold a substantial beneficial ownership interest in a company. This is generally regarded as information necessary to make informed investment decisions.

412. The level at which disclosure is required varies from jurisdiction to jurisdiction, but is generally set at a level well below that which would be characterised as a controlling interest. More stringent disclosure requirements may be appropriate for persons contemplating exercise of control.

413. The nature of the disclosure required also varies, but full public disclosure is generally thought to best meet the underlying policy rationale of disclosure where a change in control of a company has occurred or is contemplated. Regulation should have regard to the information needs of the shareholders of the subject company.

414. The information necessary to enable informed decision making will vary with the nature of the transaction, but the general objective remains true for cash offers, offers by way of tender and exchange, business combinations and privatisations.

415. Generally, in the circumstances described in the preceding sentence, this will require that shareholders of a company:

[154] Refer to footnote 125.
[155] This could include issuer bids as well as tender offers.

- have reasonable time in which to consider any offer under which a person would acquire a substantial interest in the company;

- are supplied with adequate information to enable them to assess the merits of any proposal under which a person would acquire a substantial interest in the company;

- as far as practicable, have reasonable and equal opportunities to participate in any benefits accruing to the shareholders under any proposal under which a person would acquire a substantial interest in the company;

- receive fair and equal treatment (in particular, minority shareholders) in relation to the proposal; and

- are not unfairly disadvantaged by the treatment and conduct of the directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal.

416. The relationship between CPICM 17 and 18 requires some explanation. While CPICM 17 seeks to ensure that investors are provided with timely disclosure about changes in corporate control (as set out in the Explanatory Notes on Key Question 2), CPICM 18 seeks to ensure shareholders are provided with sufficient and timely information about transactions which involve a change of control in a way that enables them to exercise rights in relation to those transactions.

Key Issues

Rights of Shareholders

1. The basic rights of equity shareholders are:

    a. The right to document[156] and transfer ownership.

    b. The right to participate on an informed basis in voting decisions (if the securities have voting rights).

[156] Register or perfect.

c. The right to participate equitably in dividends and other distributions, when, as and if declared, including distributions upon liquidation.

d. The right to pass upon changes in the terms and conditions of rights attaching to their shares.

e. The right, as far as practicable, to have reasonable and equitable opportunities to participate in any benefits accruing to the shareholders under any proposal under which a person would acquire a substantial interest in the company.

f. The right to hold a company's management accountable for their actions including their involvement or oversight, which results in breaches of the law.

g. The right to receive fair and equitable treatment (in particular, treatment of minority shareholders) including in relation to proposals described in 1(e) and in relation to bankruptcy or insolvency of the company.

Control

2. To safeguard fair and equitable treatment of shareholders, regulation should require disclosure of:

   a. Changes in controlling interests and substantial shareholdings above a specified threshold and transactions, which result or may result in changes in controlling interest and substantial shareholdings above a specified threshold.

   b. Information necessary to informed decision-making with respect to tender offers, takeover bids, and other transactions intended to effectuate a change of control or that potentially may result in a change of control, or that may consolidate control.

   c. Shareholdings of directors and senior management.[157]

   d. Shareholdings of those persons who hold a substantial beneficial ownership interest in a company.

[157] See definition in the Explanatory Notes.

Key Questions

Rights of Shareholders

1. Does the regulatory and legal frameworks address the rights and equitable treatment of shareholders in connection with the following:

    a. Voting:

        i. For election of directors?

        ii. On corporate changes affecting the terms and conditions of their securities?

        iii. On other fundamental corporate changes?

    b. Timely notice of shareholder meetings and voting decisions?

    c. Procedures that enable beneficial owners to give proxies or voting instructions efficiently?

    d. Ownership registration (in the case of registered shares) and transfer of their shares?

    e. Receipt of dividends and other distributions, when, as, and if declared?

    f. Transactions involving:

        i. A takeover bid?

        ii. Other change of control transactions?

    g. Holding the company, its directors and senior management accountable for their involvement or oversight resulting in violations of law?

    h. Bankruptcy or insolvency of the company?[158]

2. Is full disclosure of all information material to an investment or voting decision required in connection with shareholder voting decisions generally and the transactions referred to in Questions 1(a)(iii), 1(f)(i) and 1(f)(ii) specifically?

[158] This may affect the value of a listed security; shareholders should be able to determine and to exercise their rights in the event of a liquidation or insolvency.

Control

3. With respect to transactions referred to in Question 1(f)(i) and 1(f)(ii), are shareholders of the class or classes of securities[159] affected by the proposal:

    a. Given a reasonable time in which to consider the proposal?

    b. Supplied with adequate information to enable them to assess the merits of the proposal?

    c. As far as practicable, given reasonable and equitable opportunities to participate in any benefits accruing to the shareholders under the proposal?

    d. Given fair and equitable treatment (in particular, minority security holders) in relation to the proposal?

    e. Not unfairly disadvantaged by the treatment and conduct of directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal?

4. With respect to substantial holdings of voting securities:

    a. Is information about the identity and holdings of persons who hold a substantial (well below controlling) beneficial ownership interest in a company required to be disclosed in a timely manner:

        i. In public offering and listing particulars documents?

        ii. Once the ownership threshold requiring disclosure has been reached?

        iii. At least annually (e.g. in the issuer's annual report)?

    b. Is it mandatory for material changes in such ownership and other required information to be disclosed in a timely manner?

    c. Are these disclosure requirements applicable to two or more persons acting in concert even though their individual beneficial ownership might not have to be disclosed?

[159] Refer to footnote 125.

5. With respect to holdings of voting securities by directors and senior management:

    a. Is information about the beneficial ownership interest and material changes in beneficial ownership in a company required to be disclosed in a timely manner?

    b. Is such information available:

        i. In public offering and listing particulars documents?

        ii. At least annually (e.g. in the issuer's annual report)?

    c. Is the legal infrastructure sufficient to ensure enforcement of and compliance with these requirements?

Cross-Border

6. If public offerings or listings by foreign issuers are significant within the jurisdiction, does the jurisdiction require disclosure in foreign issuers' offering and listing particulars documents of any governance provisions or information relating to the foreign issuer's jurisdiction that may materially affect the fair and equitable treatment of shareholders?[160]

Explanatory Notes

417. Concerns regarding the issues treated by this Principle often arise in connection with potentially disparate treatment of majority and minority shareholders, or takeover bids and other change in control transactions where shareholders' rights are affected.

418. Key Issue 1 sets forth the basic rights of shareholders, which should be protected. Corporate governance may be addressed by general law, authorised exchange or regulated trading system rules, or a code of practice as well as securities laws and regulations.

419. The term "directors and senior management" includes: (a) the company's directors; (b) members of the administrative, supervisory and management bodies; and (c) nominees to serve in any of the aforementioned positions. The persons covered by the term "administrative,

[160] *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, supra, Parts IX A and X A and B.

supervisory or management bodies" vary in different countries and, for purposes of complying with the disclosure standards, will be determined by the host country.[161]

420. With respect to Key Questions 4(a)(i), 4(a)(ii), 4(a)(iii) and 4(b), practices vary among jurisdictions regarding the threshold that constitutes substantial ownership required to be disclosed (e.g. 5% or 10%) as well as the timeliness (e.g. 7 or 10 calendar or business days) and frequency of disclosure and the thresholds for, and frequency and timeliness of disclosure of, change in substantial ownership. Nevertheless, when such disclosures involve an actual or proposed change in control transaction, it is appropriate to look to the Explanatory Notes under Principle 16 for guidance regarding timely disclosure in such circumstances.

421. With respect to Key Questions 4(a)(i), 4(a)(ii), 4(a)(iii), 5(b)(i) and 5(b)(ii), the timeliness of the ownership disclosure called for obviously will be affected by the timeliness of filing and/or public availability of the document in which the information is included. However, the assessor also should consider whether the ownership information disclosed in such a document is as of a date reasonably close to the date of filing and/or public availability of the document.

Benchmarks

Fully Implemented

422. Requires affirmative responses to all applicable Questions.

Broadly Implemented

423. Requires affirmative responses to all applicable Questions except to Question 1(c).

Partly Implemented

424. Requires affirmative responses to all applicable Questions except to Questions 1(b), 1(c), 1(g), 1(h), 3(e), 4(a)(iii), 4(c), 5(b)(ii) and 6.

Not Implemented

[161] Id, p. 7. Disclosure of holdings of directors and senior management in a group is sufficient in lieu of disclosure of individual holdings, provided, however, that Key Question 4 would apply regarding separate disclosure of substantial ownership interests of individual directors and senior management.

425. Inability to respond affirmatively to one or more of Questions 1(a)(i), 1(a)(ii), 1(a)(iii), 1(d), 1(e), 1(f)(i), 1(f)(ii), 2, 3(a), 3(b), 3(c), 3(d), 4(a)(i), 4(a)(ii), 4(b), 5(a), 5(b)(i) or 5(c).

CPICM 19: Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality. (IOSCO 18)

426. This CPICM supports the objectives of investor protection and fair, efficient and transparent markets. It does this by requiring that financial statements[162] are prepared in accordance with high quality and internationally acceptable accounting standards. Use of these standards, in turn, seeks to ensure the information provided in financial statements is comprehensive, consistent, relevant, reliable and comparable and so supports investors in making investment decisions, regardless of the geographic location of the entity concerned.[163]

427. Regulation should seek to ensure the following:

- Financial statements are prepared by issuers.
- Those statements are prepared in accordance with accounting standards which are of a high quality and are internationally acceptable.
- An appropriate mechanism exists for the setting of these standards for use in preparing financial statements such that, where there is some dispute or uncertainty, standards can be the subject of authoritative and timely interpretation that fosters consistent application.[164]
- A regulatory framework for enforcing compliance with accounting standards.[165]

428. This CPICM should be considered and assessed in conjunction with CPICM 17, which requires full, timely and accurate disclosure of financial information material to investment decisions. The assessor should establish under CPICM 17 whether the financial statements required in public offering and listing particulars documents and periodic reports are sufficient

[162] Financial statements provide information about the financial position, financial performance (including results of operations and cash flow) and other information (such as changes in the ownership equity of an enterprise) that is useful to a wide range of users for decision-making purposes.
[163] Financial statements also show the accountability of management for the resources entrusted to them.
[164] See, generally, *Resolution on Harmonization of Accounting and Auditing Standards*, Resolution of the Presidents' Committee of IOSCO, November 1988, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES39.pdf. See also *Resolution on IASC Standards*, Resolution of the Presidents' Committee of IOSCO, May 2000, available at http://www.iosco.org/library/resolutions/pdf/IOSCORES19.pdf; *Statement on the Development and Use of International Financial Reporting Standards*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD182.pdf; *Outsourcing in Financial Services*, supra.
[165] See, generally, *Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf.

to meet the full, accurate and timely disclosure requirement, and then assess, under CPICM 19, the quality of the accounting standards used in their preparation and verification.

429. In relation to CPICM 17 to 19, assessors should assess how the Methodology applies to the set of disclosure and accounting requirements, which prevail and thus have broad application in the jurisdiction in respect of public offerings, and publicly listed and traded securities. Specific accounting or disclosure requirements which apply to specialised markets or limited categories of market participants should not affect how a jurisdiction is assessed with respect to these CPICM. Such differing requirements could be associated with, for example: the overall level of disclosure; individual versus consolidated financial statements; financial statement footnotes; or reporting on internal controls.

Key Issues

1. Regulation should require that issuers prepare audited financial statements in accordance with accounting standards, which are of a high quality and are internationally acceptable. High quality, internationally acceptable accounting standards are essential to enhance the comparability and reliability of financial statements for informed decision-making.

2. There should be an appropriate mechanism for the setting and interpretation of high quality internationally acceptable accounting standards.

3. These high quality, internationally acceptable accounting standards should be enforceable and enforced.

Key Questions

1. Are issuers required to include audited financial statements in:

    a. Public offering and listing documents?[166]

[166] There may be some circumstances – for example, in an ICIS that has not yet raised funds and an offering of a securitised product – where financial statements are unnecessary. In such circumstances, the regulator may require other information deemed relevant to the terms of such offerings.

b. Publicly available annual reports?

2. Do the required audited financial statements include:

a. A balance sheet or statement of financial position?

b. A statement of the results of operations?

c. A statement of cash flow?

d. A statement of changes in ownership equity or comparable information included elsewhere in the audited financial statements or footnotes?

3. With respect to the financial statements required in public offering and listing documents and publicly available annual reports:

a. Are these required to be prepared and presented in accordance with a comprehensive body of accounting standards?

b. Do these accounting standards require financial statements to:

i. be comprehensive?

ii. be designed to serve the needs of investors?

iii. reflect consistent application of accounting standards?

iv. be comparable if more than one accounting period is presented?

c. Are the prevailing accounting standards of an internationally acceptable quality?

4. Where unaudited financial statements are used – for example, in interim reports, and interim-period financial statements in public offering and listing documents, in full or summary format – are the financial statements presented in accordance with accounting standards that are of a high and internationally acceptable quality?

5. In regard to oversight, interpretation and independence with respect to accounting standards:

a. Does the regulatory framework provide for an organisation responsible for the establishment and timely interpretation of accounting standards?

b. If yes, are the organisation's processes open and transparent, and, if the organisation is independent, is the standard-setting or interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

6. Is there a system for enforcing compliance with accounting standards?

7. If public offerings or listings by foreign issuers are significant within the jurisdiction, does the regulator permit the use of high-quality, internationally acceptable accounting standards by foreign companies that wish to list or offer securities in the country?[167]

Explanatory Notes

430. In order to be considered comprehensive for the purposes of Key Question 3(a), the accounting standards under which annual financial statements are prepared should require footnotes that (a) present information about the basis of preparation of the financial statements and the significant accounting policies used in preparing them, and (b) include all material information required to be disclosed by such standards that is not presented elsewhere in them.[168] The assessor should determine whether and how the standards are enforced.

431. The accounting standards referred to under Key Question 3 and parts of Key Question 5 need not be standards that are established or interpreted by an organisation within the jurisdiction. Some jurisdictions may wish to adopt and rely upon standards established and/or interpreted by international or other standards-setting organisations. In such circumstances, however, it is essential that a jurisdiction have a regulatory framework in place that provides a mechanism to ensure effective implementation and enforcement of these standards. A jurisdiction's implementation and enforcement mechanisms need not rely upon the regulator or other enforcement authorities organised within the jurisdiction; however, if third-party

[167] See also discussion under Principle 16 regarding timeliness and full disclosure of financial information material to investment decisions and shareholder voting decisions. See also, generally, *Resolution on IASC Standards*, supra; *Statement on the Development and Use of International Reporting Standards in 2005*, Report of the Technical Committee of IOSCO, February 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD182.pdf; *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, supra; and *IOSCO Statement on International Auditing Standards*, June 2009, available at https://www.iosco.org/library/statements/pdf/ statements-7.pdf.

[168] See, generally, *Statement on Providing Investors with Appropriate and Complete Information on Accounting Frameworks Used to Prepare Financial Statements*, Report of the Technical Committee of IOSCO, February 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD262.pdf.

enforcement is utilised, it is essential that the regulatory framework within the jurisdiction provides that the regulator or another body that acts in the public interest is capable of overseeing the enforcement process and ensuring that the process is binding upon companies whose securities are publicly offered or publicly traded within the jurisdiction, and external auditors practising within the jurisdiction.

432. In assessing whether adequate mechanisms are in place for enforcing compliance with accounting standards under Key Question 6, assessors may take into account requirements that where financial statements deviate from accepted standards they must be restated or otherwise corrected.

433. In some jurisdictions, institutions offering Islamic financial services are required to comply with suitably modified accounting standards that adequately address the specificities of Sharī‘ah-compliant products and services. The assessor is expected to look into compliance with these national suitably modified accounting standards. This, however, may not be applicable in some other jurisdictions.

Benchmarks

Fully Implemented

434. Requires affirmative responses to all applicable Questions.

Broadly Implemented

435. Requires affirmative responses to all applicable Questions except to Questions 5(b) and 7.

Partly Implemented

436. Requires affirmative responses to all applicable Questions except to Questions 2(c), 4, 5(b), and 7.

Not Implemented

437. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), 2(b), 2(d), 3(a), 3(b), 3(c), 5(a) or 6.

CPICM 20: *Ṣukūk* should be subject to specific disclosure requirements commensurate with their specific nature and risk characteristics and which provide sufficient disclosures and transparency in all aspects related to compliance with Sharīʻah requirements. (No IOSCO equivalent)

438. Effective regulation of *ṣukūk* is important for protection of investors and for providing greater clarity and transparency to the market. *Ṣukūk* may have significantly different underlying structures, which may introduce different risk characteristics from those of conventional instruments. As such, *ṣukūk* require specific regulatory considerations within a jurisdiction's regulatory framework that address these aspects, particularly with respect to specific disclosure requirements for *ṣukūk* and additional regulatory provisions that take into consideration the Sharīʻah compliance requirements for *ṣukūk.*

439. The regulatory system should require appropriate supervision of *ṣukūk* offerings, promoting transparency, integrity and investor protection. There should be clear provisions with respect to the initial and ongoing disclosure requirements for *ṣukūk.*

440. In addition to the general Sharīʻah governance issues addressed in CPICM 10 which are applicable to *ṣukūk*, specific aspects related to the Sharīʻah compliance of *ṣukūk* are also dealt with in this principle from a disclosure perspective.

441. IFSB-19: *Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukūk and Islamic Collective Investment Schemes)* provides detailed guidance on disclosures related to *ṣukūk*. In line with IFSB-19, *ṣukūk* should be subject to the disclosure requirements outlined below.[169]

Key Issues

1. The regulatory system should ensure that the disclosure framework set out for *ṣukūk* is consistent with the characteristics of the *ṣukūk.* Where some financial characteristics of some *ṣukūk* are similar to those of a conventional bond, RSAs should ensure that the disclosure requirements for such *ṣukūk* are parallel to the relevant disclosure principles applicable to those conventional securities. Where the *ṣukūk* has features that may result in variation in its basic financial, credit and risk characteristics (such as *kafālah*/guarantee, redemption options, convertibility, exchangeability and

[169] Available at http://www.ifsb.org/download.php?id=4375&lang=English&pg=/published.php.

subordination), RSAs should ensure that additional or varied disclosure requirements relating to that feature are applied, and which are parallel to the requirements that apply when a similar feature is included in a conventional debt security.

2. Regulations should ensure sufficient disclosures regarding all Sharīʿah aspects of the *ṣukūk,* including, but not restricted to:

a. the details and composition of the Sharīʿah board;

b. the Sharīʿah review process;

c. any *fatwa* issued for a determination of Sharīʿah compliance;

d. the Sharīʿah basis of the issued ***fatwā***;

e. any deficiency or limitations in relation to the underlying asset(s) or activities of the *ṣukūk* from a Sharīʿah perspective;[170]

f. the tradability or non-tradability of the *ṣukūk*;

g. matters pertaining to purification and compensation payments, or any other Sharīʿah-related payments;

h. the role of Sharīʿah in interpretation of the *ṣukūk* documents, particularly in default, enforcement, amendment or restructuring.[171] In jurisdictions where courts are not bound to apply Sharīʿah, disclosure should state that courts would be expected to apply the relevant national law rather than Sharīʿah rules and principles in interpreting the *ṣukūk* contracts. Where this is the case, disclosures should also clarify that the resulting interpretation may not be consistent with Sharīʿah rules and principles;[172]

[170] Examples of underlying assets include those that involve cash and receivable-type assets. Disclosures should include any ratios that should be observed for the asset pool, along with any consequences of a breach in these ratios. In addition, disclosures should extend to any underlying assets or activities that include an impermissible component that requires purification in line with IFSB-19.

[171] As per IFSB-19, disclosures should state what role (if any) Sharīʿah would play in the interpretation of the *sukūk* contracts; that is, whether this would involve interpretation by the parties performing the contracts, or interpretation in a legal forum applying the selected governing law.

[172] The IsDB Group Sharīʿah Board is of the opinion that, in the case when secular laws are relied upon in the *ṣukūk* contracts, such secular laws should not be fundamentally in conflict with Sharīʿah rules and principles. Moreover, the contracting parties should satisfy themselves that this is the case.

i. any arrangements in place to provide Sharīʿah assessments or ad hoc Sharīʿah determinations in extraordinary matters that may arise post-issuance, such as default, enforcement, amendment or restructuring; and

j. other ongoing or periodic Sharīʿah-related disclosures.

3. The disclosure requirements related to the structure of the *ṣukūk* should provide sufficient clarity so as to enable the understanding and assessment of any associated risks. This should include disclosures relating to:

a. the *ṣukūk* structure, flow of funds and the principal contracts that comprise the *ṣukūk* structure;

b. the assets, investments and/or activities underlying the *ṣukūk* structure, including any incidental use, investment or activity that does not comply with Sharīʿah;

c. the mechanisms for the transfer of the asset into the *ṣukūk* structure at the time of issuance and the transfer of the asset out of the *ṣukūk* structure at redemption;

d. the use of proceeds of the *ṣukūk* issuance by the entity or entities that ultimately deploy the proceeds;

e. the ultimate source(s) of funds (i.e. to whom or to what assets investors have recourse) to make distributions on a *ṣukūk* on an ongoing basis and in enforcement;[173]

f. any mechanisms, arrangements or limitations in the event of default, enforcement, restructuring and insolvency; and

g. ongoing disclosures related to any changes to the contracts that would materially affect the Sharīʿah aspects of the *ṣukūk*.

4. The regulatory system should ensure appropriate disclosures regarding all entities material to an investment decision in the *ṣukūk* – for example, where the *ṣukūk* obligor differs from the *ṣukūk* issuer. In such cases, the information normally required

[173] Refer to IFSB-19, para. 108.

to be disclosed with respect to the issuer should also be disclosed regarding the obligor. Where the *ṣukūk* obligor(s) or originator(s) differ from the *ṣukūk* issuer, the liability for defective disclosure normally applying to an issuer should also apply to the obligor(s) and the originator(s).

Key Questions

Disclosure Requirements

1. Does the regulatory system require adequate disclosures that reflect the specific financial, credit and risk characteristics of the *ṣukūk*?

2. Does the regulatory system require sufficient disclosures of Sharīʿah-related aspects of the *ṣukūk*, including:

a. Sharīʿah adviser(s)?

b. Sharīʿah review process?

c. any *fatwā* issued for a conclusion of Sharīʿah compliance in relation to the *ṣukūk*?

d. the Sharīʿah basis of the issued *fatwa*?

e. any deficiency or limitation in relation to the asset(s) or activities underlying the *ṣukūk* from a Sharīʿah perspective?[174]

f. any limitations related to tradability or non-tradability of the *ṣukūk*?

g. whether or not there are any arrangements made in the *ṣukūk* contract for purification payments to be made in respect of non-Sharīʿah-compliant income, or any other Sharīʿah-related payments?

h. the role of Sharīʿah in interpretation of the *ṣukūk* contracts (whether interpretation by the parties performing the contracts, or interpretation in a legal forum applying the selected governing law), particularly in default, enforcement, amendment or restructuring, and in jurisdictions where courts are not bound to apply Sharīʿah in interpreting contracts, that fact and the

[174] See footnote 166.

possibility, if any, that the resulting interpretation may not be consistent with Sharīʿah principles?

i. arrangements in place to provide Sharīʿah assessments or ad hoc Sharīʿah determinations in extraordinary matters that may arise post-issuance, such as default, enforcement, amendment or restructuring, and if such arrangements do not exist, disclosures regarding any potential consequences for investors?

j. periodic Sharīʿah-related disclosures or guidance in matters arising post-issuance?

3. Does the regulatory system require disclosures that provide sufficient clarity regarding the structure of the *ṣukūk*, including those related to:

a. the *ṣukūk* structure, flow of funds and the principal contracts comprising the *ṣukūk* structure?

b. disclosures related to the assets, investments and/or activities underlying the *ṣukūk* structure?

c. the use of proceeds of the *ṣukūk* issuance?

d. the source(s) of funds (i.e. to whom or to what assets investors have recourse) to make distributions on a *ṣukūk* on an ongoing basis and in enforcement?[175]

e. mechanisms, arrangements or limitations in the event of default, enforcement, restructuring and insolvency?

f. ongoing disclosures on any changes to the contracts that would materially affect the Sharīʿah aspects of the *ṣukūk*?

4. Are there regulatory requirements ensuring that there is appropriate disclosure regarding all entities that are material to the investment decision in *ṣukūk*?

[175] Refer to IFSB-19, para. 108.

Explanatory Notes

442. Different jurisdictions may have different legal treatments as well as differing terminology for *ṣukūk*. This CPICM shall apply to all instruments that are considered to be *ṣukūk*, including those instruments that appear to have the same characteristics as *ṣukūk* even if they are not clearly termed as *ṣukūk*.

443. All key issues and key questions are to be read in reference to the more detailed guidance provided in IFSB-19.

444. With respect to Sharīʿah compliance, this CPICM takes a disclosure-based approach. However, the general Sharīʿah requirements in CPICM 10 are also applicable to *ṣukūk*. This principle should therefore be assessed in conjunction with assessment of compliance with the applicable key questions in CPICM 10 on Sharīʿah governance.

445. The assessor should also consider the disclosure requirements set out in CPICM 20 in conjunction with the disclosure requirements set out in CPICM 17.

Benchmarks

Fully Implemented

446. Requires affirmative responses to all applicable Questions.

Broadly Implemented

447. Requires affirmative responses to all applicable Questions except 2(d), 2(g), 2(h), 2(i) and 2(j).

Partly Implemented

448. Requires affirmative responses to all applicable Questions except to Questions 2(b), 2(d), 2(e), 2(f), 2(g), 2(h), 2(i) and 2(j).

Not Implemented

449. Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(c), 3(a), 3(b), 3(c), 3(d), 3(e), 3(f) or 4.

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15	*Insider Trading - How Jurisdictions Regulate It*, Report of the Emerging Markets Committee of IOSCO, May 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf	17	

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16	*General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Condition and Results of Operations*, Report of the Technical Committee of IOSCO, February 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD141.pdf	17	
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23	*Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf	17	12 14 32 34
24	*International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuer*, Report of IOSCO, September 1998, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf	17 18	
25	*International Equity Offers - Changes in Regulation Since April 1996*, Report of the Technical Committee of IOSCO, September 1997, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD71.pdf	17	

	Document	CPICM	Other CPICM
26	*Reporting of Material Events in Emerging Markets*, Report of the Emerging Markets Committee of IOSCO, September 1996, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD62.pdf	17	
27	*International Equity Offers - Changes in Regulation Since April 1994*, Report of IOSCO, September 1996, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD61.pdf	17	
28	*Report on Disclosure and Accounting*, Report of the Technical Committee of IOSCO, October 1994, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD39.pdf	17 19	
29	*International Equity Offers - Changes in Regulation Since April 1992*, Report of IOSCO, October 1994, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD38.pdf	17	
30	*Report on Disclosure*, Report of the Emerging Markets Committee of IOSCO, October 1993, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD32.pdf	17	

	Document	CPICM	Other CPICM
31	*Report on Disclosure Requirements*, Report of the Development Committee of IOSCO, October 1992, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD24.pdf	17	
32	*International Equity Offers - Changes in Regulation Since April 1990*, Report of IOSCO, September 1991, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD16.pdf	17	
33	*International Equity Offers*, Report of IOSCO, September 1989, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD2.pdf	17	
34	*Resolution on Harmonization of Accounting and Auditing Standards*, Resolution of the Presidents' Committee of IOSCO, November 1988, http://www.iosco.org/library/resolutions/pdf/IOSCORES39.pdf.	19	

2.7 Principles for Auditors, Credit Rating Agencies and Other Information Service Providers

2.7.1 Preamble

450. These CPICM are about information that investors may rely on when making investment decisions. They differ from the CPICM on issuers in that they relate to information that is not generally prepared by issuers themselves. Within modern financial markets, entities exist that analyse, evaluate, or provide assurance of information for investors about issuers, or their securities, in order to help investors with their investment decisions.

451. For the purposes of the CPICM, such entities are called “information service providers”. These analytical, evaluative or audit services can take the form of opinions on:

- the fair presentation or true and fair view of issuers’ financial statements;
- the issuers’ credit worthiness or expected financial performance; or
- other important aspects of issuers’ operations, that investors consider material to making investment decisions.

452. Accordingly, auditors, credit rating agencies (CRAs), and sell-side research analysts are covered by the CPICM in this section. Other information service providers may also fall within the scope of the following CPICM.

453. CPICM 21, 22, and 23 relate to auditors and audit standards, and are closely inter-related. They are intended to assist securities market regulatory authorities and other authorities with responsibility for auditor oversight, in developing and enhancing regulatory audit-related structures and requirements. In the jurisdictions where the securities regulator does not have primary responsibility for auditor oversight and standards, it will have an interest in promoting the existence of an oversight system that is consistent with maintaining and enhancing investor confidence in financial statements.

454. Comprehensiveness, consistency, relevance, reliability, and comparability of financial statements are crucial to informed decision making. Investors need credible and reliable financial statements when making decisions about capital allocations. The public’s perception of the credibility of financial reporting by public issuers is influenced significantly by the perceived effectiveness of external auditors in examining and reporting on financial statements. The reliability of financial information is also enhanced by audits performed by independent auditors, who attest whether the financial statements prepared by management

fairly present or provide a true and fair view of the financial position and financial performance of the issuer in accordance with the standards under which they are prepared. The audit report should give an audit opinion concerning compliance with the requirements of the accounting framework, including accounting standards and any "present fairly" or "true and fair view" requirements. Audits should be conducted in accordance with a comprehensive body of high quality and internationally accepted auditing standards and by auditors that are subject to effective oversight and that are independent of the entities they audit, in both fact and appearance.

455. CPICM 24 and 25 relate respectively to CRAs and other information service providers but are not closely inter-related. CRAs can play an important role in modern capital markets by opining on the credit risk of issuers of securities and their financial obligations. Because CRAs can play an important role in securities markets, the activities of CRAs are of interest to investors, issuers, market intermediaries, and financial regulators. Securities regulators, in particular, frequently have a dual interest in the activities of CRAs, both because CRAs may have an effect on market transparency and because some jurisdictions allow credit ratings to be used for regulatory purposes. CRAs rating Islamic securities need to take into account any specificities of those securities when they undertake the task of rating them. Whether this is done through formally separate methodologies or through a single methodology capable of covering those specifics, consistency and comparability between approaches is an important consideration.

456. In addition to CRAs, other entities exist which provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. An example of one such entity that provides analytical or evaluative services is "sell-side" securities analysts employed by the research departments of full-service investment firms such as broker-dealers and investment banks who offer research to both retail and institutional investors. Such sell-side securities analysts can face conflicts of interest that may compromise their abilities to offer investors independent, unbiased opinions. Other types of entities that provide analytical or evaluative services may also face conflicts of interest as well, which may be similar or quite different, depending on the nature of the provider and/or the information services they provide.

2.7.2 Scope

457. CPICM 21 to 23 are intended to apply to those that provide auditing services for issuers whose securities are listed, publicly offered or traded (public issuer).

458. CPICM 24 is intended to apply to all CRAs that provide rating services in respect of issuers' securities that are sold to investors. CRAs should be subject to adequate levels of oversight, the nature of which may depend on the structure of the market, the structure of the CRA industry in a given jurisdiction, how credit ratings are used in a given jurisdiction, and the corresponding regulatory risks CRAs may pose. Where credit ratings are used for regulatory purposes in a jurisdiction, "adequate levels of oversight" will mean some form of registration and ongoing supervision.

459. CPICM 25 is intended to apply to entities other than auditors or CRAs that also provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. This would include sell-side analysts.

2.7.3 CPICM 21 through 25

CPICM 21: Auditors should be subject to adequate levels of oversight. (IOSCO 19)

460. Effective oversight of those performing audit services is critical to the reliability and integrity of the financial reporting process, and helps reduce the risks of financial reporting and auditing failures in the public securities market. The ultimate purpose of such oversight is to protect the interests of investors and further the public interest in the preparation of informative, true, fair, and independent audit reports.

461. There are benefits to an auditor oversight system that is not based exclusively or predominantly on self-regulation. Oversight of auditors can occur in several ways, including within audit firms, by professional organisations and public or private sector oversight bodies, and through government oversight. Within a jurisdiction, auditors should be subject to oversight by a body that acts, and is seen to act, in the public interest. Regulation should, among other things, seek to ensure:

- audit work is conducted pursuant to high quality and internationally acceptable standards;
- rules are designed to promote the independence of the auditor;
- there are mechanisms for enforcing compliance with auditing standards; and
- audits are performed with a high degree of objectivity.

Key Issues

1. Auditors should be subject to oversight by a body that acts, and is seen to act, in the public interest. While the nature of an auditor oversight body and the process through which it carries out its activities may differ among jurisdictions, effective oversight generally includes the following mechanisms or processes that:[176]

a. Require that the auditors have proper qualifications and professional competency before being licensed to perform audits.

[176] *Principles for Auditor Oversight*, supra, pp. 3–4.

b. Withdraw authorisation to perform audits if proper qualifications and competency are not maintained.

c. Require that auditors are independent of the enterprises they audit, both in fact and in appearance.

d. Provide oversight over the quality of auditing, and implementation of auditing, independence and ethical standards, as well as quality control environments.[177]

e. Require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if the professional body acts as the oversight body, is overseen by an independent body.

f. Require that regular reviews be conducted by the auditor oversight body of audit procedures and practices of firms that audit the financial statements of public issuers. Reviews should be conducted on a recurring basis, and should be designed to determine the extent to which audit firms have and adhere to adequate quality control policies and procedures that address all significant aspects of auditing.

g. Require an auditor oversight body to also address other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients, consulting and other non-audit services, and other matters as deemed appropriate.

h. Require an auditor oversight body to have the authority to stipulate remedial measures for problems detected, and to initiate and/or to carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.

Key Questions

1. Does the regulatory system provide a framework for overseeing the quality and implementation of auditing, independence, and ethical standards, including the quality control environments in which auditors operate?

[177] See, generally, *Board Independence of Listed Companies*, Final Report of the Technical Committee of IOSCO in consultation with the OECD, March 2007, available at https://www.iosco.org/library/pubdocs/pdf/I OSCOPD238.pdf.

2. Are auditors required to be qualified and competent pursuant to minimum requirements before being licensed to perform audits, and to maintain professional competency?

3. Is there an oversight body that operates in the public interest, has an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding, such that the oversight responsibilities are carried out in a manner independent of the auditing profession?

4. Does the auditor oversight body have an established process for performing regular reviews of audit procedures and practices of firms that audit financial statements of public issuers?

5. Are there standards and processes for regular assessments by the oversight body to assess whether the auditor is and remains independent, both in fact and in appearance, of the enterprises that it audits?

6.

a. If the oversight process is performed in coordination with similar quality control mechanisms that are in place within the audit profession, does the oversight body: maintain control over key issues such as, the scope of reviews, access to, and retention of, audit work papers and other information needed in reviews; and follow up the outcome of reviews?

b. Are reviews conducted on a recurring basis, and designed to determine the extent to which audit firms have, and adhere to, adequate quality control policies and procedures that address all significant aspects of auditing?

7. Does the auditor oversight body have the authority to stipulate remedial measures for problems detected, and to initiate, and/or carry out, disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate?

Explanatory Notes

462. Oversight of auditors can occur in several ways, including within audit firms; by professional organisations; by public or private sector oversight bodies; or through government oversight.

463. The use of the term “oversight body” should be interpreted broadly. In some jurisdictions, there is a specific organisation that is charged to act in the public interest to oversee auditors and which has been granted certain powers, including rule-making authority, as well as the power to carry out inspections and discipline auditors. In other jurisdictions, there may be two or more organisations that share responsibility for fulfilling the same objectives. Regardless of the structure, the auditor oversight framework should not be based exclusively or predominantly on self-regulation. A mechanism should exist to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body.

464. The “significant aspects of auditing” referred to in Key Question 6(b) include:

- Independence, integrity and ethics of auditors.
- Objectivity of audits.
- Selection, training, and supervision of personnel.
- Acceptance, continuation, and termination of audit clients.
- Audit methodology.
- Audit performance (i.e., compliance with applicable generally accepted auditing standards).
- Consultation on difficult, contentious, or sensitive matters and resolution of differences of opinion during audits.
- Second partner reviews of audits.
- Communications with management, supervisory boards, and audit committees of audit clients.
- Communications with bodies charged with oversight over the financial reporting process.
- Provisions for continuing professional education.
- Professional competency.
- Rotation of audit personnel.

- Employment of audit personnel by audit clients.
- Consulting and other non-audit services.[178]

Benchmarks

Fully Implemented

465. Requires affirmative responses to all applicable Questions.

Broadly Implemented

466. Requires affirmative responses to all applicable Questions except to Question 6(b).

Partly Implemented

467. Requires affirmative responses to all applicable Questions except to Questions 4 and 6(b).

Not Implemented

468. Inability to respond affirmatively to one or more of Questions 1, 2, 3, 5, 6(a) or 7.

[178] *Principles for Auditor Oversight*, supra, p. 4.

CPICM 22: Auditors should be independent of the issuing entity that they audit. (IOSCO 20)

469. Independent auditors play a critical role in enhancing the reliability of financial information by attesting as to whether the financial statements prepared by management fairly present, or provide a true and fair view of, the financial condition and past performance of the issuer in compliance with accepted standards.

470. An external auditor plays a critical role in lending independent credibility to published financial statements used by investors, creditors, and other stakeholders as a basis for making capital allocation decisions. The public's perception of the credibility of financial reporting by public issuers is influenced significantly by the perceived effectiveness of external auditors in examining and reporting on financial statements. A fundamental element of this public confidence is that external auditors operate, and are seen to operate, in an environment that supports objective decision-making on key issues having a material effect on financial statements. For this to happen, auditors must be independent of the entities they audit, in both fact and appearance.

471. Standards of independence for auditors of public issuers should be designed to promote an environment in which the auditor is free of any influence, interest, or relationship that might impair professional judgment or objectivity or, in the view of the reasonable investor, might impair professional judgment or objectivity. Robust independence standards that are consistently applied and enforced are a necessary element in reassuring the investing public that auditors are in a position to exercise objective judgment in concluding on management's representations in an entity's financial statement.[179]

Key Issues

1. The regulatory framework should be designed to foster auditor independence and oversight of an auditor's independence.

2. Standards of external auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, which address at least the following threats to independence:

a. self-interest;

[179] See, generally, *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, Statement of the Technical Committee of IOSCO, October 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf.

b. self-review;

c. advocacy;

d. familiarity; and

e. intimidation.

3. Independence should include appropriate rotation of the auditor and/or the audit engagement team, such that senior member(s) of a team do not remain in key decision-making positions for an extended period.

4. In case of public issuers, regardless of the particular legal structure in a jurisdiction, a governance body that is in both appearance and fact independent of management of the company being audited (e.g., audit committee, board of corporate statutory auditors or other body independent of the entity's management) should oversee the process of selection and appointment of the external auditor.

5. Prompt disclosure to the public should be required when an auditor of a public issuer is replaced.

6. The governance structure of public issuers should contribute to the monitoring and safeguarding of the independence of its external auditor.

Key Questions

1. Does the regulatory framework set standards for the independence of external auditors?

2. Do the standards contain restrictions relating to audit firms and individuals within the audit firm regarding financial, business or other relationships with an entity that the firm audits?

3. Do the standards address the following:

a. self-interest?

b. self-review?

c. advocacy?

d. familiarity?

e. intimidation?

4. Are there regulatory standards that govern the provision of non-audit services to an entity that an audit firm audits?

5. Are auditors required to establish and maintain internal systems, governance arrangements, and processes for monitoring, identifying and addressing threats to independence, including the rotation of auditors and/or senior member(s) of the audit engagement team, and ensuring compliance with the standards?

6. From the perspective of public issuers:

a. Is the external auditor required to be independent in both fact and appearance of the entity being audited?

b. Is there a governance body independent in both fact and appearance of the management of the entity (e.g., audit committee, board of corporate statutory auditors or other body independent of the entity's management) that oversees the process of selection and appointment of the external auditor?

c. Are governance standards intended to promote and contribute to the monitoring and safeguarding of the independence of the external auditor?

d. Is prompt disclosure of information about the resignation, removal, or replacement of an external auditor required?

7. Is there an adequate mechanism in place for enforcing compliance with auditor independence standards, for example: to stipulate remedial measures for problems detected and to initiate and carry out disciplinary proceedings to impose sanction on auditors and audit firms as appropriate; to refuse to accept, or require revision of, audit reports; or for lack of independence?

Explanatory Notes

472. When considering how the regulatory framework is designed to address auditor independence and adequate oversight of an auditor's independence, the following more specific points are relevant:

- Standards of independence should identify appropriate measures that the auditor

should implement in order to address any threats to independence that arise within permissible activities and relationships.

- Standards of independence should be supported by rigorous requirements for audit firms to establish and maintain internal systems and processes for monitoring, identifying, and addressing threats to independence and ensuring compliance with relevant standards, regulations, prohibitions and restrictions.

- Standards of independence should require the auditor to identify and evaluate all significant, or potentially significant, threats to independence, including those arising from recent relationships with the entity being audited that may have preceded the appointment as auditor, and demonstrate how the auditor has addressed such significant threats.

Benchmarks

Fully Implemented

473. Requires affirmative responses to all applicable Questions.

Broadly Implemented

474. Requires affirmative responses to all applicable Questions except to Question 5.

Partly Implemented

475. Requires affirmative responses to all applicable Questions except to Questions 4 and 5.

Not Implemented

476. Inability to respond affirmatively to one or more of Questions 1, 2, 3(a), 3(b), 3(c), 3(d), 3(e), 6(a), 6(b), 6(c), 6(d) or 7.

CPICM 23: Audit standards should be of a high and internationally acceptable quality. (IOSCO 21)

477. High quality auditing standards help safeguard the integrity of an issuer's financial statements. Auditing standards are necessary safeguards of the reliability of financial information, such standards should be comprehensive, well-defined and of a high and internationally acceptable quality. They are a necessary counterpart to high quality and internationally accepted accounting standards and their application in audits contributes to providing investors with accurate and relevant information on financial performance.

478. Regulation regarding audit standards should require:

- An independent verification of financial statements and compliance with accounting principles through professional external auditing.
- An appropriate mechanism for the setting of quality standards and to ensure that where there is some dispute or uncertainty, standards can be the subject of authoritative and timely interpretation that is consistently applied.
- Any audit is conducted pursuant to standards of a high and internationally acceptable quality.

Key Issues

1. Regulation should require that financial statements prepared by public issuers be audited in accordance with a comprehensive set of auditing standards.

2. Such auditing standards should be of high and internationally acceptable quality in order to contribute to the quality of financial reporting and reliability of financial information, and thereby support investor confidence and decision-making.

3. There should be an appropriate mechanism for the setting and interpretation of the auditing standards.

4. There should be a regulatory framework for enforcing compliance with auditing standards.

Key Questions

1. Does the regulatory framework require that financial statements included in public offering and listing particulars documents, and publicly available annual reports, be audited in accordance with a comprehensive set of auditing standards?

2. Are the prevailing auditing standards of a high and internationally acceptable quality?

3.

a. Does the regulatory framework provide for an organisation responsible for the establishment and timely updating of auditing standards?

b. If yes, are the organisation's processes open, transparent and subject to public oversight, and, if the organisation is independent, is the standard setting and interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

4. Is there an adequate mechanism in place for enforcing compliance with auditing standards?

Explanatory Notes

479. This CPICM should be considered and assessed in conjunction with CPICM 17, which requires full, timely, and accurate disclosure of financial information material to investment decisions, and CPICM 19, which requires the use of accounting standards of a high and internationally acceptable quality. The assessor should establish under CPICM 17 and 19 whether the financial statements required in public offering and listing particulars documents, and periodic reports are sufficient to meet the full, accurate and timely disclosure requirement, and then assess, under CPICM 23, the auditing standards used in their verification.

480. The auditing standards referred to above need not be standards that are established or interpreted by an organisation within the jurisdiction. Some jurisdictions may wish to adopt and rely upon standards established and/or interpreted by international or other standards-setting organisations.

Benchmarks

Fully Implemented

481. Requires affirmative responses to all applicable Questions.

Broadly Implemented

482. Requires affirmative responses to all applicable Questions except to Question 3(b).

Partly Implemented

483. Requires affirmative responses to all applicable Questions except to Questions 3(a) and 3(b).

Not Implemented

484. Inability to respond affirmatively to one or more of Questions 1, 2 or 4.

CPICM 24: Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision. (IOSCO 22)

485. Credit rating agencies (CRAs) can play an important role in modern capital markets. CRAs typically opine on the credit risk of issuers of securities and their financial obligations. Given the vast amount of information available to investors today – some of it valuable, some of it not – CRAs can play a useful role in helping investors and others sift through this information, and analyse the credit risks they face.

486. Because CRAs can play an important role in securities markets, their activities are of interest to investors, issuers, market intermediaries and financial regulators. Securities regulators, in particular, frequently have a dual interest in the activities of CRAs, both because CRAs may have an effect on market transparency and because some jurisdictions allow CRA ratings to be used for regulatory purposes.

487. The regulatory system should ensure appropriate oversight of CRAs with respect to the quality and integrity of the rating process and the additional risk characteristics that are considered in the rating process, particularly in ensuring that credit ratings assigned through different methodologies are consistent and comparable across conventional and Islamic securities. The fact that these methodologies must be consistent and comparable does not in any way allow them to neglect essential differences and characteristics distinguishing Islamic securities. Therefore, a CRA when rating an Islamic security should do so based on its nature, since it is different from conventional securities in terms of its underlying structure. In particular, if it represents debts only, as in the case of *murābaḥah ṣukūk*, it cannot be traded unless at par; whereas if it represents shares of undivided ownership in assets, it can be traded based on an agreed-upon price between the two parties. These basic financial, credit, risk or other characteristics must be taken into consideration when rating such securities because they are part and parcel of the securities' nature. Violation of such characteristics would result in Sharī'ah non-compliance risk, which must in turn impact on the rating. As a result, if CRAs' methodologies neglect the specificities of Islamic securities and their characteristics mentioned above, this will result in the issuance of defective ratings.

488. If a CRA applies the same methodology to both conventional and Islamic securities, regulators should ensure that Islamic and conventional products that are similarly rated are equivalent enough in terms of their features and risk characteristics to be rated using the same methodology and, in particular, that there are no material risks – for example,

arising from the structure of the product – that the methodology does not capture. On the other hand, where CRAs claim to undertake rating services that are specific for Islamic securities or use a separate methodology, regulators should likewise ensure that the methodologies used are clearly defined, consistent and comparable with ratings for conventional securities.

489. Because CRAs can play an important role in helping market participants incorporate into their decision making voluminous, diverse and highly complicated information about a particular investment, regulators, market participants and CRAs themselves have an interest in ensuring that CRAs carry out this role in an honest and fair manner. Where credit ratings are used for regulatory purposes – for example, permitting regulated entities to use ratings of a security as part of a net capital assessment, or requiring that fund managers only include securities rated above a certain level in some types of funds – the regulator's interest in the activities of these CRAs may be even greater.

490. Accordingly, CRAs should be subject to adequate levels of oversight, the nature of which depends on:

- the structure of the market;
- the structure of the CRA industry in a given jurisdiction;
- how credit ratings are used in a given jurisdiction; and
- the corresponding regulatory risks CRAs pose.

491. Where credit ratings are used for regulatory purposes in a jurisdiction, "adequate levels of oversight" of the CRA issuing those ratings will mean some form of registration and ongoing supervision albeit, as noted below, not necessarily by the regulator in whose jurisdiction the ratings are used.

Key Issues

1. CRAs issuing ratings for the Islamic capital market should also apply the IOSCO CRA Principles and the IOSCO Code, which articulates four objectives that

CRAs, regulators, issuers and other market participants should strive to achieve.[180] The four objectives are designed to encourage the adoption of procedures and mechanisms that promote:

a. the quality and integrity of the rating process;

b. CRA independence and avoidance of conflicts of interest;

c. the provision of timely information about, and the procedures, methodologies and assumptions behind, a rating; and

d. the protection of non-public information from premature disclosure or use by the CRA or its employees that is unrelated to a CRA's rating activities.

2. An oversight regime designed to achieve these objectives may take many different forms. In some cases, a jurisdiction may decide that these objectives may be best implemented through internal CRA mechanisms and promoted those seeking financing, those providing financing and other market participants. In other cases, a jurisdiction may decide that the objectives may be best achieved through regulatory requirements. As a result, mechanisms for implementing the objectives may take the form of any combination of:

a. government regulation;

b. regulation imposed by non-government statutory regulators;

c. industry codes; and

d. internal rating agency policies and procedures.

3. Where a CRA's ratings are used for regulatory purposes, however, the regulatory system should establish mechanisms that seek to achieve the above objectives through registration and oversight requirements that impose binding and enforceable obligations on CRAs.

4. Where CRAs provide specialised ratings for Islamic securities, due consideration should be given to the appropriate recognition criteria for such CRAs and assessment of the approach used, with respect to validity, integrity, quality,

[180] *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies*, Final Report, Report of the Technical Committee of IOSCO, February 2011, p. 6, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD346.pdf.

consistency and comparability of methodologies used, including whether they deal appropriately with any risks specific to those securities.

Key Questions

Registration

1.

a. Does the jurisdiction have a definition of “credit rating” and/or “credit rating agency” or otherwise define a scope of activities for the purpose of imposing registration and supervision requirements on entities that engage in the business of determining and issuing credit ratings that are used for regulatory purposes, including for those CRAs that claim to issue specialised credit ratings for Islamic securities?

b. Are CRAs located in the jurisdiction, and whose ratings are used for regulatory purposes in the jurisdiction, subject to registration (“regulated CRAs”)?

c. Do the jurisdiction’s registration requirements provide the regulator with the ability to obtain all information it deems necessary from a CRA seeking registration in order to determine whether the requirements for registration have been fulfilled?

d. If a CRA’s ratings are used for regulatory purposes, but the CRA itself is not located in the regulator’s market and the regulator does not require registration or oversight of the CRA in question, has the regulator made a reasonable judgment to ensure that the CRA is subject to registration and oversight as required by CPICM 24?

Ongoing Supervision

2.

a. Do the jurisdiction’s requirements provide the regulator with the ability to obtain all information about a regulated CRA that the regulator deems necessary to perform adequate oversight of the regulated CRA?

b. Are CRAs whose ratings are used for regulatory purposes in the jurisdiction, and who are located in the jurisdiction:

i. supervised on an ongoing basis;

ii. subject to examination by the regulator; and

iii. subject to enforcement of the jurisdiction's requirements?

Registering Authority

3. Does the regulator have the power to:

a. Refuse to register a CRA if the registration requirements have not been met, and to withdraw, suspend or condition a registration or authorisation in the event of a failure of a regulated CRA to meet relevant requirements?

b. Impose adequate measures and sanctions to address a failure of a regulated CRA to meet relevant requirements?

Oversight Requirements: Quality and Integrity

4. Does oversight of regulated CRAs incorporate requirements that address whether:

a. Regulated CRAs adopt and implement written procedures and methodologies designed to ensure that:

i. they issue initial credit ratings based on a fair and thorough analysis of all information known to the CRA that is relevant to its analysis according to the CRA's published rating methodology; and,

ii. except for credit ratings that clearly indicate they do not entail ongoing surveillance, the regulated CRA updates credit ratings as new information becomes available in accordance with the regulated CRA's published rating methodology for monitoring credit ratings?

iii. ratings for Islamic securities are comparable to the ratings issued for conventional securities and take appropriate account of any special features of Islamic securities?

b. Regulated CRAs maintain internal records to support their credit ratings?

c. Regulated CRAs have sufficient resources to carry out high-quality credit assessments?

Oversight Requirements: Conflicts of Interest

5. Does oversight of regulated CRAs incorporate requirements that address whether:

a. Regulated CRA credit rating decisions are independent and free from political or economic pressures and from conflicts of interest arising due to the regulated CRA's ownership structure, business or financial activities, securities trading, or the financial interests of the regulated CRA's employees (including securities trading by the employees and their compensation arrangements)?

b. Regulated CRAs (1) identify, and (2) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence:

i. the opinions and analyses regulated CRAs produce; or

ii. the judgment and analyses of the individuals the regulated CRAs employ, who have an influence on ratings decisions?

c. Regulated CRAs disclose actual and potential conflicts of interest arising from the nature of compensation arrangements for producing credit ratings?

Oversight Requirements: Transparency and Timeliness

6. Does oversight of regulated CRAs incorporate requirements that address whether:

a. Regulated CRAs distribute their credit ratings in a timely manner?

b. Regulated CRAs disclose credit ratings on a non-selective basis?

c. Regulated CRAs publish sufficient information about their procedures, methodologies and assumptions, so that outside parties can understand how a rating was arrived at by the regulated CRA, and the attributes and limitations of such a rating?

d. Regulated CRAs publish sufficient information about the historical default rates of their credit ratings, so that interested parties can understand the historical performance of their credit ratings?

Oversight Requirements: Confidential Information

7. Does oversight of regulated CRAs incorporate requirements that address whether CRAs protect non-public information:

a. provided by issuers so that such information is only used for the purposes related to their rating activities; and

b. with respect to pending rating actions?

Explanatory Notes

492. CRAs vary considerably in their size, scope of operations, and business models. Depending on these factors, not all regulatory issues may be present in every jurisdiction, and regulators should be afforded flexibility when assessing the regulatory issues CRAs raise in their own markets. Regulators also approach the regulatory issues raised by CRAs in different ways, with (for example) some approaching oversight of CRAs as a natural or de facto oligopoly that is regulated in a fashion similar to a "utility," while others may emphasise increasing competition in the CRA market. The approach chosen by regulators may have an effect on the emphasis they place on the different regulatory issues outlined above.

493. Legal systems vary in structure and specific provisions between jurisdictions. However, they embed implementation measures in varying degrees in order to achieve the objectives of the four IOSCO CRA Principles (quality and integrity of the ratings process, management of conflicts, transparency, and treatment of confidential information).

494. *In respect of Key Questions 4–7*, there may be different ways of ensuring that these Questions can be answered affirmatively.[181] For example, regulated CRAs may be subject to: regulatory provisions on the national level that set forth the objectives themselves; conditions to become registered, or maintain registration, that promote the objectives;

[181]The Key Questions are based on the principles set forth in the CRA Principles. The *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies*, supra, describes the implementation undertaken in regulatory programmes in various, different jurisdictions in order to give effect to the IOSCO CRA Principles.

requirements to establish policies and procedures designed to achieve the objectives; or disclosure requirements that promote the objectives.

495. *In respect of Key Question 1(d)*, given the structure of the global CRA industry at the time of adoption of this Methodology, there will be jurisdictions where credit ratings are used for regulatory purposes where the relevant CRA is located (in the sense of physical presence) in a different jurisdiction. In such cases, steps may have been taken to reduce the use of such credit ratings for regulatory purposes. Where the use of credit ratings for regulatory purposes has not been eliminated, the regulator should be able to demonstrate that it has made a reasonable judgment not to register or oversee the CRA, based on factors such as:

- the activities of the CRA in the jurisdiction;
- the regulatory arrangements in the home jurisdiction.

496. Alternatively, in place of a registration requirement, the regulator may impose some oversight or reporting requirements and make arrangements for supervisory cooperation with the regulator which registers the CRA.

497. In respect *of Key Question 4(c)*, regulated CRAs should have sufficient resources to determine credit ratings according to their published and documented ratings methodologies, including sufficient personnel to properly assess the entities they rate, seek out information they need in order to make an assessment, and analyse all the information relevant to their decision-making processes.

498. In respect *of Key Question 6(b)*, the non-selective disclosure of credit ratings means the disclosure of credit ratings which are consistent with the regulated CRA's business model. For example, a regulated CRA operating under the subscriber-pay model may disclose its credit ratings only to persons who pay to access the credit ratings.

Benchmarks

Fully Implemented

499. Requires affirmative responses to all applicable Questions.

Broadly Implemented

500. Requires affirmative responses to all applicable Questions except to Questions 4(a), 4(c), 5(c) and 6(a).

Partly Implemented

501. Requires affirmative responses to all applicable Questions except to Questions 1(c), 4(a)(i), 4(a)(ii), 4 (b), 4(c), 5(c), 6(a), 6(b), 6(c), 6(d), 7(a), and 7(b).

Not Implemented

502. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(d), 2(a), 2(b), 3(a), 3(b), 4(a)(iii), 5(a) or 5(b).

CPICM 25: Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them. (IOSCO 23)

503. In many markets, entities exist which provide analytical or evaluative services of various types to investors to assist them with assessing the desirability of a particular investment opportunity. Depending on the degree to which the regulatory system relies on them, or the impact their activities have on the market, such entities may need to be subject to regulation or oversight. An example of one such entity that provides analytical or evaluative services is "sell-side" securities analysts employed by the research departments of full-service investment firms (such as broker-dealers and investment banks) who offer research to both retail and institutional investors. Such sell-side securities analysts can face conflicts of interest that may compromise their ability to offer investors independent unbiased opinions. Other types of entities that provide analytical or evaluative services may also pose risks to the users of these services, or to the integrity of the market, and therefore may warrant oversight and regulation. Oversight and regulation of these entities may also be warranted if the regulatory system relies on the services they provide.

Key Issues

1. Entities that provide analytical or evaluative services to investors, such as sell-side securities analysts, provide investors with valuable insights by distilling the wide range of information that is available to the markets. "Sell-side" securities analysts, in particular, can face conflicts of interest that may compromise their ability to offer investors independent unbiased opinions. Biased research can harm investors and undermine the fairness, efficiency and transparency of the markets.

2. Among the principal regulatory concerns regarding sell-side securities analysts, is the opportunity for fraud and deception, but also the risks posed to investors by hidden conflicts of interest.[182]

[182] See generally *IOSCO Statement of Principles for Addressing Sell-Side Analyst Conflicts of Interest*', Report of the Technical Committee of IOSCO, September 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf

3. The key issues the regulator should consider when determining whether entities that provide analytical or evaluative services should be subject to oversight and regulation include:

a. the type of analytical or evaluative services that these entities provide;

b. the impact of their services on a given market with regard, in particular, to the potential risks that their activities pose to the users of these services or to the integrity of the market, specifically with respect to potential conflicts or the integrity of the service;

c. whether the services offered by these entities are relied on for regulatory purposes and, if so, to what degree; and

d. where the regulator determines that the services provided by a type of entity have enough impact on the market to warrant oversight, whether, and to what extent, regulation or oversight is necessary to help address identified risks.

Key Questions

1. Does the regulator periodically consider whether the different types of entities that provide analytical or evaluative services warrant regulation and oversight because of the impact of their activities on the market or because of the degree to which the regulatory system relies on them?

2. Where the regulator identifies the need for regulation and oversight, is the regulation and oversight put into place appropriate to the risks posed by these types of entities?

3. With respect to sell-side securities analysts:

a. Does regulation contain provisions directed at eliminating, avoiding, managing or disclosing conflicts of interest that can arise from:

i. Analysts' trading activities or financial interests?

ii. The trading activities or financial interests of the entities that employ them?

iii. The business relationships of the entities that employ them?

iv. The reporting lines for analysts and their compensation arrangements?

b. Does regulation contain provisions directed at an entity's compliance systems and senior management responsibility:

i. Requiring written internal procedures or controls to identify and eliminate, manage or disclose actual and potential analyst conflicts of interest?

ii. Requiring procedures to eliminate or manage the undue influence of issuers, institutional investors and other outside parties upon analysts?

iii. Requiring complete, timely, clear, concise, specific, and prominent disclosures of actual and potential conflicts of interest?

c. Does regulation contain provisions directed at integrity and ethical behaviour, such as requiring analysts, and/or the firms that employ analysts, to act honestly and fairly with clients?[183]

Explanatory Notes

504. The entities that could be covered by this CPICM could be quite broad. Jurisdictions will vary considerably in their assessments of the risks posed by different types of entities that provide analytical or evaluative services, and even in their determination of what type of entity would fall within this CPICM. Furthermore, depending on the jurisdiction's laws, some entities that provide analytical or evaluative services may be regulated by bodies other than the securities regulator. Likewise, some jurisdictions may restrict the authority of the government to regulate certain types of entities that provide analytical or evaluative services if the services they provide are viewed as particularly critical (possibly with laws

[183] Assessors should recognise that issues relating to ethics and integrity can be addressed by a variety of mechanisms, including "fit and proper" requirements, statutory disqualification, industry and SRO codes of conduct, etc.

against fraud rather than regulation used to shield against egregious conflicts of interest or deception).[184] These differences in approach to regulating such entities should be deemed acceptable.

505. *With regard to Key Questions 1 and 2*, to date, the only entities offering investors analytical or evaluative services that IOSCO has identified, and for which it has developed principles or standards, are sell-side securities analysts.

506. There is overlap between CPICM 25 and both CPICM 7 (Perimeter of Regulation) and CPICM 8 (Conflicts of Interest). CPICM 25 can be viewed as a subset of both CPICM 7 and CPICM 8, insofar as conflicts of interest and other potentially problematic practices by information service providers can pose particular risks to investor protection and market integrity. Consequently, it is possible that a regulator addresses CPICM 25 through its general review of the perimeter of regulation and conflicts of interest in the market.

507. There is also overlap between CPICM 25 and CPICM 7 insofar as the regulator does not have the legal authority to regulate an information service provider that it identifies as presenting a significant risk to the market's integrity. In such cases, CPICM 7 is more applicable insofar as the regulator identifies the risk, and legislative authority to address it is sought.

Benchmarks

Fully Implemented

508. Requires affirmative responses to all applicable Questions.

Broadly Implemented

509. Requires affirmative responses to all applicable Questions except Question 3(c).

[184] For example, laws protecting freedom of the press or freedom of speech may limit the degree to which some entities are regulated in some jurisdictions.

Partly Implemented

510. Requires affirmative responses to all applicable Questions except Questions 3(b)(iii) and 3(c).

Not Implemented

511. Inability to respond affirmatively to one or more of Questions 1, 2 (where relevant because of the outcomes of the review in Question 1) and 3(a), 3(b)(i) and 3(b)(ii).

BIBLIOGRAPHY FOR PRINCIPLES RELATING TO AUDITORS, CREDIT RATING AGENCIES AND OTHER INFORMATION SERVICE PROVIDERS

	Document	**CPICM**	**Other CPICM**
1	*Code of Conduct Fundamentals for Credit Rating Agencies*, Report of IOSCO, December 2004 (Revised May 2008 and March 2015),	24	
2	*Principles for Oil Price Reporting Agencies*, Report of the Technical Committee of IOSCO, October 2012, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf		
3	*Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies*, Final Report, Report of the Technical Committee of IOSCO, February 2011, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD346.pdf	24	

	Document	CPICM	Other CPICM
4	*IOSCO Statement on International Auditing Standards*, November 2007, http://www.iosco.org/news/pdf/IOSCONEWS109.pdf	21	
5	*Board Independence of Listed Companies,* Final Report of the Technical Committee of IOSCO in consultation with the OECD, March 2007, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf	21	
6	*Survey on the Regulation of Non-Audit Services Provided by Auditors to Audited Companies,* Summary Report of the Technical Committee and Emerging Markets Committee of IOSCO, January 2007, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD231.pdf	21	

	Document	CPICM	Other CPICM
7	*Issuer Internal Control Requirements — A Survey*, Report of the Technical Committee and the Emerging Markets Committee of IOSCO, December 2006, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD229.pdf	21	17
8	*Survey Report on Regulation and Oversight of Auditors,* Report of the Technical Committee and Emerging Markets Committee of IOSCO, April 2005, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD199.pdf	21	
9	*IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies*, Statement of the Technical Committee of IOSCO, September 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf **"CRA Principles"**	24	

	Document	CPICM	Other CPICM
10	*IOSCO Statement of Principles for Addressing Sell-Side Analyst Conflicts of Interest*, Report of the Technical Committee of IOSCO, September 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf	25	32
11	*Principles for Auditor Oversight*, Statement of the Technical Committee of IOSCO, October 2002, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf	21	19
12	*Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, Statement of the Technical Committee of IOSCO, October 2002, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf	21 22	

2.8 Principles Relating for Islamic Collective Investment Schemes

2.8.1 Preamble

512. The legal form taken by Islamic collective investment schemes varies between jurisdictions, but in all jurisdictions they play an important role, channelling resources to the securities markets and offering investors a means to achieve diversified exposure to investment opportunities. To the extent that investors place their money in ICIS, appropriate regulation is increasingly important.

513. Proper regulation of ICIS is critical to the objectives of investor protection and the preservation of confidence in the market.

514. ICIS, like other investment vehicles, are subject to disclosure requirements.[185] However, investors in ICIS rely upon operators of the ICIS to manage the ICIS and its investment portfolio and to act in their best interests. ICIS are widely marketed to retail investors, who may place enhanced reliance on ICIS operators and, therefore, may be vulnerable to misconduct by ICIS operators. Regulation should promote and ensure a high level of compliance by entities involved in ICIS operations.

515. Regulation of ICIS should cover:

- the eligibility, governance, organisation and operational conduct of the ICIS operator;
- adherence by the ICIS to Sharī'ah rules and principles;
- adherence to the terms of the prospectus and other constituent documents;
- the proper safekeeping of investors' funds and the assets of the ICIS;

but not the wisdom of investment decisions (where these are within the terms of the constituent documents).

516. Supervision should seek to ensure that the assets of an ICIS are managed in the best interests of its investors, and in accordance with the ICIS objectives and the regulation to which it is subject. This will include:

[185] CPICM 17–19 and CPICM 28.

- ensuring promotion of high standards of competence, integrity and fair dealing;
- that the assets are held in safekeeping on behalf of investors; and
- having mechanisms in place to confirm that the investments of the ICIS are valued properly.

517. Supervision of an ICIS operator in this regard includes oversight of arrangements to ensure that investors are exposed to a level of risk that is consistent with the ICIS' objectives, as well as to ensure that any regulatory minimum level of diversification is maintained.[186]

2.8.2 Scope

518. CPICM 26 requires regulation to set standards for those involved in the operation of an ICIS and marketing ICIS interests; CPICM 26 is mainly devoted to client asset protection; CPICM 27 addresses ICIS-focused disclosure requirements; and CPICM 28 deals with the issues of asset valuation and pricing and redemption of ICIS units/shares.

519. CPICM 26-29 are interrelated and complement each other and should be appropriately implemented to seek to ensure proper investor protection. In addition, assessment under CPICM 28, dealing with disclosure requirements, should be consistent with, and/or compared to, the assessment of disclosure obligations as set forth under the CPICM for Issuers.[187]

520. The term "ICIS operator" is intended as the legal entity that has overall responsibility for management and performance of the functions of the ICIS, which may include managing the ICIS portfolio of assets and operational services.[188]

521. The term "ICIS" includes open-ended funds that will redeem their units or shares (whether on a continuous or periodic basis). It also includes closed-ended funds whose shares or units are traded on regulated or organised markets. The term "ICIS" also includes Sharī'ah-compliant exchange-traded funds (ETFs), which generally are open-ended funds

[186] *Principles for the Supervision of Operators of Collective Investment Schemes*, Report of the Technical Committee of IOSCO, September 1997, p. 4, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf.
[187] CPICM 15–17.
[188] See *Report on Investment Management*, Report of the Technical Committee of IOSCO, July 1995, 'Glossary of Terms', p. 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD45.pdf.

that trade throughout the day on an exchange.[189] The rules governing the legal form and structure of ICIS vary across jurisdictions and may embrace ICIS based on one of the Sharīʿah-compliant types of financing or investment contracts.

522. In some jurisdictions, closed-ended funds are not subject to special licensing or supervisory requirements and are, instead, regulated according to the terms of relevant exchange listing rules. If this is the case in the assessed jurisdiction, the situation should be duly accounted for, and a detailed explanation and assessment of the applicable listing rules should be undertaken taking into account the investor protection objectives of the Key Issues in this Section.

523. In many jurisdictions, the requirements relating to ICIS vary according to whether the ICIS is offered to the public. In fact, most jurisdictions tend to reduce regulatory oversight in relation to private placements. The definition of what amounts to an offer to the public varies. The assessor should not attempt to substitute his or her judgment for what constitutes a public offering but should indicate: which offerings are included and subject to the full panoply of requirements; and how regulatory oversight is different for private placements or non-retail offerings. The assessor should explain the differences in treatment and assess the consequences from an investor protection viewpoint – investor protection being the main objective of the ICIS CPICM.

524. Where appropriate, the assessor should make reference to the assessment of CPICM 7.

525. An increasing number of ICIS are marketed across jurisdictional boundaries. It is also common for ICIS promoters, managers and custodians to be located in several different jurisdictions and not the same jurisdiction as investors to whom the ICIS is promoted. Therefore, particular attention should be paid to the possible need for international cooperation and the interrelation with CPICM 14 to 16 relating to cooperation.

526. The assessor should determine the type and complexity of ICIS in the jurisdiction, the number of ICIS in existence, the assets under management, the types of permitted investments and level of gearing or leverage to gauge the regulatory challenge. It is possible that a specific jurisdiction will not have its own framework for the establishment of ICIS. If a jurisdiction does not have its own ICIS regulatory framework, it may not wish to admit offerings that do not meet the basic requirements as to legal format in these CPICM. To the

[189] Sharīʿah-compliant ETFs are thus included in the scope of this methodology and should be subject to appropriate ICIS operator qualifications, legal form and structure, and custody, disclosure and valuation/redemption requirements.

extent ICIS established under other jurisdictions' laws may be offered, the assessor should consider whether:

- the entity engaged in marketing should be authorised, recognised or otherwise eligible (CPICM 24);

- there are requirements concerning the public offer of ICIS products (CPICM 26, 27 and 28);

- there is adequate information sharing between the jurisdictions of establishment and the jurisdiction being assessed.

527. The greater the level of ICIS activity in a particular jurisdiction, the more likely it is that each of the CPICM 26 to 29 should be rated as *Not Implemented* rather than *Not Applicable* if no requirements are applied to cross-border business.

528. Securities law and regulation cannot exist in isolation from the other laws of a jurisdiction. To determine whether CPICM 26 to 29 are implemented in a manner that achieves their objectives, it is therefore necessary to consider the jurisdiction's legal framework in that regard and, in particular, laws and regulations on insolvency (having an impact on the treatment of ICIS in default) as well as laws and regulations on dispute resolution mechanisms or other remedies (and having an impact on investors' ability to seek redress or compensation) in view of the nature of an ICIS.

2.8.3 CPICM 26 through 29

CPICM 26: The regulatory system should set standards for the eligibility, governance, organisation and operational conduct of those who wish to market or operate an Islamic collective investment scheme. (IOSCO 24)

529. Investor protection is the key objective. ICIS operators and ICIS should meet clearly defined standards as set by the regulatory system, for both initial approval and continuing operation.[190]

530. The eligibility standards and operating conditions to act as ICIS operators should seek to ensure that those who operate or market ICIS are qualified to do so. This includes standards as set out by the regulatory system on honesty and integrity of the ICIS operator and being experienced and competent to operate, or advise, on the suitability of an ICIS. These standards should also cover ICIS governance and internal organisation of ICIS operators, including having accounting procedures, an adequate risk management framework, including effective liquidity risk management processes, and resources and processes in place to ensure ongoing compliance.[191] There should be effective mechanisms to assess compliance with these standards and with the policies and procedures the ICIS operator has in place.[192]

531. ICIS governance should provide for a framework that seeks to ensure that an ICIS is organised and operated in the interests of ICIS investors and in a Sharīʿah-compliant manner, and not in the interests of the connected persons (who may also include the Sharīʿah adviser(s) of the ICIS). In order to ensure that ICIS operators do not breach their duties, it is fundamental that their organisation and activity is subject to at least annual review by an independent auditor and/or ongoing review and oversight by an independent third

[190] See *Report on Investment Management*, supra, p. 7.

[191] Id. See *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods*, Report of the Technical Committee of IOSCO, November 2002, pp. 3 and 5, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD136.pdf. For factors relevant to the honesty and integrity of the manager, see *Investment Management Risk Assessment: Management Culture and Effectiveness*, Report of the Technical Committee of IOSCO, November 2002, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD137.pdf; and see *Investment Management Risk Assessment: Marketing and Selling Practices*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf. See also *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD158.pdf; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD169.pdf; *Anti-Money Laundering Guidance for Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at https://www.iosco.org/ library/pubdocs/pdf/IOSCOPD205.pdf.

[192] Although an ICIS operator should comply with the eligibility criteria from the commencement of its activities, different approaches may be adopted by the regulator regarding when to assess compliance with those standards, provided that the mechanisms in place are effective in terms of investor protection. See also the Explanatory Notes.

party, in addition to meeting the corresponding Sharī'ah governance requirements set out in CPICM 10.

532. The appropriate identification, monitoring and management of risks and compliance with internal control policies and procedures by ICIS operators should be ensured, and should be appropriate and proportionate to the size, complexity and risk profile of the ICIS.

533. To assist in supervision and to promote compliance, there should also be clear responsibilities for maintaining records of the operations of the ICIS.

534. The operation of an ICIS raises the potential for conflict between the interests of investors in the ICIS and those of ICIS operators or associated parties (including Sharī'ah advisers). The regulatory system should seek to ensure that ICIS operators identify the potential conflicts of interest and properly manage any conflicts that do arise by taking corrective actions (including, where appropriate, through disclosure).

535. In all cases, ICIS operators should act in the best interests of ICIS investors and in accordance with the principle of fair treatment of investors. Generally, this will require regulation covering – in addition to the issues mentioned above (ICIS governance, Sharī'ah governance, internal organisation, accounting procedures, record-keeping and risk management) – topics such as due diligence in the selection of ICIS investments and conduct of business, including best execution, appropriate trading and timely allocation of transactions, commissions and fees, related party transactions and underwriting arrangements. [193]

536. Many ICIS operators delegate certain ICIS operational responsibilities to third parties. The use of delegates should not, in any way, be permitted to diminish the effectiveness of the primary regulation and supervision of an ICIS. A delegate should comply

[193] See *Conflicts of Interests of CIS Operators*, Report of the Technical Committee of IOSCO, May 2000, p. 11, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD108.pdf; *Best Practice Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the Technical Committee of IOSCO, October 2005, p. 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf; *Good Practices in Relation to Investment Managers' Due Diligence When Investing in Structured Finance Instruments*, Final Report, Report of the Technical Committee of IOSCO, July 2009, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD300.pdf. For a discussion on fees and commissions, see *Fees and Commissions within the CIS and Asset Management Sector: Summary of Answers to Questionnaire*, Report of the Technical Committee of IOSCO, October 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD157.pdf; *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004, available at t https://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf. In relation to soft commissions, see *Soft Commission Arrangements for Collective Investment Schemes*, Final Report, Report of the Technical Committee of IOSCO, November 2007, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD255.pdf.

with all regulatory requirements applicable to the conduct of the principal's business activities. An ICIS operator should remain responsible for the delegate's compliance.[194]

537. The regulatory system should require supervision throughout the life of a particular ICIS. Supervision of an ICIS operator should promote high standards of competence, integrity and investor protection.[195] There should be clear powers with respect to:

- registration/authorisation of an ICIS;[196]
- inspections to be carried out in order to ensure compliance by ICIS operators;
- investigations of suspected breaches;
- remedial action to be taken in the event of breach or default; and
- cooperation with foreign regulators for the purposes of registration/authorisation of an ICIS, supervision and enforcement.

538. These powers should be sufficient to allow action in respect of all supervised entities with responsibilities under the ICIS.

Key Issues

Eligibility Criteria

1. The regulatory system should require ICIS operators and ICIS to comply with clear criteria for both initial approval and continuing operation.[197] The eligibility[198] criteria to act as an ICIS operator, as set out by the regulatory system, should comprise requirements on the internal organisation of the ICIS operator, including risk management mechanisms encompassing, inter alia, liquidity risk management,

[194] See, for example, *Delegation of Functions*, Report of the Technical Committee of IOSCO, December 2000, p. 5, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD113.pdf.
[195] See *Principles for the Supervision of Operators of Collective Investment Schemes*, supra, p. 6.
[196] The registration or authorisation of CIS may take the form of document filing, CIS registration, or approval of the parties to the CIS (such as the operator and custodian) as appropriate to the overall regulatory system. See *Report on Investment Management*, supra.
[197] See *Report on Investment Management*, supra, p. 8: operators and schemes must meet clearly defined standards as set out by the regulatory authority for both initial approval and continuing operation.
[198] The term "eligibility" is intended to include authorisation, licensing, registration or other preconditions to operating or marketing a CIS: see *Report on Investment Management*, supra, p. 7. The CIS operator should comply with the eligibility criteria from the commencement of its activities (irrespective of whether the marketing of the CIS is made in an active or a passive way, or through private placement), but different approaches may be adopted regarding when compliance with those criteria is assessed by a regulator.

internal controls and accounting procedures, ICIS governance and Sharī'ah governance. There should be effective mechanisms to assess compliance of the ICIS operator with the eligibility criteria and with the policies and procedures it has in place. The eligibility criteria should also include additional requirements for ICIS operators with respect to possession of an adequate level of knowledge in Islamic finance to ensure that the fund's operations adhere to Sharī'ah principles.

2. The regulator should have clear responsibility and powers with respect to authorisation/registration of ICIS.[199] The authorisation/registration of ICIS should have regard to the possible need for international cooperation.

Supervision and Ongoing Monitoring

3. Records of the business and internal organisation of the ICIS operator should be maintained. The records should be made available to the regulator upon request.

4. The regulator should apply proper supervision throughout the life of a particular ICIS. Supervision should promote high standards of competence, integrity and investor protection.

5. The regulator should require ICIS operators to have in place appropriate and effective systems and mechanisms for monitoring ex-ante and ex-post Sharī'ah compliance.[200]

6. There should be clear powers to allow action in respect of all supervised entities with responsibilities under the ICIS and to share information with foreign securities regulators for both supervision and enforcement.

Conflicts of Interest and Operational Conduct

7. The regulatory system should set standards of conduct to be complied with on an ongoing basis by ICIS operators, including due diligence in the selection of ICIS investments.[201] ICIS operators should act in the best interests of ICIS investors and in accordance with the principle of fair treatment of investors.[202]

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[199] Includes the operator and/or the pool. See *Report on Investment Management*, supra, p. 11.

[200] See Principle 3 of IFSB-6: *Guiding Principles on Governance for Islamic Collective Investment Schemes*. Available at http://www.ifsb.org/standard/ifsb6.pdf.

[201] An operator should act with due skill, care and diligence, and has a duty to make decisions as to the investment portfolio structure and administrative procedures of the ICIS so as to secure its objectives: see *Report on Investment Management*, supra, pp. 7–8.

[202] See *Soft Commission Arrangements for Collective Investment Schemes*, supra, pp. 7 and 23; *Report on Investment Management*, supra, pp. 7–8.

8. The regulatory system should seek to ensure that the risk of conflicts of interest arising is minimised and that any conflicts that do arise are properly identified and managed by taking appropriate actions, including where appropriate through disclosure.

Delegation

9. The use of delegates should not, in any way, be permitted to diminish the effectiveness of the primary regulation and supervision of an ICIS. The ICIS operator remains responsible for the functions it delegates. The ICIS operator should not be allowed to delegate its functions to the extent that it becomes an empty box.

10. A delegate should be accountable either directly or through the delegator for compliance with all regulatory requirements applicable to the conduct of the principal's business activities.

Key Questions

Eligibility Criteria

1. Does the regulatory system set standards for the eligibility of those who wish to:

   a. Market an ICIS?[203]

   b. Operate an ICIS?[204]

2. Do the eligibility criteria for an ICIS operator[205] include the following:[206]

   a. Honesty and integrity of the operator?

[203] With respect to market intermediaries that may be involved in marketing or operating an ICIS, such as brokers, dealers and investment advisers, see also CPICM 30 to 33 on Market Intermediaries regarding approaches to regulation of such intermediaries. For a discussion pertaining to the marketing of a CIS, see *Investment Management Risk Assessment: Marketing and Selling Practices*, supra; *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, supra.

[204] For a discussion pertaining to the operation of a CIS, see *Best Practices Standards on Anti Market Timing and Associated Issues for CIS*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD207.pdf.

[205] Includes the operator and/or the pool. Key Question 2 refers to the eligibility criteria that need to be complied with by an ICIS operator from the commencement of its activities, whereas Key Question 3 refers to the assessment of the compliance with those criteria by the regulator.

[206] Different regulatory approaches may be adopted on when to assess compliance with the eligibility criteria.

b. Having appropriate and sufficient human and technical resources to ensure that it is capable of carrying out the necessary functions of an ICIS operator?

c. Financial capacity of the ICIS or the ICIS operator that would allow the launching and operation of the ICIS in appropriate conditions?

d. Ability to perform specific powers and duties?[207]

e. Having, or employing, appropriate identification, monitoring and management of risks, based on, among other things, the size, the complexity and the risk profile of the ICIS?

f. Having internal controls and compliance arrangements sufficient to ensure it can carry out its business diligently, effectively, honestly and fairly, and to ensure ongoing compliance with Sharī'ah requirements?[208]

3. Does the regulatory system provide for effective mechanisms to assess compliance with the criteria referred to in Questions 2(a) to 2(f)?[209]

4. Does the regulatory system set standards for the ICIS governance[210] seeking to ensure that ICIS are organised and operated in the interests of ICIS investors, and not in the interests of ICIS connected persons?

5. Does the regulatory system set standards for the Sharī'ah governance arrangements of ICIS to ensure that ICIS have appropriate mechanisms in place to uphold the claim of Sharī'ah compliance?

6. Does the authorisation/registration of ICIS take into account the possible need for international cooperation in the case of ICIS marketed across jurisdictions or where promoters, managers, or custodians are located in several different jurisdictions?

[207] An ICIS operator has a duty to make decisions as to the investment portfolio structure and administrative procedures of the ICIS so as to secure its objectives. The ICIS operator must not exceed the powers conferred on it by the ICIS' constituting documents or particulars: see *Report on Investment Management*, supra.
[208] See *Principles for the Supervision of Operators of Collective Investment Schemes*, supra, p. 15.
[209] There may be different approaches regarding when a regulator assesses compliance with the eligibility criteria: see the explanatory notes.
[210] See the IOSCO Technical Committee Reports *Examination of Governance for Collective Investment Schemes, Part I and Part II*, of June 2006 and February 2007, respectively, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD219.pdf (June 2006) and https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD236.pdf (February 2007).

Supervision and Ongoing Monitoring

7. Is the regulator responsible for monitoring ongoing compliance with the standards applicable to ICIS and ICIS operators? In particular, does the regulator have clear responsibilities and powers with respect to:

a. Registration or authorisation of an ICIS?[211]

b. Inspections to ensure compliance by ICIS operators?

c. Investigation of suspected breaches?

d. Remedial action in the event of breach or default?

8. Does the ongoing monitoring involve a review of reports submitted to the regulator with regard to ICIS and entities involved in the operation of an ICIS (ICIS operators, custodians, etc.) on a routine basis or on a risk-assessment basis?[212]

9. Does the ongoing monitoring involve, where appropriate, performance of on-site inspections of entities involved in operating ICIS (ICIS operators, custodians, etc.)?[213]

10. Do the regulatory authorities proactively perform investigative activities[214] in order to identify suspected breaches with respect to entities involved in the operation of an ICIS?

11. Is the operator of an ICIS subject to a general and continuing obligation to report to the regulatory authority or investors, either prior to or after the event, any information relating to material changes in its management or organisation, or in the by-laws of the ICIS, or the ICIS operator?

12. Does the regulatory system assign clear responsibilities for maintaining records on the organisation and business of the ICIS operator? Does the regulatory system provide for the keeping of books and records in relation to transactions involving ICIS assets, and all transactions in ICIS shares or units?

[211] See *Report on Investment Management*, supra, p. 11.
[212] For example, financial results.
[213] The regulatory authority may adopt a risk-based approach in the performance of inspections to ensure compliance by ICIS operators.
[214] This means activities not prompted by complaint, such as risk-based or periodic inspections, audits or surveillance.

Conflicts of Interest and Operational Conduct

13. Are there provisions:

    a. To prohibit, restrict or manage (including, if appropriate, by disclosure) certain conduct likely to give rise to conflicts of interest between an ICIS and its operators or their associates or connected parties?

    b. To require a ICIS operator to seek to minimise potential conflicts of interest and ensure that any conflicts that do arise are identified and properly managed by taking appropriate actions (including, where appropriate, through disclosure) so that the interests of investors are not adversely affected?[215]

14.

    a. Does the regulatory system require the ICIS operator to comply with operational conduct standards?

    b. In particular, is the ICIS operator required to act in the best interest of investors and in accordance with the principle of fair treatment?[216]

15. Does the regulatory system address the regulatory issues associated with:

    a. Best execution?

    b. Appropriate trading and timely allocation of transactions?

    c. Churning?

    d. Related party transactions?

    e. Underwriting arrangements?

    f. Due diligence in the selection of investments?

[215] See *Examination of Governance for Collective Investment Schemes, Part I*, supra, pp. 4, 19, 27 and 30; *Conflicts of Interest of CIS Operators*, supra, pp. 3, 6, 11, 13, 14 and 17.

[216] An ICIS operator should act with due skill, care and diligence. See *Principles for the Supervision of Operators of Collective Investment Schemes*, supra, pp. 1, 4, 8, 9 and 15; *Report on Investment Management*, supra, p. 12.

g. Fees and expenses, in order to ensure that no unauthorised charges or expenses are levied against an ICIS, or ICIS investors, and that: commission rebates; soft commission arrangements; and inducements, do not conflict with the ICIS operator's duty to act in the best interest of investors?[217]

h. Requirements for ICIS operators or ICIS to establish and implement sound liquidity risk management processes taking into account normal and stress market conditions?

Delegation

16. Does the regulatory system provide for a clear indication of circumstances under which delegation is allowed and is there prohibition of systematic and complete delegation of core functions of the ICIS operator to the extent that there is a transformation, gradual or otherwise, into an empty box?[218]

17. If delegation is permitted, is the delegation done in such a way so as not to deprive the investor of the means of identifying the company legally responsible for the delegated functions? In particular:

a. Is the ICIS operator responsible for the actions or omissions, as though they were its own, of any party, to whom it delegates a function, including compliance with the rules of conduct and other operating conditions?[219]

b. Does the regulatory system require the ICIS operator to retain adequate capacity and resources and have in place suitable processes to monitor the activity of the delegate and evaluate the performance of the delegate?[220]

c. Can the ICIS operator terminate the delegation and make alternative arrangements for the performance of the delegated function where appropriate?

[217] *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, supra, pp. 2, 10, 11 and 12; *Principles for the Supervision of Operators of Collective Investment Schemes*, supra, pp. 1, 7, 8, 14 and 15.
[218] See also *Delegation of Functions*, supra.
[219] See *Report on Investment Management*, supra, p. 9.
[220] The degree of monitoring would depend on the extent of the delegation, to whom the delegation was made (e.g. to authorised intermediaries or to others) and the type of jurisdiction in which the delegate is located.

d. Are there requirements for disclosure to investors in relation to the delegation arrangements and the identity of the delegates?

e. Does the regulatory system allow the regulator to take appropriate actions in case of delegations which may give rise to a conflict of interest between the delegate and the investors?

18. If delegation is permitted, is the delegation done in such a way so as not to jeopardise the ability of the regulator to effectively access data related to the delegated functions, either directly through the delegate(s) or through the ICIS operator?

Explanatory Notes

539. Consideration should be given to the ability of the regulator to perform ongoing supervision and to take action in respect of all supervised entities with responsibilities under the scheme for enforcement purposes and, more broadly, to ensure that the objectives of regulation are attained. To this end, where appropriate, the assessor should make reference to the assessment of CPICM 11, 12 and 13.

540. Attention should also be paid to the international features of the ICIS business of the assessed jurisdiction. According to the CPICM, these elements should not hinder proper supervision. Assessors should take into account whether the regulatory system recognises the need for possible international cooperation for an ICIS' registration and supervision, in particular in the case of ICIS marketed across jurisdictions or where promoters, managers, or custodians are located in several different jurisdictions. Where appropriate, cross reference should be made to the assessment of CPICM 14, 15, and 16 on international cooperation.[221]

541. *With respect to Key Question 2(e)*, assessors can consider, for example, the extent to which an ICIS operator should have a risk management framework supported by appropriate and documented policies and procedures and by an independent risk management function, proportionate to the size, complexity, and risk profile of the ICIS.

542. *With respect to Key Question 2 and 3*, assessors should take into account that the eligibility criteria need to be complied with (by an ICIS operator) from the commencement of its activities, but there may be different regulatory approaches regarding when to assess

[221] See also the Preamble to this Section on ICIS.

eligibility for registration/authorisation, including, for example, the honesty and integrity of ICIS operators. Fit and proper testing is not the only means by which regulators can approach honesty and integrity of ICIS operators. (For example, statutory disqualifications may offer an acceptable alternative approach.) It is not necessary that a regulator assess compliance with the eligibility criteria at the time of the initial approval in order to comply with Key Question 3. However, the mechanisms in place need to be effective in terms of investor protection so as to ensure that the ICIS operator is qualified to market or operate an ICIS. In this respect, assessors should consider the entire regulatory system; both the extent to which compliance with eligibility criteria is assessed, by the competent authority, prior to commencement of marketing of an ICIS; as well as the existence of a rigorous inspection programme designed to effectively monitor compliance with eligibility criteria on an ongoing basis.

543. *With respect to Key Question 4*, assessors can consider, for example, if the internal organisation and activities of an ICIS operator are required to be subject to independent review and oversight from an objective and informed perspective.

544. *With respect to Key Question 7(d)*, assessors should consider whether the regulator has adequate powers to protect investors' interests, including taking actions to withdraw authorisation/registration, freeze ICIS assets or the ICIS operator's assets, instigate administrative or civil proceedings, and recommend criminal action where appropriate.[222] Remedial actions in the event of breach or default should include effective, proportionate and dissuasive sanctions for unlicensed operation of an ICIS and/or for violation of ICIS operator obligations.

545. Assessors should also take into account whether the sanctions for unlicensed operation of an ICIS and/or for violation of ICIS operator obligations are consistently applied in the assessed jurisdiction.

546. *With respect to Key Questions 9 and 10*, assessors should take into account that, where an entity involved in the operations of an ICIS is not subject to the regulation of a securities regulator, the relevant on-site inspections and investigations may be conducted through cooperation with other relevant financial regulators.

547. *With respect to Key Question 12*, assessors should also consider whether or not proper books and records in relation to the internal organisation and business of the ICIS are required to be maintained for an appropriate time and in the event of a winding-up.

[222] See *Report on Investment Management,* supra, p. 11.

Benchmarks

Fully Implemented

548. Requires an affirmative response to all applicable Questions.

Broadly Implemented

549. Requires affirmative responses to all applicable Questions except to Questions 10, 17(d) and 17(e).

Partly Implemented

550. Requires affirmative responses to all applicable Questions except to Questions 6, 8, 9, 10, 11, 15(a), 15(b), 15(c), 15(d), 15(e), 15(f), 15(g), 16, 17(d), 17(e) and either Question 13(a) or 13(b).

Not Implemented

551. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 2(a), 2(b), 2(c), 2(d), 2(e), 2(f), 3, 4, 5, 7(a), 7(b), 7(c), 7(d), 12, 14(a), 14(b), 15(h), 17(a), 17(b), 17(c) or 18, and to both Questions 13(a) and 13(b).

CPICM 27: The regulatory system should provide for rules governing the legal form and structure of Islamic collective investment schemes and the segregation and protection of client assets. (IOSCO 25)

552. The legal form and structure of ICIS vary among jurisdictions however they are important to the protection of investors. The legal form and structure affects the interests and rights of the participants in the ICIS, and enables the pool of investors' funds to be distinguished and segregated from the assets of other entities and of the operator.

553. The legal form and structure chosen for ICIS has implications for the risk of default or breach associated with the scheme. The regulatory system should require that, on the one hand, the legal form and structure of ICIS and, on the other, the implication thereof on the risks associated with the ICIS, are disclosed to investors, and ensure that these risks to investors are addressed either through statute, conduct rules or mandatory covenants in the constituent documents of an ICIS.

554. The regulatory system should ensure adequate segregation and protection of client assets, including through use of custodians and/or depositories that are, in appropriate circumstances, independent. Client assets should be interpreted as: assets that are held or controlled on behalf of investors in an ICIS, including securities, positions and, where appropriate, collateral and margin payments.

555. The regulatory system should recognise the benefits for investor protection and confidence in financial markets of effective mechanisms to protect client assets from the risk of loss and the insolvency of ICIS operators.[223]

556. As part of its ongoing supervision, the regulator should seek to ensure that within its jurisdiction there are mechanisms which best achieve the overall objective of client asset protection, taking into account its insolvency and investment services laws, regulations and practices, and the objectives of market efficiency and investor protection.

Key Issues

Legal Form/Investors' Rights

1. The regulatory system should address the legal form of ICIS and the nature of the rights and interests of investors. Appropriate disclosure of such form and rights

[223] See *Client Asset Protection*, Report of the Technical Committee of IOSCO, August 1996, p. 2, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

should be provided to investors. Such rights should not be left to the discretion of the ICIS operator.

2. Supervision should seek to ensure that any restrictions on type, or level, of investment,[224] or financing, are being complied with.

Separation of Assets/Safekeeping

3. The regulatory system should ensure adequate segregation of the pool of investors' assets from the assets of the ICIS operator and of other entities.

4. The regulatory system should ensure that effective mechanisms are in place to protect client assets from the risk of loss and insolvency of the ICIS operator and, where third party custodians are used, that client assets are identified as such to any third party custodian and equivalent protection is afforded to such assets.

5. The risks arising from a default or a breach associated with the legal form and structure chosen for a given ICIS should be disclosed to investors.

6. The regulatory system should ensure that the above risks to investors are duly addressed through statutes, rules, or mandatory arrangements.

Key Questions

Legal Form/Investors' Rights

1. Does the regulatory system provide for requirements as to the legal form and structure of ICIS that delineates the interests of participants and their related rights?

2. Does the regulatory system provide that the legal form and structure of an ICIS, as well as the implications thereof for the nature of risks associated with the ICIS, be disclosed to investors in such a way that they are not dependent upon the discretion of the ICIS operator?[225]

[224] In relation to money market funds see *Policy Recommendations for Money Market Funds*, Final Report, Report of the Board of IOSCO, October 2012, p. 11, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf.

[225] See generally *Investment Management Risk Assessment: Marketing and Selling Practices*, supra.

3. Is there a regulatory authority responsible for ensuring that the form and structure requirements are observed?

4. Does the regulatory system provide that where material changes are made to investor rights that do not require prior approval from investors, notice is given to them before the changes take effect?

5. Does the regulatory system provide that where material changes are made to investor rights, notice is given to the relevant regulatory authority?

6. Does the regulator have powers aimed at ensuring that any restrictions on type, or level, of investment, or borrowing, are being complied with?

Separation of Assets/Safekeeping

7. Does the regulatory system require adequate segregation of ICIS assets from the assets of the ICIS operator and its managers or other entities?[226]

8. Does the regulatory system provide for either of the following requirements governing the safekeeping of ICIS assets:

a. the obligation to entrust the assets to custodians and/or depositaries that are in appropriate circumstances independent; or

b. special legal or regulatory safeguards in cases where the functions of custodian and/or depositary are performed by the same legal entity as is responsible for investment functions (or related entities).

9. Does the regulatory system provide for adequate protection of client assets from losses or insolvency of the ICIS operator, and the obligation that, where third party custodians are used, client assets are identified as such to any such custodian and equivalent protection is afforded to the client assets, including when the custodian has entrusted all or some of the assets in its safekeeping to a third party?[227]

[226] See *Guidance on Custody Arrangements for Collective Investment Schemes*, Discussion Paper of the Technical Committee of IOSCO, September 1996, p. 5, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD60.pdf. See generally *Client Asset Protection*, supra.

[227] Where third party custodians are used, there should be separation of the assets of an ICIS from the assets of the custodian itself. The liability of a custodian for any losses suffered by the investors as a result of its unjustifiable failure to perform its obligations or its improper performance of them cannot be affected by the fact that it has entrusted to a third party all or some of the assets in its safekeeping: see *Standards for the Custody of Collective Investment Schemes' Assets*, Final Report, Report of the Board of IOSCO, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf; *Client Asset Protection*, supra; *Report on Investment Management*, supra.

10. Does the regulatory system adequately provide for an orderly winding up of ICIS business, if needed?

Explanatory Notes

557. In evaluating safekeeping, consideration should be given by an assessor to whether the supervisory system in the assessed jurisdiction is capable of ensuring that all ICIS investments, including cash deposits, are properly held in safekeeping.

558. Consideration also should be given to the ability of the system to ensure that the risks of default or breach associated with the scheme are properly addressed. It is important that the interests of ICIS investors are duly protected not only while the ICIS is a going concern, but also when its continuity is affected by circumstances which require it to be wound up.

559. The assessor should verify that the regulatory system requires the rights of investors in ICIS, or impediments to investors exercising their rights, to be clearly disclosed.

560. The assessor should also take into account whether supervision of ICIS promotes financial stability. In particular, requirements on money market funds (MMFs) should include restrictions on the type of assets that are permitted to be held. To this end, where appropriate, the assessor should make reference to the assessment of CPICM 6.

561. *With respect to Key Question 3*, assessors should consider also whether there is any evidence that the requirements relating to the form and structure of an ICIS are enforced in the assessed jurisdiction.

Benchmarks

Fully Implemented

562. Requires affirmative responses to all applicable Questions.

Broadly Implemented

563. Requires affirmative responses to all applicable Questions except to Question 4.

Partly Implemented

564. Requires affirmative responses to all applicable Questions except to Questions 4 and 5.

Not Implemented

565. Inability to respond affirmatively to one or more of Questions 1, 2, 3, 6, 7, 8(a) or 8(b), 9 or 10.

CPICM 28: Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of an Islamic collective investment scheme for a particular investor and the value of the investor's interest in the scheme. (IOSCO 26)

566. This CPICM is intended to ensure that matters material to the value of an investment in an ICIS are the subject of disclosure to investors and potential investors. Disclosure about an ICIS should assist investors in understanding the nature of the investment vehicle and the relationship between risk and return, so that investors evaluating ICIS performance do not focus solely on return, but also on the risk assumed to produce the return.[228] However, investors should be free to choose the level of market risk to which they are exposed.

567. The goal of disclosure should be to provide investors with sufficient information on a timely basis, in a language and a format that are easy to understand having regard to the type of investor, to evaluate whether and to what extent the ICIS is an appropriate investment vehicle for them.[229]

568. Disclosure should promote comparability among various ICIS.[230] Where appropriate, disclosure should take into account the specific features of the ICIS (e.g. ETFs).

569. One particular aspect of disclosure requiring close attention is the disclosure of all fees and other charges that may be levied under the ICIS. Information on fees and charges should be disclosed to both prospective and current investors in a way that enables the investors to understand their nature, structure and impact on the ICIS's performance.[231] There should also be clear disclosure of investment policies.[232]

570. Advertisements concerning ICIS should not contain inaccurate, untrue, or misleading statements.

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[228] See *Disclosure of Risk: A Discussion Paper*, Report of the Technical Committee of IOSCO, September 1996, p. 2, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD59.pdf. For a discussion of the obligation to disclose fees and expenses, see Key Question 8 below.

[229] See, generally, *Investor Disclosure and Informed Decisions: Use of Simplified Prospectuses by Collective Investment Schemes*, Report of the Technical Committee of IOSCO, July 2002, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD131.pdf.

[230] See *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards,* supra, p. 5.

[231] See *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds,* supra, pp. 3–4.

[232] For a discussion of the obligations to disclose voting practices, see, generally, *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure*, supra.

Key Issues

1. Disclosure should assist investors in understanding the nature of the investment vehicle and the relationship between risk and return.

2. All matters material to a valuation of the ICIS, including fees and charges, should be disclosed to investors and potential investors.

3. Information should be provided on a timely basis and in an easy to understand format and language having regard to the type of investor.

4. There should be clear disclosure of investment policies.

5. Supervision should seek to ensure that the stated investment policy or trading strategy, or any policy required by regulation, is being followed.

6. Advertisements concerning ICIS should not contain inaccurate, false or misleading statements and should not detract the investors' ability to make their own judgment about investing in the ICIS.

7. To evaluate the suitability of ICIS more effectively, additional information related to specificities of Islamic finance such as Sharī'ah governance, Sharī'ah screening process, and possibility of purification should be disclosed in line with the IFSB's *Guiding Principles on Disclosure Requirements for Islamic Capital Market Products*.[233]

Key Questions

1. Does the regulatory system require that all matters material to the valuation of an ICIS are disclosed to investors and potential investors on a timely basis?

2. Does the regulatory system require that the information referred to in Question 1 above be disclosed to investors and potential investors in an easy to understand format and language having regard to the type of investor?[234]

[233] IFSB-19: *Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Ṣukūk and Islamic Collective Investment Schemes).*
[234] See *Disclosure of Risk: A Discussion Paper*, supra, p. 3.

3. Does the regulatory system require the use of standard formats for disclosure of offering documents and periodic reports to investors?

4. Does the regulatory system include a general disclosure obligation to allow investors, and potential investors, to evaluate the suitability of the ICIS for that investor or potential investor?

5. Does the regulatory system specifically require that the offering documents, or other publicly available information, include the following:

a. The date of issuance of the offering document?

b. Information concerning the legal constitution of the ICIS?

c. The rights of investors in the ICIS?

d. Information on the operator and its principals?

e. Information on the methodology of asset valuation?

f. Procedures for purchase, redemption and pricing of units/shares?

g. Relevant, audited financial information concerning the ICIS?

h. Information on the custodial arrangements (if any)?

i. The investment policy(ies) of the ICIS?

j. Information on the risks involved in achieving the investment objectives?

k. The appointment of any external administrator or investment managers or advisers who have a significant and independent role in relation to the ICIS (including delegates)?

l. Fees and charges in relation to the ICIS, in a way that enables investors to understand their nature, structure and impact on the ICIS' performance?[235]

6. Does the regulatory authority have the power to hold back, or intervene, with regard to offering documents? For example, are there regulatory actions available in

[235] See, generally, *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds,* supra.

the event that the information is inaccurate, misleading or false, or does not satisfy the filing/approval requirements?

7. Does the regulatory system cover advertising material outside of the offering documents? In particular, does it prohibit inaccurate, false, or misleading advertising? Are there regulatory actions available to the regulator with regard to advertising material outside of the offering document?

8. Does the regulatory system require that the offering documents be kept up to date to take account of any material changes affecting the ICIS?

9. Does the regulatory system require a report to be prepared in respect of ICIS' activities either on an annual, semi-annual or other periodic basis?

10. Does the regulatory system require the timely distribution of periodic reports?[236]

11. Does the regulatory system require that the accounts of an ICIS be prepared in accordance with high quality, internationally acceptable accounting standards?

12. Does the regulator have powers to ensure that the stated investment policy or trading strategy, the authorised investments that the ICIS is able to undertake, or any policy required by regulation is being followed? [237]

13. Does the regulatory system require an ICIS to make sufficient disclosures about its Sharī'ah governance arrangements and Sharī'ah compliance?

14. Does the regulatory system require an ICIS to make sufficient ongoing disclosures about operational matters and their compliance with Sharī'ah principles?

15. Does the regulatory system ensure that disclosures for special types of ICIS[238] (as outlined in IFSB-19) reflect their specific structures, operational considerations and risks?

[236] See also *Explanatory Notes*.
[237] See generally *Principles for the Supervision of Operators of Collective Investment Schemes,* supra.
[238] Special types of ICIS addressed in IFSB-19 include property funds, Islamic real estate investment trusts (REITs), ETFs, MMFs, private equity and venture capital funds, and commodity funds.

Explanatory Notes

571. The assessor should cross-reference to assessment under CPICM 17 to 23 as appropriate. ICIS normally target retail investors; therefore, particular attention should be paid to ensure the regulatory system is structured to prevent investors being misled by inappropriate presentation of elements (e.g. risks associated with the investment policies and trading strategies of the scheme, reference to past performance, and fees and other charges that may be levied under the scheme). The information should be provided in an easy-to-understand format and language having regard to the type of investor. Proper consideration should be given by the assessor to the retail nature of ICIS business.

572. For the purposes of Key Question 5(g), the offering documents, or other publicly available information, may refer to relevant, audited financial information concerning the ICIS that is previously or simultaneously provided or made available.

573. For the purposes of Key Questions 6, 7 and 12, assessors should also take into account whether there is any evidence of actions taken by the regulator in those areas.

574. For the purposes of Key Questions 13 and 14, assessors should take into account the recommended disclosure requirements set out in IFSB-19, including those related to investments, Sharīʻah review and governance (set out in paras 139–45); treatment of tainted assets or income (set out in paras 146–7); *zakāh* or other Sharīʻah-related obligatory payments (set out in paras 148–9); and operations-related disclosures for ICIS (paras 152–3).

Benchmarks

Fully Implemented

575. Requires affirmative responses to all applicable Questions.

Broadly Implemented

576. Requires affirmative responses to all applicable Questions except to Questions 3, 10 and 14.

Partly Implemented

577. Requires affirmative responses to all applicable Questions except to Questions 3, 5(b), 10 and 11.

Not Implemented

578. Inability to respond affirmatively to one or more of Questions 1, 2, 4, 5(a), 5(c), 5(d), 5(e), 5(f), 5(g), 5(h), 5(i), 5(j), 5(k), 5(l), 6, 7, 8, 9 12, 13, 14 or 15.

CPICM 29: Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in an Islamic collective investment scheme. (IOSCO 27)

579. Proper valuation of ICIS assets is critical to ensure investor confidence in ICIS as a reliable and robust investment vehicle, and for proper investor protection, especially in cases where a market price is unavailable. Regulation should seek to ensure that all property of an ICIS is fairly and accurately valued, that the net asset value (NAV) of the ICIS is correctly calculated.[239]

580. The regulatory system should permit the responsible authority to ensure compliance with the relevant rules.

581. Regulation should require the ICIS operator to publish or disclose the price of the ICIS on a regular basis to enable the investor, or potential investor, to assess performance over time.

582. The law or rules governing ICIS should enable investors to redeem units or shares on a basis that is made clear in the constituent documents and/or the prospectus. The regulatory system should address the general or exceptional circumstances in which there may be suspension or deferral of: routine valuation and pricing; or regular redemption, of ICIS units or shares.

Key Issues

Asset Valuation

1. Regulation should ensure that all property of an ICIS is fairly and accurately valued, and that the NAV of the ICIS is correctly calculated. The interests of the investor are generally better protected by the use of value-based reporting[240] wherever reliable market or fair values can be determined.[241]

[239] See *Principles for the Supervision of Operators of Collective Investment Schemes,* supra, p. 10.
[240] Value-based reporting is understood as marking financial assets to market or using market prices (values) where these are available and reliable.
[241] A mandatory requirement in some jurisdictions. See *Best Practice Standards on Anti Market Timing and Associated Issues for CIS,* supra, p. 7.

2. ICIS should be valued regularly at specified intervals and on any day that ICIS units are purchased or redeemed.

3. ICIS operators should be responsible for publishing or disclosing the price of the ICIS on a regular basis to enable investors or potential investors to assess the performance of the ICIS over time.

4. Valuation methods should be applied consistently unless change is desirable in the interest of investors.

5. The valuation policies and procedures should be periodically reviewed. A third party should review the ICIS valuation process at least annually.[242]

Pricing and Redemption Issues

6. Regulation should require that the basis upon which investors may redeem units or shares is made clear in the constituent documents and/or the prospectus.

7. Incoming, continuing and outgoing investors should be treated equitably, such that purchases and redemptions of ICIS interests are affected in a non-discriminatory manner.

8. Suspension of redemptions in the open-ended ICIS may be justified only: (a) if permitted by law, regulation or regulators, and in exceptional circumstances provided such suspension is in the best interest of unitholders or market efficiency; or (b) if the suspension is required by law, regulation or regulators.[243]

9. Regulation should ensure that rights of suspension protect the interests of investors, rather than the interests of the ICIS operator.

10. Regulators and unitholders should be kept informed of any suspension of redemption rights.

[242] See *Principles for the Valuation of Collective Investment Schemes*, Report of the Board of IOSCO, May 2013, p. 9, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD413.pdf.
[243] See *Principles for Suspension of Redemptions in Collective Investment Schemes*, Report of the Board of IOSCO, January 2012, p. 11, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD367.pdf.

Key Questions

Asset Valuation

1. Are there specific regulatory requirements in respect of the valuation of ICIS assets?[244]

2. Are there regulatory requirements that the NAV of ICIS be calculated:

   a. On a regular basis?

   b. Each day that ICIS units are purchased or redeemed?

   c. In accordance with high-quality, accepted accounting standards used on a consistent basis?

3. Are there specific regulatory requirements in respect of the fair valuation of assets where market prices are not available?

4. Are there specific regulatory requirements where amortised cost accounting[245] is permitted?

5. Are third parties (e.g., independent auditors) required to check the valuations of ICIS assets?

Pricing and Redemption Issues

6. Does the regulatory system:

   a. Require the basis upon which investors may redeem units/shares to be made clear in the constituent documents and/or the prospectus?

   b. Provide for specific regulatory requirements in respect of the pricing upon redemption or subscription of units/shares in an ICIS?

[244] See also *Principles for the Supervision of Operators of Collective Investment Schemes*, supra, p. 10. In addition, there should be some arrangement for valuing illiquid holdings if any. See also Key Issue 3.

[245] In Islamic finance, the amortised cost of an instrument is the amount at which the instrument is measured at initial recognition minus repayments/redemptions, plus or minus the cumulative amortisation using the effective profit rate method of any difference between that initial amount of investment and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility. The effective profit rate method allocates the cash flows from the instrument through a uniform rate of return including all cash flows, considering all contractual terms (or best expectations), excluding expected future losses.

7. Does regulation ensure that the valuations made are fair and reliable?

8. Does regulation require the price of the ICIS be disclosed or published on a regular basis to investors or prospective investors?

9. Are there regulatory requirements, rules of practice, and/or rules addressing pricing errors? Are the relevant regulatory authorities able to enforce these rules?

10. Does the regulatory system address the general or exceptional circumstances in which there may be suspension, or deferral, of: routine valuation and pricing; or regular redemption, of ICIS units or shares?

11. Does the regulator have the power to ensure compliance with the rules applicable to asset valuation, pricing and suspension of the redemption and subscriptions?

12. Does the regulatory system require that the regulator:

a. Be kept informed of any suspension or deferral of redemption rights?

b. Have the authority to address situations where the ICIS operator: is failing to honour redemptions; or is imposing a suspension of redemptions in a manner that is not consistent with the ICIS constitutive documents and prospectus, or the contractual relationship between the ICIS participants and the ICIS operator; or is otherwise deemed to be in violation of national law?

Explanatory Notes

583. The valuation of the property of an ICIS and the calculation of the NAV are extremely important, as the NAV[246] reflects the price, which an investor pays when investing in an ICIS (subject to any additional upfront charges) and the price an investor will receive should a holding be liquidated. Assessors should pay proper attention to the calculation modalities and to the timing, and frequency, of publication of the ICIS NAV. Assessors should also evaluate whether the supervision of the ICIS confirms that the operator has systems

[246] NAV is calculated by dividing the total value of the investments in an ICIS by the number of units in issue, plus or minus adjustments for accrued fees, expenses and other liabilities.

and controls in place to ensure a fair and accurate valuation of the property of an ICIS, and that calculations of the NAV are correct at each valuation point, as indicated in Key Issue 2.

584. The type and frequency of valuation may depend on the availability and timing of redemption rights, the types of interests that may be held within an ICIS, and the permitted legal structure of an ICIS.

585. In the jurisdiction, if there are third parties appointed to perform valuation services (such as valuation agents), the responsible entity should conduct initial and periodic due diligence on such third-party valuation service providers.

586. The right to redeem units/shares is a key feature of open-ended ICIS. The assessor should evaluate whether the rules in place are sufficient to prevent fees or charges payable by an investor, in the case of redemption, from being conceived so as to prevent investors from exercising their rights.[247] Assessors should take into account that the rights of suspension, available to the ICIS operator, may not be exerted in ways that impair the protection of investors' interests, and that regulators are able to enforce decisions aimed at protecting investors' interests. In the case of closed-end funds, assessors may consider how regularly such ICIS are priced.

587. *With respect to Key Question 6*, assessors should consider whether the accuracy of the ICIS NAV calculation is required to be checked by auditors, which are subject to adequate levels of oversight and independence in accordance with CPICM 21 to 23. However, it is not necessary that independent auditors check each individual valuation of an ICIS for a positive answer to Key Question 6.

588. *With respect to Key Question 10,* assessors should also consider whether there is any evidence that the requirements on asset valuation and pricing are enforced in the assessed jurisdiction.

Benchmarks

Fully Implemented

589. Requires affirmative responses to all applicable Questions.

[247] Imposing any fees or charges on the redemption of the ICIS units/shares is a practice that is not Sharī'ah-compliant unless it is imposed for a specific service provided to the unitholder.

Broadly Implemented

590. Requires affirmative responses to all applicable Questions except to Question 9.

Partly Implemented

591. Requires affirmative responses to all applicable Questions except to Questions 3, 4, 5, 9 and 11.

Not Implemented

592. Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 2(c), 6(a), 6(b), 7, 8, 10, 12(a) or 12(b).

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2.9 Principles Relating to Market Intermediaries

2.9.1 Preamble

593. The CPICM relating to Market Intermediaries sets out requirements related to entry criteria, capital and prudential requirements, conduct of business, ongoing supervision and discipline of market intermediaries, and the consequences of default and financial failure.

594. Market intermediaries should conduct themselves in a way that protects the interests of their clients and helps to preserve the integrity of the market. Fundamental principles include:

- A firm should observe high standards of integrity and fair dealing.
- A firm should act with due care and diligence in the best interests of its clients and the integrity of the market.
- A firm should observe high standards of market conduct.
- A firm should not place its interests above those of its clients and should give similarly situated treatment to similarly situated clients.
- A firm should comply with any law, code or standard relevant to securities regulation as it applies to the firm.
- A firm should, if it claims to offer Sharī‘ah-compliant services or products, have systems (i.e. controls, policies and procedures) in place to ensure that they are in compliance with Sharī‘ah principles.

Supervision and Enforcement

595. In addition, regulation of the various types of market intermediaries should aim to provide for:

- Proper ongoing supervision with respect to market intermediaries.

- The right to inspect the books, records and business operations of a market intermediary.[248]

- A full range of investigatory powers and enforcement remedies available to the regulator or other competent authority in cases of suspected or actual breaches of regulatory requirements.

- A fair and expeditious process leading to discipline and, if necessary, suspension or withdrawal[249] of a licence.

- The existence of an efficient and effective mechanism to address investor complaints.

596. CPICM 30 to 33 deal with market intermediaries. CPICM 30 addresses authorisation and the standards for authorisation; CPICM 31 addresses ongoing monitoring and the initial and ongoing capital requirements and prudential standards for intermediaries; CPICM 32 addresses other operational standards for market intermediaries and standards for conduct of business to protect the interests of clients and their assets and for ensuring proper management of risks; and CPICM 33 addresses procedures for minimising the consequences to investors and markets of the failure of a market.

597. The oversight of market intermediaries should primarily be directed to the areas where their capital, client assets and public confidence may most be put at risk. These include the risks of:

- Incompetence, poor risk management, or risk management that fails to be adequate in the context of an extraordinary event. Any of these may lead to a failure: (1) to provide best execution; (2) to obtain prompt settlement; and/or (3) to provide appropriate advice.

- Breach of duty, laws and regulations (which may lead to misappropriation of client funds or property, the misuse of client instructions for the intermediary's own trading purposes, i.e., "front running" or trading ahead of clients).

- Manipulation, insider trading and other trading irregularities; or fraud, money

[248] Inspection powers should be available to a regulator to ensure compliance with all relevant requirements, even in the absence of a suspected breach of conduct. There must be complementary requirements for the maintenance of comprehensive records. See also *CPICM 11.*

[249] The term "withdrawal" would include revocation.

laundering or terrorist financing taking place at the intermediary.

- Conflicts of interest.

- Insolvency of an intermediary (which may result in loss of client money, securities or trading opportunities, and may reduce confidence in the market in which the intermediary participates).

598. In assessing the adequacy of regulation, assessors should consider both the activities regulators perform directly, as well as those activities performed by SROs (including an assessment of the adequacy of the supervision of such self-regulatory activities by the regulator).

2.9.2 Scope

599. The CPICM under this Section apply to market intermediaries. Some or all of the CPICM may also apply to investment advisers, depending on the nature of the investment adviser's business, as explained below.

600. "Market intermediaries" generally include those who are in the business of managing individual portfolios, executing orders, and dealing in or distributing securities. A jurisdiction may also choose to regulate as a market intermediary an entity that engages in any one or more of the following activities:[250]

- Receiving and transmitting orders.

- Proprietary trading/dealing on own account.

- Providing advice regarding the value of securities or the advisability of investing in, purchasing, or selling securities.

- Securities underwriting.

[250] A market intermediary may also be authorised, in addition to the activities mentioned in the paragraph above, to hold custody of client assets (e.g. safekeeping and administration of securities) as an ancillary activity. Custody in this context means "physically" holding the client assets (i.e. in electronic or in paper form) where they could be at risk of custodial error or misappropriation. However, merely being able to deduct an advisory fee from customer assets held not at the adviser but rather at a bank or broker–dealer would not be considered having "custody".

- Placing of financial instruments without a firm commitment basis.

601. “Investment advisers” are those principally engaged in the business of advising others regarding the value of securities or the advisability of investing in, purchasing or selling securities. This does not mean that they cannot provide other services. In some jurisdictions, an investment adviser that deals on behalf of clients and/or is permitted to hold client assets would be classified as a market intermediary. In other jurisdictions, investment advisers are treated separately from market intermediaries. When this distinction exists, the scope of CPICM 30 to 33 may apply differently depending on the type of investment adviser.[251] Regulation should depend on, and be appropriate to, the adviser’s activities. This is clarified in more detail under the heading of “investment advisers” in CPICM 30.

602. To the extent that this section calls for an assessment of the ongoing operations of intermediaries consistent with the CPICM, the assessor should be certain that any conclusions reached are consistent with those contained in CPICM 11, 12 and 13 related to enforcement and inspection powers and implementation of such powers.

[251] In this respect, three types of investment adviser could be identified:
(a) Investment advisers that deal on behalf of clients.
(b) Investment advisers that do not deal on behalf of clients, but are permitted to have custody of client assets.
(c) Investment advisers who neither deal on behalf of clients nor hold or have custody of client assets nor manage portfolios, but who offer only advisory services without offering other investment services.

2.9.3 CPICM 30 through 33

CPICM 30: Regulation should provide for minimum entry standards for market intermediaries. (IOSCO 29)

603. The licensing[252] and supervision of market intermediaries, including its staff, should set minimum standards for them and provide consistency of treatment for all similarly situated market intermediaries. It should also reduce the risk to investors of loss caused by negligent or illegal behaviour and/or inadequate capital.

604. If a market intermediary claims Sharī'ah compliance in any of its activities, relevant regulatory requirements should be present to ensure that such claims are being upheld.

Key Issues

Authorisation

1. The authorisation, licensing or registration should specify the services or activities which the market intermediary is authorised to provide.

2. The authorisation, licensing or registration of market intermediaries should set minimum standards of entry that make clear the basis for authorisation and the standards that should be met on an ongoing basis. Such standards should include:

a. An initial minimum capital requirement as set forth in CPICM 31.

b. A comprehensive assessment of the applicant and all those who are in a position directly, or indirectly, to control, or materially influence, the applicant. In this regard, regulation should determine the conditions or criteria to be met by the market intermediary and its staff in order to be allowed to participate in the market. This should include, but not be restricted to, a demonstration of appropriate knowledge, including knowledge of Islamic finance and Sharī'ah principles where the intermediary makes claims concerned with Sharī'ah compliance, business

[252] The terms "licensing", "authorisation" and "registration" are used interchangeably in this section. In some jurisdictions, "authorisation" or "registration" is used instead of "licensing". The term "licence" in this section should be understood to refer also to authorisation and registration.

conduct, resources, skills, ethical attitude (including a consideration of past conduct), and internal organisation.[253]

c. A requirement that the entry standards be consistently applied.

d. Appropriate Sharī'ah governance requirements in line with those set out in CPICM 10, if the intermediary makes claims of Sharī'ah compliance for any of its activities.

Authority of Regulator

3. The licensing authority should have the power to:

a. Refuse licensing of a market intermediary, subject only to administrative or judicial review, if authorisation requirements have not been met.

b. Withdraw, suspend or apply a condition to a licence or authorisation where a change in control or other change results in a failure to meet relevant requirements, according to CPICM 3.

4. The regulator, or the SRO subject to the regulator's oversight, should demonstrate an ability to carry out an effective review of applications for licensing or authorisation to ensure compliance with regulatory requirements.

Ongoing Requirements

5. Periodic updating of relevant information and reporting of material changes in circumstances affecting the conditions of licensing should be required in order to ensure that continued licensing remains appropriate. For example, changes in control, or material influence, should be required to be made known to the regulator, such that it may seek to ensure that its assessment of the market intermediary remains valid.

6. To enable investors to better protect their own interests, the regulator should seek to ensure that the public has access to relevant information concerning the licensee or authorised market intermediary such as: the identity of senior management,

[253] Examples from jurisdictions include: statutory disqualification programmes and detailed criteria relating to education, training, experience or the so-called "fitness and propriety" of an applicant to be met before a person may be licensed. These criteria are intended to protect the investor. See generally *Fit and Proper Assessment — Best Practice*, Final Report, Report of the Emerging Markets Committee of IOSCO, December 2009, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD312.pdf.

and those authorised to act in the name of the market intermediary; the category of licence held and its current status; and the scope of authorised activities.[254]

Investment Advisers

7. In jurisdictions where investment advisers are treated separately from market intermediaries, as explained in the scope section above, investment advisers that deal on behalf of clients or that are permitted to have custody of client assets should be licensed. There are investment advisers who neither:

a. deal on behalf of clients nor hold, or have custody of, client assets; nor

b. manage portfolios, but who only offer advisory services without other investment services. In this case, separate licensing of the investment adviser may not be strictly required.[255]

8. In regulating the activities of investment advisers, the regulator may elect to place emphasis on the substantive licensing criteria and the capital and other requirements recommended for regulation of other market intermediaries, as explained under CPICM 30 to 33. Alternatively, the regulator may use a disclosure-based regime designed to permit potential advisory clients to make an informed choice of advisers subject to the activities performed by the investment adviser.

9. Regardless of these two options, the regulatory scheme should include the following requirements based on the type of adviser:

a. If an investment adviser deals on behalf of clients,[256] the capital and other operational controls (explained in CPICM 30 to 33) applicable to other market intermediaries also should apply to the adviser.

b. If the investment adviser does not deal, but is permitted to have custody of client assets,[257] regulation should provide for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party), and capital and organisational requirements as explained under CPICM 30 to 33.

[254] The information must be freely available and readily accessible. It may be maintained in a central repository by the regulator or by an SRO.
[255] Where an investment adviser is offering advice through market intermediaries that are adequately licensed according to the Principles, separate licensing of the investment adviser may not be required.
[256] Investment adviser type (a) in footnote 76.
[257] Investment adviser type (b) in footnote 76.

10. At a minimum, however, the regulatory scheme selected for investment advisers should contain the following elements of the markets intermediaries regime, as applicable:

a. A licensing regime that is sufficient to establish authorisation to act as an investment adviser and to ensure access by the public to an up-to-date list of authorised investment advisers;

b. Bars against the licensing of persons who have violated securities or similar financial laws or criminal statutes during a specific time period preceding their application.

c. Recordkeeping requirements.

d. Clear and detailed disclosure requirements to be made by the investment adviser to potential clients.[258]

e. Rules and procedures designed to prevent guarantees of future investment performance and misuse of client assets, and to address potential conflicts of interest.[259]

Key Questions

Authorisation

1. Does the jurisdiction require that, as a condition of operating a securities business, the market intermediaries (as defined above) are licensed?

2. Are there minimum standards or criteria that all applicants for licensing must meet before a licence is granted (or denied)[260] that are clear and publicly available, which:

a. Are fair and equitable for similarly situated market intermediaries?

[258] For example, descriptions of 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 (if relevant) that is updated periodically and as material changes occur.

[259] It may not be possible to resolve all potential conflicts but conflicts should be addressed and if not resolved, at least disclosed.

[260] In some jurisdictions, the criteria are stated for denying or disqualifying potential applicants.

b. Are consistently applied?

c. Include an initial capital requirement, as applicable?

d. Include a comprehensive assessment of the applicant and all those in a position to control, or materially influence, the applicant, which requires a demonstration of appropriate knowledge including knowledge of Islamic capital market products and Sharīʿah rules and principles as appropriate, business conduct, resources, skills, ethical attitude (including a consideration of past conduct)?

e. Include an assessment of the sufficiency of internal organisation and risk management and supervisory systems in place, including relevant written policies and procedures, which enable ongoing monitoring as to whether the minimum standards are still met?

f. Include presence of Sharīʿah governance processes in line with the relevant requirements set out in CPICM 10, if the intermediary makes a claim of Sharīʿah compliance.

3. Does the regulator, or the SRO subject to the regulator's oversight, have in place processes and resources to effectively carry out a review of applications for licence?

Authority of Regulator

4. Does the relevant authority have the power to:

a. Refuse licensing, subject only to administrative or judicial review, if authorisation requirements have not been met?

b. Withdraw, suspend or apply a condition to a licence where a change in control or other change results in a failure to meet relevant requirements on an ongoing basis?

c. Take effective steps to prevent the employment of persons (or seek the removal of persons) who have committed securities violations or who are otherwise unsuitable, so that they cannot continue to engage in intermediary activities, even if these persons are not separately licensed market intermediaries, if they can have a material influence on the firm?

Ongoing Requirements

5. Are market intermediaries required: to update periodically relevant information with respect to their licence; and to report immediately to the regulator (or licensing authority) material changes in the circumstances affecting the conditions of the licence?[261]

6. Is the following relevant information about licensed market intermediaries available to the public:

a. The existence of a licence, its category and status?

b. The scope of permitted activities and the identity of senior management and names of other authorised individuals who act in the name of the market intermediary?

Investment Advisers

7. Does the regulatory scheme for investment advisers require that, as applicable:

a. If an investment adviser deals on behalf of clients, the capital and other operational controls (explained in CPICM 30 to 33) applicable to other market intermediaries also should apply to the investment adviser?

b. If the investment adviser does not deal but is permitted to have custody of client assets, regulation provides for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party) and capital and organisational requirements as explained under CPICM 30 to 33?

c. In the case of both (a) and (b), as well as investment advisers who manage client portfolios without dealing on behalf of clients or holding client assets, does regulation impose relevant requirements that cover recordkeeping, disclosure and conflicts of interest as explained in CPICM 32?

[261] There should be regular information provided to the regulator that indicates the market intermediary's ongoing activities. In addition, where there is a change in the market intermediary's staff, activities or environment that would have a material effect on its ability to perform its role, this should be reported to the regulator in a timely fashion.

Explanatory Notes

605. Some jurisdictions may license persons who operate an ICIS as ICIS operators; other jurisdictions may license ICIS operators as investment advisers. This characterisation should be without prejudice to their assessment under CPICM 25 through 29, on ICIS, according to the assessment criteria for those CPICM and, in any case, these CPICM should still apply to the market intermediaries' activities of that investment adviser.

606. Recognition of another licensing regime, in connection with access to domestic clients by a foreign intermediary subject to relevant conditions, is contemplated as being a licensing or authorisation programme under the assessment benchmarks, provided that the criteria used are transparent, clear, consistently applied and address the objectives of the CPICM.

607. Where individuals or entities are licensed, registered or authorised in more than one capacity, assessors must assure what criteria are applied to each category.

608. Where a jurisdiction has an SRO that licences market intermediaries, assessment of the appropriate oversight of the process by the regulator is addressed under CPICM 9.

609. When considering Key Question 3, assessors should give consideration to CPICM 3 on resources.

610. When considering Key Question 2(e), assessors should give consideration to the extent to which assessment of these systems by the regulator, or its designee (such as an SRO), is possible prior to the granting of a licence.

Benchmarks[262]

Fully Implemented

611. Requires affirmative responses to all applicable Questions.

Broadly Implemented

[262] In the case of investment advisers, affirmative answers are only required to those Questions applicable to the category of adviser(s) permitted in the jurisdiction. This does not refer to Sharī'ah-compliant principal protected, or protected minimum rate of return plans for which appropriate disclosures are made.

612. Requires affirmative responses to all applicable Questions except to Question 6(b).

Partly Implemented

613. Requires affirmative responses to all applicable Questions except to Questions 2(e), 4(c), 6(b).

Not Implemented

614. Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 2(c), 2(d),, 2(f), 3, 4(a) 4(b), 5, 6(a), 7(a), 7(b) and 7(c) to the extent applicable.

CPICM 31: There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake. (IOSCO 30)

615. Capital adequacy standards foster confidence in the financial markets and investor protection. Establishment of adequate initial and ongoing capital standards also contributes to ensuring the protection of investors, and the integrity and stability of financial systems. A market intermediary should be required to ensure that it maintains adequate financial resources to meet its business commitments and to withstand the risks to which its business is subject.

616. Assessors should assess each country's capital adequacy standards by reference to the capital adequacy principles published by IOSCO.[263] The relevant sections of IFSB-15: *Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services (Excluding Islamic Insurance [Takāful] Institutions and Islamic Collective Investment Schemes)* can also be useful by analogy for regulators in considering the treatment of Islamic instruments for capital adequacy purposes. Regulators should define the regulatory approach used to determine the capital adequacy treatment for such instruments.

Key Issues

1. There should be an initial capital requirement for market intermediaries as a condition of authorisation. This requirement should be based on a capital adequacy test that addresses the risks to such firms judged by reference to the nature and amount of the business expected to be undertaken.

2. There should be an ongoing capital requirement directly related to the nature of the risks and the amount of business actually undertaken by a market intermediary. The capital required should be maintained by the market intermediary and be subject to timely periodic reporting to the regulator or authorised SRO that is subject to regulatory oversight. This should involve a combination of regular reporting, and one-off trigger-based early warning reporting when the threshold levels for minimum capital are approached.

[263] See *Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf.

3. Market intermediaries should be subject to capital adequacy and liquidity standards, which should cover solvency. Lack of liquidity can cause difficulties for a firm because it might not be able to meet its liabilities as they fall due.[264]

4. Capital adequacy standards [265] should be designed to allow a market intermediary to absorb some losses and continue to operate, particularly in the event of large, adverse market moves, and to achieve an environment in which it could wind down its business over a relatively short period without loss to: its clients; its counterparties; or the clients of other firms, and without disrupting the orderly functioning of the financial markets. Capital standards should be designed to provide supervisory authorities with time to intervene to accomplish the objective of orderly wind down.

5. In addition to the organisational requirements under CPICM 32, a market intermediary should be subject to:

a. Independent audits of its financial condition.

b. Inspections, including periodic and for cause examinations, by a regulator, or an authorised SRO that is subject to regulatory oversight.

6. The regulator should have specific authority to impose: restrictions on a market intermediary's regulated business activities; and more stringent capital monitoring and/or reporting requirements, if a market intermediary's capital deteriorates or when it falls below minimum requirements.[266]

7. Any exposure of a market intermediary to significant risks arising from the activities of other entities in its group(s) should be addressed. Consideration should be given as to the need for information about the activities of unlicensed and off balance sheet affiliates.[267]

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[264] Id, p. 17.
[265] Id, Part IV at pp. 10–21.
[266] For example, when it is determined that an intermediary is in danger of not being able to fulfil its obligations towards its clients, the market or its creditors, or it is determined that the intermediary's financial condition is deteriorating although still above minimum requirements. Assessors should note that although this is a regulatory requirement, in the first instance, the responsibility for managing risks rests with the firm.
[267] See, for example, *Sound Practices for the Management of Liquidity Risk at Securities Firms*, Report of the Technical Committee of IOSCO, June 2002, p. 5, para. 21, available at http://www.iosco.org/library/pubdocs/pdf/_IOSCOPD128.pdf. See also *Multidisciplinary Working Group on Enhanced Disclosure*, Joint Report of the Basel Committee on Banking Supervision, the Committee on the Global Financial System of the G-10 Central Banks, the International Association of Insurance Supervisors and IOSCO, April 2001, pp. 2 and 21, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD116.pdf.

Key Questions

1. Are there initial and ongoing minimum capital requirements for market intermediaries? Are there also liquidity standards? Do the capital and liquidity standards address solvency?

2. Are the capital adequacy requirements structured to result in capital addressed to the full range of risks to which market intermediaries are subject (e.g., market, credit, liquidity and operational risks)?

3. Are capital adequacy requirements sensitive to the quantum of risks undertaken; that is, does required capital increase as risk increases (e.g., in the event of large market moves)?

4. Are capital standards designed to allow a market intermediary to absorb some losses, and to wind down its business over a relatively short period without loss to its clients or disrupting the orderly functioning of the markets?

5. Are relevant market intermediaries required to maintain records such that capital levels can be readily determined at any time?

6. Are the detail, format, frequency and timeliness of reporting to the regulator, and/or the SRO, sufficient to reveal a significant deterioration in the capital adequacy position of market intermediaries?

7. Is the financial position of the market intermediary subject to audit by independent auditors to provide additional assurance that the financial position reflects the risks that the market intermediary undertakes?

8. Does the regulator:

   a. Regularly review market intermediaries' capital levels?

   b. Take appropriate action when these reviews indicate material deficiencies?

9.

   a. Does the regulator have specific authority to impose: restrictions on a market intermediary's regulated business activities; and more stringent capital monitoring and/or reporting requirements, if a market intermediary's

capital deteriorates so as to endanger its capacity to fulfil its obligations or when it falls below minimum requirements?

b. Is there evidence that the regulator exercises this authority?

10. Does the prudential framework address risks from outside the regulated entity, for example, from unlicensed affiliates and off-balance sheet affiliates?

Explanatory Notes

617. In assessing the CPICM generally, it should be understood that there are two main approaches to the setting of capital adequacy standards for market intermediaries. A "net capital" approach is used in the United States, Canada, Japan, and some other non-EU jurisdictions. The purpose of the net capital approach is, among other things, to protect clients and creditors by requiring broker-dealers to maintain sufficient liquid assets to allow the orderly self-liquidation of financially distressed broker-dealers. The other main approach is incorporated in the EU's Capital Requirements Regulation and in the Credit Institutions Directive, which are based on the amendment to the Basel Capital Accord to incorporate market risks.[268] The emphasis in this approach is on ensuring the capital solvency of firms. The two approaches differ somewhat in their objectives, but their practical effects overlap to a significant extent. There may be other equivalent approaches that address the performance standards of the CPICM, for example, in relation to investment advisers,[269] and there may also be other equivalent approaches in various countries. In the latter case, assessors need to consider if the rules of that particular country comply with the capital adequacy principles published by IOSCO.[270]

618. There are also different approaches to assessing the risks posed to market intermediaries by affiliated entities. One approach is to require the regulated entity, the registered broker-dealer, to provide extensive "risk assessment" information to the regulator concerning its material affiliates. A number of other jurisdictions have regulatory authority over such affiliates and may require the affiliates to provide information to them directly.

[268] See Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC; and Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 648/2012.
[269] CPICM 30, Key Issue 8, regarding investment advisers.
[270] See *Capital Adequacy Standards for Securities Firms*, supra. For additional guidance, see *Guidance to Emerging Market Regulators regarding Capital Adequacy Requirements for Financial Intermediaries,* Report of the Emerging Markets Committee of IOSCO, December 2006, pp. 24–25, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD230.pdf.

619. The EU generally requires securities firms to provide capital adequacy information on a consolidated basis, and to meet capital requirements at the consolidated group level as well as at the level of individual regulated entities. The assessment criteria recognise that other approaches may be employed.

620. Some market intermediaries act in such a way that their activity is of lower risk. Where the market intermediary does not handle client money directly, is an inter-dealer broker with no principal at risk, or operates on a matched-book basis,[271] it may be appropriate to set capital requirements at a level lower than the level applicable to market intermediaries that carry client assets or take principal positions for their own account.

621. Capital adequacy requirements may explicitly refer to a particular risk, but be set at a level that in practice covers other risks as well. The assessor should inquire about the method of minimum capital determination being used, and the types of market intermediaries in the jurisdiction to which it applies; taking into account that more than one method or technique of computing capital or capital requirements is permitted under the CPICM.[272]

Benchmarks

Fully Implemented

622. Requires affirmative responses to all applicable Questions.

Broadly Implemented

623. Requires affirmative responses to all applicable Questions except to Question 10.

Partly Implemented

624. Requires affirmative responses to all applicable Questions except to Questions 6, 9(b) and 10.

Not Implemented

[271] Note that this does not include market intermediaries that take positions on their own account.
[272] For greater detail on the specified risks, see *Methodologies for Determining Minimum Capital Standards for Internationally Active Securities Firms which Permit the Use of Models under Prescribed Conditions,* Report of the Technical Committee of IOSCO, May 1998, pp. 5 et seq., available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD77.pdf.

625. Inability to respond affirmatively to one or more of Questions 1, 2, 3, 4, 5, 7, 8(a), 8(b) and 9(a).

CPICM 32:	**Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organisation and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters. (IOSCO 31)**

626. Market intermediaries should conduct their businesses in a way that protects the interests of their clients and their assets and helps preserve the integrity of the market.

627. Regulation should require that market intermediaries have in place appropriate internal policies and procedures for observance of securities laws and appropriate internal organisation and risk management systems. Regulation should not be expected to remove risk from the marketplace but should aim to ensure that there is proper management of that risk.

628. Instances of operational breach can occur despite the existence of internal procedures designed to prevent misconduct or negligence. It is not practicable for the regulator to oversee adherence to those internal procedures on a day-to-day basis; that is the primary responsibility of the management of the market intermediary. Management must ensure that they are able to discharge that responsibility.

Key Issues

Management and Supervision

1. The management of a market intermediary should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm. This includes ensuring that the firm is structured appropriately and has an adequate internal structure and controls, given the types of business in which it engages, including any activities, which have been outsourced,[273] to ensure investor protection and the management of risks.

   a. Management must ensure adherence to internal procedures on a day-to-day basis. They must understand the nature of the firm's business, its internal

[273] See *Principles on Outsourcing of Financial Services for Market Intermediaries*, Report of the Technical Committee of IOSCO, February 2005, p. 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD187.pdf.

control procedures and environment and its policies on the assumption of risk, and clearly understand the extent of their own authority and responsibilities. This should include those for ensuring continuing compliance with the resolutions of a Sharīʿah board or similar body.

b. All relevant information about the business must be:

i. timely;

ii. readily accessible; and

iii. regularly reported to management, and such information should be subject to procedures intended to maintain its security, availability, reliability and integrity.

2. Periodic evaluation of risk management processes within a regulated entity is necessary. This should be conducted by someone of sufficient autonomy so as not to compromise the evaluation. SROs and third parties, such as external auditors, may be used to assist in this process.

Organisational Requirements[274]

3. Market intermediaries should have systems or processes in place that seek to ensure that they are complying with all applicable laws and regulations and to reduce their risk of legal or regulatory sanctions, financial loss or reputational damage.

4. The details of the appropriate internal organisation of a firm, including risk management, internal audit and compliance functions (including internal Sharīʿah audit and internal Sharīʿah compliance functions), will vary according to the size of the firm, the nature of its business and the risks it undertakes. Information regarding the firm's internal organisation should also be available to the regulator upon request. With regards to a market intermediary's internal organisation, the regulatory framework should require the following to be considered:

a. Compliance with all applicable legal, regulatory and Sharīʿah requirements, as well as with the firm's own internal policies and procedures, should be monitored, where appropriate, by a separate compliance function[275] that

[274] See *Compliance Function at Market Intermediaries*, Final Report, Report of the Technical Committee of IOSCO, March 2006, p. 7, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf.
[275] See id, p. 7.

reports directly to senior management in a structure that makes it independent from operational divisions.

b. Maintenance of effective policies and operational procedures and controls in relation to the firm's day-to-day business, including:

   i. clear policies covering the risk management and internal controls applicable to proprietary trading; and

c. procedures that seek to ensure the integrity, security, availability, reliability and thoroughness of all information, business continuity, as well as outsourcing procedures.[276] Evaluation of the "effectiveness" of those operational procedures and controls in light of whether they serve reasonably to ensure:

   i. The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner.

   ii. Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors, or may be susceptible to abuses which expose the firm or its clients to inappropriate risks.

d. Addressing any conflicts of interest arising between its interests and those of its clients. Where the potential for conflicts arise, a market intermediary should ensure fair treatment of all its clients by taking reasonable steps to manage the conflict through organisational measures to prevent damage to its clients' interest, such as: internal rules, including rules of confidentiality; proper disclosure; or declining to act where conflict cannot be resolved.

5. If Direct Electronic Access (DEA) is allowed, market intermediaries should use controls, including automated pre-trade controls, which can limit or prevent a DEA client from placing an order that exceeds the market intermediary's existing position or credit limits.[277]

[276] Those operational procedures could include consideration of the use of risk transfer mechanisms (and the implications of their use in transforming or transferring risks).

[277] See *Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, pp. 17, 21–22, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf.

Protection of Clients

6. Where a market intermediary has control of, or is otherwise responsible for, assets belonging to a client which it is required to safeguard, it should make adequate arrangements to safeguard clients' ownership rights (for example, segregation and identification of those assets). These measures are intended to: provide protection from defalcation; facilitate the transfer of positions in cases of severe market disruption; prevent the use of client assets for proprietary trading or the financing of a market intermediary's operations; and assist in orderly winding up of the insolvency of an individual market intermediary and the return of client assets.

7. Particular obligations of an intermediary should include:

a. An intermediary should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail.[278]

b. Where client assets are to be held or placed in a foreign jurisdiction and will be subject to the client asset protection and/or insolvency regimes of that foreign jurisdiction and not the home jurisdiction, the intermediary should inform the clients of that fact. Any required disclosure of the relevant client asset protection regime(s) and arrangements and the consequent risks involved should be in writing and be prepared in clear, plain, concise and understandable language. Legal or financial jargon not commonly understood should be avoided.[279]

8. Intermediaries as defined in IOSCO's *Report on Suitability Requirements with Respect to the Distribution of Complex Financial Products* should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing complex financial products. The classification of customers should be based on a reasonable assessment of the customer concerned, taking into account the complexity and riskiness of different products. The regulator

[278] See *Recommendations Regarding the Protection of Client Assets*, Final Report, Report of the Board of IOSCO, January 2014, p. 3 (Principle 1), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf.
[279] Id, p. 5 (Principle 5, Means of Implementation 2).

should consider providing guidance to intermediaries in relation to customer classification.[280]

9. Market intermediaries should have an efficient and effective mechanism to address investor complaints.

10. With regards to a market intermediary's conduct with clients, the following are to be considered as important components:

a. When establishing a business relationship with a client, a market intermediary should identify, and verify, the client's identity using reliable, independent data. A market intermediary should also obtain sufficient information to identify persons[281] who beneficially own or control securities and, where relevant, other accounts.[282] Procedures to implement this requirement will facilitate a market intermediary's ability to mitigate the risk of being implicated in fraud, money laundering or terrorist financing.

b. A market intermediary should obtain and retain from its clients any information about their circumstances and investment objectives relevant to the services to be provided. Where the activities of a market intermediary extend to giving specific advice, the advice should be given based on an understanding of the needs and circumstances of the customer.[283]

c. The client should be able to obtain a written contract of engagement or account agreement, or a written form of the general and specific conditions of doing business through the market intermediary.

d. Records containing the above information should be kept for a reasonable number of years in accordance with best practices in order to facilitate investor protection and exchange of information between jurisdictions.[284] If market intermediaries are permitted to use reliable third parties to meet their client obligations under these CPICM, they nonetheless remain

[280] For the definitions of the terms "intermediary" (including exemptions), "distribution" and "complex financial products", see *Suitability Requirements with Respect to the Distribution of Complex Financial Products*, Final Report, Report of the Board of IOSCO, January 2013, footnote 4, pp. 4–6, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD400.pdf.

[281] For example, by obtaining the beneficial owner's name and address. See *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, supra, pp. 4–6.

[282] For further clarification of this requirement, see the discussion under Principle 2: id, pp. 7–8.

[283] In this context, the "know your customer" principle relates to suitability of investment recommendations and disclosure obligations. It should be distinguished from obligations relating to client identification imposed to prevent money laundering.

[284] See *Principles on Client Identification and Beneficial Ownership for the Securities Industry,* supra, pp. 10–14.

responsible for the performance of such obligations. Policies and procedures should be established which ensure the integrity, security, availability, reliability and thoroughness of all information, including documentation and electronically stored data, relevant to the market intermediary's business operations.

e. A market intermediary should disclose or make available adequate information to its client in a comprehensible and timely way so that the client can make an informed investment decision. It may be necessary for regulation to require a particular form of disclosure where products carry risk that may not be readily apparent to the retail client. Recruitment and training should seek to ensure that staff who provide investment advice understand the characteristics of the products they advise upon.

f. A market intermediary should promptly, and at suitable intervals, provide each client with a report of the value and composition of the clients' account or portfolio including, as appropriate, an account of transactions and balances.[285]

g. A market intermediary should provide each client with information about fees and commissions.

h. Disclosures of key information[286] regarding Islamic collective investment schemes to retail investors in their distribution prior to subscription[287] should be clear, accurate and not misleading to the target investor.[288]

i. A market intermediary should act with due care and diligence in the best interests of its clients and protect their assets, and in a way that helps preserve the integrity of the market.

j. The regulator should be able to demonstrate that it has in place a supervision programme that includes internal processes, skilled and

[285] *Recommendations Regarding the Protection of Client Assets,* supra, p. 3 (Principle 2).
[286] The term "key information" is described by IOSCO in this context as "necessarily vary[ing] depending on the type of financial product being offered. For some complex financial products with a multitude of risks, the amount of key information that a regulator might mandate for immediate disclosure to the investor under a 'layered approach' may be greater than for less complicated products": see *Principles of Point of Sale Disclosure*, Report of the Technical Committee of IOSCO, November 2009, p. 28, footnote 30, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD310.pdf.
[287] Id, p. 4, footnote 5.
[288] Id, p. 31 (Principle 5).

knowledgeable staff, and other resources that monitor compliance by market intermediaries with these requirements.[289]

Key Questions

Management and Supervision

1. With regards to a market intermediary's internal organisation, does the regulatory framework require the following to be considered:

   a. An appropriate management and organisation structure, including in relation to activities that have been outsourced?[290]

   b. Adequate[291] internal controls, including those for ensuring continuing compliance with the rulings of any Sharī'ah board or similar body?

   c. Management that is required to bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm?

2. Does the regulatory framework require market intermediaries to provide all relevant information about the business in a timely, readily accessible way, and to regularly report to management? Is such information subject to procedures intended to maintain its security, availability, reliability and integrity?

3. Does the regulatory framework require a market intermediary to be subject to an objective,[292] periodic evaluation of its internal controls and risk management processes?

Organisational Requirements

4. Does the regulatory framework include the assessment of a market intermediary's compliance function, taking into account the market intermediary's size

[289] *Recommendations Regarding the Protection of Client Assets,* supra, p. 7 (Principle 7).
[290] See *Principles on Outsourcing of Financial Services for Market Intermediaries,* supra, pp. 3–4.
[291] The notion of adequacy should take into account the size of the firm, the nature of its business, and the types and amount of risks it undertakes.
[292] This evaluation should be performed by someone of sufficient autonomy so as not to compromise the evaluation.

and business? When the regulator becomes aware of deficiencies, are steps taken to require market intermediaries to improve their compliance function?

5. Does the regulatory framework require a market intermediary to establish and maintain appropriate systems of client protection, risk management, and internal and operational controls, including policies, procedures and controls relating to all aspects of its day-to-day business intended reasonably to ensure:

a. The integrity of the firm's dealing practices, including the treatment of all clients in a fair, honest and professional manner?

b. Appropriate segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, may result in undetected errors, or may be susceptible to abuses, which expose the firm, or its clients, to inappropriate risks?

6. Taking into account CPICM 8, does the regulatory framework require a market intermediary:[293]

a. To endeavour to address a conflict of interest arising between its interests and those of its clients, or between its clients?

b. Where the potential for conflicts arises:

i. to have mechanisms in place to manage conflicts of interests that seek to ensure an unbiased decision-making process and fair treatment of all its clients; and

ii. consider further steps if the mechanisms identified in (a) prove inadequate, which may include disclosure of the conflict, internal rules of confidentiality, and declining to act where a conflict cannot be resolved?

7. If DEA is allowed, does the regulatory framework require market intermediaries to use controls, including automated pre-trade controls, which can limit or prevent a

[293] *Market Intermediary Management of Conflicts that Arise in Securities Offerings*, Final Report, Report of the Technical Committee of IOSCO, November 2007, Part 2, at pp. 7–14, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD257.pdf; *IOSCO Statement of Principles for Addressing Sell-side Analyst Conflicts of Interest*, supra.

DEA client from placing an order that exceeds the market intermediary's existing position or credit limits?[294]

Protection of Clients

8. If a market intermediary has control of, or is otherwise responsible for, assets belonging to a client which it is required to safeguard, are there regulations that require proper protection for them (for example, segregation and identification of those assets) by the market intermediary? Do these measures facilitate the transfer of positions and assist in the orderly winding-up in the event of financial insolvency and the return of client assets?

9. Does the regulatory framework require market intermediaries to maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held? Does the regulatory framework require that the records be maintained in such a way that they may be used as an audit trail?[295]

10. Where client assets are to be held or placed in a foreign jurisdiction and will be subject to the client asset protection and/or insolvency regimes of that foreign jurisdiction and not the home jurisdiction, does the regulatory framework require the intermediary to inform the clients of that fact? Does the regulatory framework require market intermediaries to provide any required disclosures of the relevant client asset protection regime(s) and arrangements and the consequent risks involved in writing, which is prepared in clear, plain, concise and understandable language and that avoids the use of legal or financial jargon that is not commonly understood?

11. Does the regulatory framework require market intermediaries to provide for an efficient and effective mechanism to address investor complaints?

12. Does the regulatory framework require market intermediaries to identify, and verify, the client's identity using reliable, independent data, including persons who beneficially own or control securities?

13. Does the regulatory framework require market intermediaries to obtain and retain information from a client about their circumstances and investment objectives relevant to the services to be provided?

[294] See *Principles for Direct Electronic Access to Markets,* supra, p. 20.
[295] *Recommendations Regarding the Protection of Client Assets,* supra, p. 3 (Principle 1).

14. Does the regulatory framework require a market intermediary to "know its customer" before providing specific advice to a client?

15. Does the regulatory system require that intermediaries, as defined in IOSCO's *Report on Suitability Requirements with Respect to the Distribution of Complex Financial Products* [296] adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing complex financial products?

16. Does the regulatory framework require market intermediaries to keep records containing the above information for a reasonable number of years? Is the market intermediary required to maintain those books and records in such a way that allows the supervisor to be able to find all the relevant facts relating to a particular transaction?

17. Does the regulatory framework require market intermediaries to provide to the client a written contract of engagement or account agreement, or a written form of the general and specific conditions of doing business through the market intermediary?

18. Does the regulatory framework require a market intermediary to disclose, or make available, information to its client so that the client can make an informed investment decision?

19. Does the regulatory framework require market intermediaries to provide a client with statements of account (including details on the client assets held for or on behalf of such a client) on a regular basis (at least annually) and reasonably promptly upon request?[297]

20. Does the regulatory framework require market intermediaries to provide a client with information about any fees and commissions associated with the client's transactions?

21. Does the regulatory regime require that disclosures of key information regarding ICIS to retail investors in their distribution prior to subscription be clear, accurate and not misleading to the target investor?

[296] See Key Issue 8 and footnote 280.
[297] *Recommendations Regarding the Protection of Client Assets,* supra, p. 3 (Principle 2).

22. Does the regulatory framework require market intermediaries to act with due care and diligence in the best interests of its clients and their assets and in a way that helps preserve the integrity of the market?

23. Can the regulator demonstrate that it has in place a supervision programme, including internal processes that seek to monitor compliance by market intermediaries with these requirements?[298]

Explanatory Notes

629. Treatment of client assets also may be relevant to adequacy of capital as addressed in CPICM 31.

630. What constitutes adequate disclosure by a market intermediary may depend on the type of services being offered. For example, the disclosures required of a pure order taker would be different from those of a full-service broker also providing investment advice.

631. Key Question 19 should not be interpreted as imposing or requiring a fiduciary duty on all market participants in dealing with their clients.

632. The term "compliance function" is used as a generic reference to refer to the range of roles and responsibilities for carrying out specific compliance activities and responsibilities. The expression does not intend to denote any particular organisational structure, recognising the diversity of size and type of securities firms.[299]

633. In smaller firms, there may be an overlap between senior management who trade or provide advice and the compliance function. In such a case, procedures are required to prevent conflicts of interest or other problems regarding the performance of their compliance responsibilities. [300]

[298] Id, p. 7 (Principle 7).
[299] See *Compliance Function at Market Intermediaries,* supra, p. 7.
[300] See id, p. 12. Assessors need to recognise the difficulty of achieving complete independence for the compliance function in smaller firms.

Benchmarks

Fully Implemented

634. Requires affirmative responses to all applicable Questions.

Broadly Implemented

635. Requires affirmative responses to all applicable Questions except to Question 11.

Partly Implemented

636. Requires affirmative responses to all applicable Questions except to Questions 3, 5(a), 5(b), 6(a) or 6(b), 7 (if applicable), 10, 11, 12, 14, 17, 18 and 21.

Not Implemented

637. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 2, 4, 8, 9, 13, 15, 16, 19, 20, 22, 23.

CPICM 33: There should be procedures for dealing with the failure of a market intermediary in order to minimise damage and loss to investors and to contain systemic risk. (IOSCO 32)

638. The failure of a market intermediary can have a negative impact on clients and counterparties and may have systemic consequences. The regulator must have a clear and flexible plan in place to deal with the eventuality of failure by market intermediaries.

Key Issues

1. The regulator should have a clear plan for dealing with the eventuality of failure by market intermediaries. The circumstances of financial failure are unpredictable, so the plan should be flexible.

2. The regulator should attempt to minimise damage and loss to investors and to the functioning of the financial system caused by the failure of a market intermediary. A combination of actions may be necessary:

   a. to restrain conduct;

   b. to aim to ensure that assets are properly managed; and

   c. to provide information to the market.

3. Depending upon the prevailing domestic bank regulatory model, it may also be necessary to cooperate with banking regulators and, if the domestic arrangements require it, insolvency authorities. As a minimum position, the regulator should have identified contact persons at other relevant domestic and foreign market authorities.[301]

4. The regulator should have a mechanism/monitoring system in place to determine the potential systemic impact of the failure of a market intermediary in a very short time frame.

[301] See *Report on Cooperation between Market Authorities and Default Procedures*, Report of the Technical Committee of IOSCO, March 1996, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD49.pdf.

Key Questions

1. Does the regulator have clear plans for dealing with the eventuality of a firm's failure, including a combination of activities: to restrain conduct; to ensure assets are properly managed; and to provide information to the market, as necessary?

2. Are there early warning systems or other mechanisms in place to give the regulator notice of a potential default by a market intermediary, and time to address the problem and take corrective actions?

3. Does the regulator have the power to take appropriate actions (which are, where applicable, in line with Sharī'ah rules and principles): In particular, can it:

    a. Restrict activities of the market intermediary with a view to minimising damage and loss to investors?

    b. Require the market intermediary to take specific actions – for example, moving client accounts to another market intermediary?

    c. Request appointment of a monitor, receiver, curator or other administrator, or, in the absence of such power, can the regulator apply to the relevant authorities to take possession or control of the assets held by the market intermediary or by a third party on behalf of the market intermediary?

    d. Apply other available measures intended to minimise client, counterparty and systemic risk in the event of intermediary failure, such as client and settlement *takāful* schemes or guarantee funds?

4. Can the regulator demonstrate that it has the power and practical ability to take these actions against a market intermediary?

5. Do the regulator's processes and procedures for addressing financial disruption include communication and cooperation with other regulators, both domestic and foreign, where appropriate, and is there evidence that contact arrangements are in place and that such cooperation occurs?

Explanatory Notes

639. In assessing the adequacy of the regulatory regime to protect client assets in the possession of failed or failing market intermediaries, in addition to consideration of the adequacy of capital and other prudential regulations, it is appropriate to consider the adequacy of arrangements for segregation, if applicable. Also, it is appropriate to consider the availability and adequacy of *takāful* and/or compensation schemes designed to protect clients' funds and securities in the event of a market intermediary's insolvency, as well as settlement assurance schemes or other arrangements that may minimise counterparty and systemic risk.

640. The assessor should indicate what combination of arrangements is available and how they are intended to mitigate risk.

641. Assessments of CPICM 33 should be consistent with any findings under the assessment of CPICM 6 on systemic risk, and with any findings related to risk management practices under CPICM 30 and 31.

Benchmarks

Fully Implemented

642. Requires affirmative responses to all applicable Questions.

Broadly Implemented

643. Requires affirmative responses to all applicable Questions except to Question 3(d).

Partly Implemented

644. Requires affirmative responses to all applicable Questions except to Questions 3(b), 3(c) and 3(d).

Not Implemented

645. Inability to respond affirmatively to one or more of Questions 1, 2, 3(a), 4 and 5.

BIBLIOGRAPHY FOR PRINCIPLES RELATING TO MARKET INTERMEDIARIES

	Documents	**CPICM**	**Other CPICM**
1	IFSB-9: *Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services,* https://ifsb.org/download.php?id=4365&lang=English&pg=/published.php	32	
2	*Recommendations Regarding the Protection of Client Assets*, Report of the Board of IOSCO, January 2014, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf	32 32	
3	*Suitability Requirements with Respect to the Distribution of Complex Financial Products*, Report of the Board of IOSCO, January 2013, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD400.pdf	32	
4	*Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf	32 34	

	Documents	CPICM	Other CPICM
5	*Fit and Proper Assessment – Best Practice*, Final Report, Report of the Emerging Markets Committee of IOSCO, December 2009, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD312.pdf	30	
6	*Principles of Point of Sale Disclosure*, Report of the Technical Committee of IOSCO, November 2009, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD310.pdf	32 32	
7	*Market Intermediary Management of Conflicts that Arise in Securities Offerings*, Final Report, Report of the Technical Committee of IOSCO, November 2007, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD257.pdf	32	
8	*Guidance to Emerging Market Regulators Regarding Capital Adequacy Requirements for Financial Intermediaries*, Report of the Emerging Markets Committee of IOSCO, December 2006, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD230.pdf	31	

	Documents	CPICM	Other CPICM
9	*Regulatory and Market Differences: Issues and Observations*, Report of the Joint Forum, May 2006, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD215.pdf	31	
10	*Compliance Function at Market Intermediaries*, Final Report, Report of the Technical Committee of IOSCO, March 2006, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD214.pdf	32	
11	*Principles on Outsourcing of Financial Services for Market Intermediaries*, Report of the Technical Committee of IOSCO, February 2005, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD187.pdf	32 32	
12	*Outsourcing in Financial Services*, Report of the Joint Forum, February 2005, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD184.pdf	32	10 18
13	*Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, Report of the Technical Committee of IOSCO, November 2004,	30	26 28

	Documents	CPICM	Other CPICM
	http://www.iosco.org/library/pubdocs/pdf/IOSCOPD178.pdf		
14	*Principles on Client Identification and Beneficial Ownership for the Securities Industry*, Report of IOSCO, May 2004, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD167.pdf	32	11
15	*Report on Securities Activity on the Internet III*, Report of the Technical Committee of IOSCO, October 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD159.pdf	32	12 13 17
16	*IOSCO Statement of Principles for Addressing Sell-Side Analyst Conflicts of Interest*, Report of the Technical Committee of IOSCO, September 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf	32	25
17	*Trends in Risk Integration and Aggregation*, Report of the Joint Forum, August 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD149.pdf	31	

	Documents	CPICM	Other CPICM
18	*Operational Risk Transfer Across Financial Sectors*, Report of the Joint Forum, August 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD148.pdf	31	
19	*Initiatives by the BCBS, IAIS and IOSCO to Combat Money Laundering and the Financing of Terrorism*, Report of the Joint Forum, June 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD146.pdf	32	11
20	*Sound Practices for the Management of Liquidity Risk at Securities Firms*, Report of the Technical Committee of IOSCO, June 2002, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD128.pdf	31	
21	*Risk Management Practices and Regulatory Capital: Cross-Sectoral Comparison*, Report of the Joint Forum, November 2001, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD122.pdf	31	
22	Securities Activity on the Internet II, Report of the Technical Committee of IOSCO, June 2001,	34	12 17

	Documents	CPICM	Other CPICM
	http://www.iosco.org/library/pubdocs/pdf/IOSCOPD120.pdf		
23	*Multidisciplinary Working Group on Enhanced Disclosure*, Joint Report of the Basel Committee on Banking Supervision, the Committee on the Global Financial System of the G-10 Central Banks, the International Association of Insurance Supervisors and IOSCO, April 2001, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD116.pdf	31	
24	*Securities Activity on the Internet*, Report of the Technical Committee of IOSCO, September 1998, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD83.pdf	32 34	12 14 17
25	*Methodologies for Determining Minimum Capital Standards for Internationally Active Securities Firms which Permit the Use of Models under Prescribed Conditions*, Report of the Technical Committee of IOSCO, May 1998, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD77.pdf	31	

	Documents	CPICM	Other CPICM
26	*Report on Cooperation between Market Authorities and Default Procedures*, Report of the Technical Committee of IOSCO, March 1996, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD49.pdf	33	37
27	*Operational and Financial Risk Management Control Mechanisms for Over-the-Counter Derivatives Activities of Regulated Securities Firms,* Report of IOSCO, July 1994, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD35.pdf		
28	*Capital Requirements for Multinational Securities Firms*, Report of the Technical Committee of IOSCO, November 1990, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD14.pdf	31	
29	*International Conduct of Business Principles*, Report of the Technical Committee of IOSCO, July 1990, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD8.pdf	32	
30	*Capital Adequacy Standards for Securities Firms*, Report of IOSCO, October 1989,	31	

	Documents	CPICM	Other CPICM
	http://www.iosco.org/library/pubdocs/pdf/IOSCOPD1.pdf		
31	*Resolution on Rules of Ethics of Intermediaries*, Resolution of the Presidents' Committee of IOSCO, September 1989, http://www.iosco.org/library/resolutions/pdf/IOSCORES43.pdf	32	

2.10 Principles Relating to Secondary Markets and Other Markets

2.10.1 Preamble

646. Regulators in all jurisdictions acknowledge that investors want fair, efficient and transparent markets. The CPICM under this section are intended to promote these objectives. The fairness of the markets is closely linked to investor protection and to the prevention of improper trading practices.

647. In CPICM 34 to 38, the word "markets" should be understood in its widest sense, including any facility used to trade Sharī'ah-compliant securities or where applicable to Islamic capital markets, Sharī'ah-compliant hedging products, or structured products that may be used in certain jurisdictions for risk management purposes. The word "markets" used in this section does not cover public offerings of securities that are meant to be dealt with under CPICM 17 through 19 relating to issuers. In addition to traditional organised exchanges, secondary and other markets should be understood to include various forms of non-exchange trading market systems. These systems include, among others, alternative trading systems (ATSs), multilateral trading facilities (MTFs), organised trading facilities (OTFs), and "proprietary" systems developed by intermediaries, typically offering their services to other brokers, banks and institutional/retail investors who meet the operator's credit standards.

648. Notwithstanding the broad meaning of "markets", for assessment purposes this Methodology is directed to topics that have been addressed by IFSB Standards and IOSCO reports which are broadly applicable to Islamic capital markets. Authorised exchanges and regulated trading systems – that is, market systems that bring together multiple buyers and sellers in a manner that results in completed transactions or trades – are the main focus of this assessment.

649. Regulation appropriate to a particular secondary or other market will depend upon the nature of the market, its products and its participants. The applicable CPICM help to ensure that such markets serve their fundamental price discovery and hedging functions, while operating free from manipulation and susceptibility to abusive trading schemes.

650. Regulation will increasingly need to take account of the growing internationalisation of trading, and the impact of technological developments on markets and their infrastructure.[302]

651. The operation of some exchanges and trading systems is performed by the markets and systems themselves. In others, it is undertaken by a separate entity that acts as the operator. In this section, the terms “authorised exchange” and “regulated trading system” should be understood to include both of these types of exchanges and trading systems.[303]

652. The level of regulation will depend upon the characteristics of the market in question, including: (a) the level of development of the Islamic capital market sector, the structure of the market and the sophistication of its participants; (b) rights of access; (c) types of products traded; (d) the degree of integration with other markets; (e) the extent of cross-border business; (f) the impact of technological developments; and (g) the ability of the operators to fulfil any self-regulatory and risk management role under the powers and authority granted by law.

653. Because regulation may differ according to market structure, market participant or product, information about such differences, and the rationale for such differences, is an important component of any assessment. For example, the CPICM do not specify particular regulatory methodologies. In most cases, the CPICM may be implemented by legislation, administrative rules, advisories, guidelines or procedures, market rules, equitable principles of trade or best practices, or professional market codes of conduct, agreed market conventions or, for electronic markets, integrated into the algorithm; provided, however, that whatever method of implementation is chosen is enforceable to the extent necessary to achieve its objectives and takes into account the Benchmarks.

654. Accordingly, in order to accurately assess regulatory structure, assessors must understand the market structure, including clearing and settlement arrangements, types of participants and international linkages (both foreign and domestic). The introduction to this Assessment Methodology provides further guidance regarding the effect of market structure on the approach to undertaking an assessment.

[302] See *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency*, Report of the Technical Committee of IOSCO, October 2011, p. 7 et seq., available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD361.pdf.

[303] References to “operator” herein should be understood to include the authorised exchange or regulated trading system, and vice versa.

655. The CPICM also recognise that "in some cases it will be appropriate that a trading system should be largely exempt from direct regulation…" but will require approval from the relevant regulator after proper consideration by the regulator of the type of approval (or exemption) necessary. If this is the case, the criteria should be transparent, accessible and consistently applied.[304] The effect of exemptions on the market and public may be relevant to inquiries into the "perimeter of regulation" inquiry under CPICM 7.

656. In addition, in many jurisdictions, the authorisation or recognition process and relevant requirements for electronic trading systems sponsored by foreign operators may differ from the process for fully domestic systems.[305] Similarly, some jurisdictions may provide tiered levels of regulation for markets, depending upon the type of product traded and sophistication of the participants. Still other jurisdictions regulate alternative trading systems as brokers and apply regulation consistent with that for market intermediaries under the CPICM coupled with certain rules on transparency, insider trading and market abuse prohibitions. Such flexibility in regulation is consistent with the CPICM. Differences related to the type of service provided, product traded and participants in the market are generally accepted bases for drawing appropriate regulatory distinctions.[306]

657. Confidence in the rule of law, the enforceability of contracts, and the adequacy of commercial and insolvency law are critical to the effective regulation of secondary and other markets, so to the extent gaps exist these should be identified in the assessment.

2.10.2 Scope

658. CPICM 34 to 38 examine how a jurisdiction's overall regulatory structure ensures the integrity of regulated markets.

659. CPICM 34 and 35 examine the general requirements for authorisation of exchanges and trading systems and their ongoing supervision. Specifically, CPICM 34 examines the criteria that are required when an exchange or trading system is *initially*

[304] For example, exemption from some requirements for trading systems with limited trading volumes may be appropriate. Also, in many jurisdictions, the trading markets for sovereign (and, in some cases, sub-sovereign) *ṣukūk* are not subject to regulation, or are subject to more limited regulation, than the trading markets for corporate securities.

[305] There should, however, be no unnecessary barriers to entry and exit from markets and products. In some cases, these may be caused by laws not subject to the control of regulators, such as fiscal or other general laws. For example, however, access criteria can be based on mutual recognition, additional disclosure or other requirements.

[306] See *Supervisory Framework for Markets*, Report of the Technical Committee of IOSCO, May 1999, Section IV.A (Alternative Trading Systems), at p. 13, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf.

authorised in a jurisdiction. CPICM 35, on the other hand, examines the procedures by which the regulator is assured of the ongoing compliance by an authorised exchange or regulated trading system with the relevant conditions thought necessary as prerequisites to authorisation.

660. CPICM 36, 37 and 38 focus on specific regulatory objectives that are intended to promote market integrity. CPICM 36 focuses on the extent to which the regulatory structure promotes transparency (defined in terms of the availability of pre-trade and post-trade information), which is important for the price discovery process, mitigating the potentially adverse impact of market fragmentation, with respect to pre-trade transparency, and/or the efficient functioning of the market, with respect to post-trade transparency.[307] CPICM 37 focuses on the regulations and mechanisms that prohibit, detect and deter manipulative (or attempts at manipulative) conduct, fraudulent or deceptive conduct, or other market abuses. Finally, CPICM 38 focuses on the mechanisms in place to ensure the proper management of large exposures, defaults and market disruptions.

[307] See *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, pp. 69–70.

2.10.3 CPICM 34 through 38

CPICM 34: The establishment of trading systems including securities exchanges should be subject to regulatory authorisation and oversight. (IOSCO 33)

661. The regulator's authorisation of exchanges and trading systems, including the review and approval of trading rules, helps to ensure fair and orderly markets.[308] The fairness of markets is closely linked to investor protection and, in particular, by the prevention of improper trading practices.

662. Regulation should seek to ensure that investors are provided fair access to market facilities on a non-discriminatory basis. Regulation should promote market practices and structures that ensure fair treatment of orders and a reliable price formation process. This includes the requirement of an appropriate post-trade reporting system that provides the public promptly with information concerning the prices at which trades were executed.

663. If an exchange or trading system admits the trading of Sharīʿah-compliant products that are marked as such, and has the responsibility to determine their compliance with Sharīʿah requirements, the regulatory system should ensure that such exchanges have the capability, appropriate resources and internal processes which provide reasonable assurance that the issuer is complying with the relevant Sharīʿah requirements, including disclosure of any material changes.

Key Issues

Criteria for Authorisation

Exchanges or Trading Systems Subject to Regulation

1. Regulation should provide for the assessment of the initial and ongoing propriety and competence of the operator of an exchange or trading system as a secondary or other market as defined in the Preamble. The operator should be accountable to the regulator and, when assuming principal, settlement, guarantee or

[308] Assessors should refer to the following IOSCO reports for background – in particular, regarding trading rules and the promotion of fair and orderly markets: *Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems*, Report of IOSCO, October 1994, p. 5 et seq., available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD42.pdf. See also *Securities Activity on the Internet*, supra, p. 19 et seq.; and *Securities Activity on the Internet II*, supra, p. 6 et seq. (on information sharing).

performance risk,[309] must comply with prudential and other requirements designed to reduce the risk of non-completion of transactions.

2. Where an exchange or trading system has responsibility for determining whether a product is Sharīʿah-compliant or not, regulators should ensure that the exchange has the proper resources and competency to do so.

3. Where an exchange or trading system admits Islamic products other than Sharīʿah-compliant shares to trading (such as *ṣukūk*), it should have sufficient knowledge to properly evaluate product design and other relevant features.

Supervision

4. The regulator should assess the reliability of all the arrangements made by the operator for the monitoring, surveillance and supervision of the exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, and compliance with Sharīʿah requirements and securities legislation. There must be mechanisms in place to identify and address disorderly trading conditions and to ensure that contravening conduct, when detected, will be dealt with. Details of trading control mechanisms (including, but not limited to, trading halts, volatility interruptions, limit-up/limit-down controls, and other trading limitations)[310] and assistance available to the regulator in circumstances of potential trading disruption on the market should be provided to the regulator.

5. In order to provide an appropriate level of stability, regulators should require trading venues to have in place mechanisms to help ensure the resiliency, reliability and integrity (including security) of critical systems.[311] While the prevention of failures is important, trading venues should also be required to be prepared for dealing with such failures and, in this context, establish, maintain and implement as appropriate a business continuity plan.[312]

[309] Principal, settlement, guarantee or performance risk can be assumed through a *takaful* fund or a *takaful* scheme whereby all market participants become members of such a fund. Another scenario is where the exchange assumes such risks only on a *tabarru*' basis without stipulating this as a condition. In a third scenario, the exchange would act as a third-party guarantor or a *kafīl*, assuming these risks without any counter-value. However, in cases of negligence or misconduct the exchange will be held liable.

[310] See Recommendation 2 in *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, p. 45.

[311] See Recommendation 1 in *Mechanisms for Trading Venues to Effectively Manage Electronic Trading Risks and Plans for Business Continuity*, Final Report, Report of the Board of IOSCO, December 2015, p. 18, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD522.pdf.

[312] See id, Recommendation 2, at p. 34.

6. When functions are outsourced, such outsourcing does not negate the liability of the outsourcing market for any and all functions that the market may outsource to a service provider. The outsourcing market must retain the competence and ability to be able to ensure that it complies with all regulatory requirements. Accordingly, with respect to the outsourcing of key regulatory functions, markets should consider how and whether such functions may be outsourced. Outsourcing should not be permitted if it impairs the market authority's[313] ability to exercise its statutory responsibilities, such as proper supervision and audit of the market.

Products and Participants

7. The regulator should, as a minimum requirement, be informed of the types of securities and products to be traded on the exchange or trading system, and should review/approve the rules governing the trading of the product, where applicable. In doing so, the market and/or the regulator should:

a. Consider product design principles, where applicable, listing requirements and trading conditions.

b. Ensure that access to the system or exchange and to associated products is fair, transparent and objective, and consider the related admission criteria and procedures.[314]

Execution Procedures

8. The order execution rules, as well as any cancellation procedures, should be disclosed to the regulator and to market participants, and should be applied fairly to all participants.

The exchange or trading system's order routing procedures should also be clearly disclosed to the regulator and to market participants, applied fairly, and should not be inconsistent with relevant securities regulation (e.g., client precedence or prohibition

[313] The term "market authority" is used in this context to refer to the authority in a jurisdiction that has statutory or regulatory powers with respect to the exercise of certain regulatory functions over a market. The relevant market authority may be a regulatory body, an SRO and/or the market itself: *Principles on Outsourcing by Markets*, Final Report, Report of the Technical Committee of IOSCO, July 2009, footnote 2, p. 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD299.pdf.

[314] See *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, p. 45.

of front running or trading ahead of customers).[315]

9. The fairness of latency differences resulting from different technical connection options and, in particular, from co-locating high speed algorithmic trading systems[316] adjacent to exchange servers raises significant technical and market integrity issues.[317]

10. Direct electronic access (DEA) refers to the process by which a person transmits orders on their own (i.e., without any handling or re-entry by another person) directly into the market's trade matching system for execution.[318]

11. A market should not permit DEA unless there are in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate trading limits.[319]

12. Markets should provide member intermediaries with access to pre-trade and post-trade information (on a real-time basis) to enable these intermediaries to implement appropriate monitoring and risk management controls.[320]

Trading Information

13. Information on completed transactions, trading information and rules and operating procedures[321] should be available, and the regulator should verify that it is provided on an equitable basis to all similarly situated market participants.[322]

In an environment where trading occurs across multiple trading spaces, regulators should seek to ensure that proper arrangements are in place in order to facilitate the

[315] Not all jurisdictions grant SRO obligations to markets. The specific responsibilities of a market will always be defined by the applicable laws and regulations.
[316] The use of such algorithmic trading systems involves complex mechanisms that may result in committing Sharīʿah prohibitions or the violation of Sharīʿah parameters in regards to the buying and selling of securities and, as a result, should be avoided. In particular, it may contravene the Sharīʿah principle that a person should not sell securities that he does not possess, possession implying not only that a purchase has been agreed but that the transaction has been settled by delivery of the securities.
[317] See *Principles for Direct Electronic Access to Markets,* supra, p. 15.
[318] Id, Appendix 1, definition of DEA.
[319] Id, p. 20, Principle 6.
[320] Id, p. 17, Principle 5. This Principle reflects the Technical Committee's recognition that in the dispersed world of electronic trading, intermediaries must have timely access to relevant pre-trade and post-trade information in order to facilitate the performance of their traditional risk management functions in the context of DEA.
[321] Dark pools, and transparent markets that offer dark orders, should provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed: see Principle 5 at p. 30 in *Principles for Dark Liquidity*, Final Report, Report of the Technical Committee of IOSCO, May 2011, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD353.pdf.
[322] Market participants include not only market members, but also investors in a larger sense.

consolidation and dissemination of information as close to real time as is technically possible and reasonable.[323]

a. Any categorisation of participants, for the purpose of access to pre-trade information, should be made on a reasonable basis.

b. Any differential access to such information should not unfairly disadvantage specific categories of participants.

14. Full trade documentation and an audit trail should be available to the regulator.

Key Questions

Exchanges or Trading Systems Subject to Regulation

1. Does the establishment of an exchange or trading system[324] require authorisation?

2. Are there criteria for the authorisation[325] of exchange and trading system operators that:

a. Require analysis and authorisation of the market by a competent authority?

b. Seek evidence of operational or other competence of the operator of an exchange or trading system?

c. Require the operator of an exchange or trading system that assumes principal, settlement, guarantee or performance risk, to comply with prudential and other requirements designed to reduce the risk of non-completion of transactions (e.g., mandatory margin assessment and collection, capital or financial resources, member contributions, guaranty fund, credit or position limits on Sharīʿah-compliant trades)?

[323] See Recommendation 2 in *Regulatory Issues Raised by Changes in Market Structure*, Final Report, Report of the Board of IOSCO, December 2013, p. 21, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD431.pdf.

[324] To the extent a trading system is treated as a broker, the applicable requirements under these CPICM would be those related to market intermediaries, coupled with any transparency, insider trading or market abuse requirements.

[325] The term "authorisation" should be interpreted to include "licensed", "granted authority to do investment business" or "recognition".

d. Permit the regulator to impose ongoing conditions (as appropriate) on the operator of an authorised exchange or regulated trading system, such as the obligation to establish: rules; policies; and procedures, to prevent fraudulent behaviour, treat all members or participants fairly, and have the capacity to carry out the market's and the competent authority's obligations?[326]

e. Require the operator of an exchange that is responsible for determining the Sharī'ah compliance of a product, to have the necessary resources and competency to make such a determination?

f. Require an exchange to have sufficient knowledge to evaluate product design and other relevant features of Islamic instruments if the exchange admits Islamic products other than Sharīʿah-compliant shares (such as *ṣukūk*) to trading?

Supervision [327]

3. Does regulation require an assessment of:

a. The reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange or trading system and its members or participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with Sharī'ah requirements and securities legislation? The market's dispute resolution and appeal procedures or arrangements as appropriate, its technical systems standards and procedures related to operational failure, information on its recordkeeping system, reports of suspected breaches of law, arrangements for holding client funds and securities, if applicable, and information on how trades are cleared and settled?

b. Whether the trading venue has in place suitable trading control mechanisms (such as trading halts, volatility interruptions, limit-up/limit-

[326] *Supervisory Framework for Markets*, supra, states at p. 7: "Through the authorisation process, the regulator retains an important enforcement tool: the ability to prohibit or place restrictions upon operations." This is implicit in the concept of being "accountable".
[327] Id, pp. 8–9.

down controls and other trading limitations) to deal with volatile market conditions?[328]

c. Assistance available to the regulator, in circumstances of potential trading disruption on the system?

d. Whether the relevant market authority (i.e., the regulator or relevant SRO), the outsourcing market, and its auditors, have: access to the books and records of service providers relating to an exchange's outsourced activities; and the ability to obtain promptly, upon request, other information concerning activities that are relevant to regulatory oversight?

Fairness of Order Execution Procedures

4. With respect to order execution procedures:

a. Are order routing procedures clearly disclosed to regulators and to market participants, applied fairly, and not inconsistent with relevant securities regulation (e.g., requirements with respect to precedence of client orders and prohibition of front running or trading ahead of customers)?[329]

b. Are execution rules disclosed to the regulator and to market participants, and consistently applied to all participants?

c. Where applicable, does the regulator review the trade matching or execution algorithm of automated trading systems for fairness?

d. Do all system users have equal opportunity to connect, and maintain the connection to, the electronic trading system, and are differences in order execution response times disclosed by the system operator?

e. Are there in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate risk limits?

[328] See Recommendation 2 in *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, p. 45.

[329] Regulatory issues may depend on whether orders are transmitted to an organised regulated market or to other regulated trade execution and matching systems. See also the discussion in paras 67–73 of *Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems*, supra.

Operational Information

5. With respect to trading information:

   a. Do similarly situated market participants have equitable access to market rules and operating procedures?

   b. Are adequate records (i.e., audit trails) available to reconstruct trading activity within a reasonable time?

   c. Is the system capable of disclosing the types of information that it is designed to make available, and, conversely, of providing safeguards to preserve the confidentiality of other information, the disclosure of which is not intended?

   d. Does the market provide member intermediaries with access to relevant pre- and post-trade information (on a real-time basis) to enable these intermediaries to implement appropriate monitoring and risk management controls?

Explanatory Notes

664. Not all of the regulatory objectives set out above would apply to ATSs, MTFs or proprietary trading systems in the same way.[330] For example, some jurisdictions use a combination of intermediary and market regulation for trading systems. In addition, in some jurisdictions, only exchanges may have rules relating to disciplining members or participants. However, trading systems should have mechanisms for ensuring compliance with, at a minimum, securities legislation.

665. The assessor should understand the regulatory structure used by the jurisdiction and apply the appropriate Benchmarks. For example, when combinations of regulatory programmes are used, some trading systems may be regulated under CPICM for Market Intermediaries, subject to adequate transparency arrangements and market abuse prohibitions and surveillance. This observation also applies to CPICM 35 and 36.

[330] The extent to which a jurisdiction regulates these types of trading systems will vary. Not all jurisdictions authorise or otherwise regulate ATSs or proprietary trading systems.

666. The availability of trading information, particularly when combined with the speed of electronic trading technology and the increased linkages among markets, both within the market's jurisdiction and in other jurisdictions where traders or information providers have access to the market, can exacerbate the market consequences of transactions that are executed in error. A regulator's assessment into the reliability of all arrangements made by the operator for the monitoring, surveillance and supervision of an exchange, or trading system, should include, among other things, a consideration of the need of an exchange, or a trading system, for adopting error trade policies.[331]

667. More broadly, a regulator's review of an exchange, or a trading system, should inquire into any linkages or inter-connections with other trading venues, both domestic and outside the jurisdiction.[332]

668. A regulator may recognise an exchange, or trading system, established in another jurisdiction based on the equivalence, or comparability, of the regulation applicable to the market in its domestic jurisdiction consistent with these CPICM. In cases of multiple markets, the assessor will be required to form a judgment about the criteria applied by the regulator having due regard to the volume of trading and turnover, and the related importance of the market.

669. Assessors should consider a CPICM to be *Not Applicable* whenever it does not apply given the nature of the securities market in the given jurisdiction (where there is no operating exchange or trading system, established, or operating, within the jurisdiction), and relevant structural, legal, and institutional considerations. In such a case, the reason for the determination should be documented.

[331] See *Policies on Error Trades*, Final Report, Report of the Technical Committee of IOSCO, October 2005, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD208.pdf. Recommendation 7, at p. 16, states that "market supervisors should support the implementation of error trade policies that are consistent with [the report]".

[332] A variety of IOSCO Reports have discussed the implications of "linkages" or "inter-connections" among trading systems and products as well as the need for regulators to cooperate and share information to address these cross-market and cross-jurisdictional effects. As general background on this issue, see e.g. *Principles Regarding Cross-Border Supervisory Cooperation*, supra; *Multi-Jurisdictional Information Sharing for Market Oversight*, supra; *Regulatory Issues Arising from Exchange Evolution,* Final Report, Report of the Technical Committee of IOSCO, November 2006, p. 26 et seq., available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD225.pdf; *Report on Trading Halts and Market Closures*, Report of the Technical Committee of IOSCO, November 2002, p. 23 et seq., available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD138.pdf; See generally recommendation 11 – risks in links between CCPs in *Recommendations for Central Counterparties*, Final Report, Report of the Technical Committee of IOSCO and the Committee on Payment and Settlement Systems (CPSS), November 2004, available at https://www.iosco.org/library/pubdocs/pdf/ IOSCOPD176.pdf. See also Responsibility E in *Principles for Financial Market Infrastructures*, Report of the Technical Committee of IOSCO and the CPSS, April 2012, available at http://www.iosco.org/library/pubdocs/pdf/ IOSCOPD377-PFMI.pdf.

Benchmarks

Fully Implemented

670. Requires affirmative responses to all applicable Questions.

Broadly Implemented

671. Requires affirmative responses to all applicable Questions except to Question 3(b) in so far as it pertains to dispute resolution or applicable appellate procedures, and to Question 4(c).

Partly Implemented

672. Requires affirmative responses to all applicable Questions except to Questions 4(c), 4(d) and 5(b) and Question 3(b) as otherwise permitted under *Broadly Implemented*.

Not Implemented

673. Inability to respond affirmatively to one or more of Questions 1, 2(a), 2(b), 2(c), 2(d), 2(e), 2(f), 3(a), 3(b) subject to the departures set forth in *Broadly Implemented* above, 3(c), 4(a), 4(b), 4(e), 5(a), 5(c) or 5(d).

CPICM 35:	**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. (IOSCO 34)**

674. Orderly smooth functioning markets promote investor confidence. Accordingly, there should be ongoing supervision of the markets.[333]

Key Issues

1. The regulator must remain satisfied that the conditions thought to be necessary pre-requisites of authorisation remain in place during operation.

2. Amendments to the rules or requirements of the authorised exchange or regulated trading system should be provided to, or approved by, the regulator.

3. Authorisation of the authorised exchange or regulated trading system should be re-examined, or withdrawn, when it is determined that the system is unable to comply with the conditions of its authorisation, or with securities law or regulation.

Key Questions

1. Does the regulatory system:

   a. Include a programme whereby the regulator or an SRO, which is subject to oversight by the regulator:

      i. monitors day-to-day trading activity on the exchange or trading system (through a market surveillance programme);

      ii. monitors conduct of market intermediaries (through examinations of business operations); and

[333] See *Supervisory Framework for Markets,* supra, p. 3.

iii. collects and analyses the information gathered through these activities?[334]

b. Include regulatory oversight mechanisms to verify compliance by the exchange, or trading system, with its statutory or administrative responsibilities, particularly as they relate to the integrity of the markets, market surveillance, the monitoring of risks and the ability to respond to such risks?[335]

c. Provide the regulator with adequate access to all pre-trade and post-trade information available to market participants?

2. Does the regulatory framework require that amendments to the rules or requirements of the exchange, or trading system, must be provided to, or approved by, the regulator?

3. When the regulator determines that the exchange, or trading system, is unable to comply with the conditions of its approval, or with securities law or regulation is there a mechanism that permits the regulator to:

a. Re-examine the exchange, or trading system, and impose a range of actions, such as restrictions or conditions on the market operator?

b. Withdraw the exchange, or trading system, authorisation?

Explanatory Notes

675. These issues and questions apply to both exchanges and trading systems; however, they may apply in different ways. For example, an exchange may also act as an SRO and therefore have regulatory responsibilities; a trading system may not act as an SRO. Consequently, the rules or requirements for an exchange will have broader scope-— such as issuer and participant regulation. Trading systems requirements may outline the market structure of the trading system, how orders are entered, interact and are executed. They will not have the same regulatory impact as exchange rules.

[334] See id, p. 9.
[335] Such information can be provided through formal mechanisms, such as written reports and inspections, or through informal mechanisms such as regular meetings: see *Supervisory Framework for Markets*, supra, p. 9.

676. Question 3(a) gives more content to the phrase “re-examine the market’s authorisation.” “Since licence revocation is such a serious disciplinary action, in many cases, market operators will not believe it would ever be used and therefore it may not be an effective deterrent. The regulator also should have the clear power to impose an escalating range of disciplinary actions, such as conditions or restrictions on the market operator. While imposition of these restrictions should be subject to some procedural fairness conditions, the process must not be so slow, or cumbersome, so as to prevent regulators acting swiftly and effectively when required.” If not, the regulator should be invited to discuss how revocation power can be used to buttress its ability to use moral suasion to achieve corrective action.

677. If the regulator does not have authority to withdraw the exchange, or trading system, authorisation because the authorisation was not subject to approval by the regulator (e.g., the exchange was “grandfathered in”), it may be possible to adjust the rating to take account of this fact. In such circumstances, where a negative answer to Question 3(b) is the only reason for a *Not Implemented* rating, it would be permissible for an assessor to conclude that Question 3(b) is answered affirmatively and a *Partly Implemented* rating is warranted, if the regulator demonstrates it has authority to suspend all trading on the exchange or trading system for a period of at least six months.

678. Alternatively, a *Partly Implemented* rating may be justified if the regulator can answer affirmatively to Question 3(a), and the regulator demonstrates that the range of available sanctions and restrictions include the ability to revoke the authority of the market operator, or change the management of the exchange, or trading system.

Benchmarks

Fully Implemented

679. Requires affirmative responses to all applicable Questions.

Broadly Implemented

680. Requires affirmative responses to all applicable Questions except to Question 3(a).

Partly Implemented

681. Requires affirmative responses to all applicable Questions except to Questions 2 and 3(a).

Not Implemented

682. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c) or 3(b).

CPICM 36: Regulation should promote transparency of trading. (IOSCO 35)

683. Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available. The degree of transparency of a market can be measured as a deviation from a real-time standard. Pre-trade information concerns the posting of firm bids and offers, in both quote and order-driven markets, as a means to enable intermediaries and investors ("market participants") to know, with some degree of certainty, whether, and at what prices, they can deal. Post-trade information is related to the prices and volume of all individual transactions actually concluded.

684. Market transparency is generally regarded as central to both the fairness and efficiency of a market, and in particular to its liquidity and quality of price-formation.

685. Pre-trade and post-trade transparency enhances fairness and investor protection by making it easier for investors to monitor the quality of executions that they receive from their intermediaries. Transparency can also help to promote market efficiency. Inefficiencies in the pricing of securities and wider bid-offer spreads can occur when market participants are unaware of others' trading activity. This is particularly the case in dealer-dominated markets where pre-trade quotation information, if it can be obtained at all, can be obtained only from a small number of dealers, thus leaving buy-side clients at an informational disadvantage. Post-trade transparency can reduce information asymmetries between dealers and buy-side clients. If trade prices are publicly known, buy-side market participants will be more likely to question if they are not obtaining prices similar to those at which executions have occurred in the past.

686. 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.

687. Information in respect of the volumes and prices of completed trades enables market participants not only to take into account the most recent information on volumes and prices but also to monitor the quality of executions they have obtained compared with other market users.

688. In general, the more complete and more widely available trading information is, the more efficient the price discovery process should be, and the greater the public's confidence in its fairness.

689. Establishing market transparency standards is not straightforward, as the interest of individual market participants in transparency levels varies. Regulators may not require pre-trade transparency for certain types of market structures (e.g. call markets, reference-pricing venues) or certain types of orders (e.g. large orders of institutional investors that do not wish such orders to be displayed), taking into account the impact on price discovery, fragmentation, fairness and overall market quality considering in particular the relative overall proportion of dark trading compared to lit trading.[336] Regulators need to assess the appropriate level of transparency of any particular market structure with considerable care.[337]

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Key Issues

1. Ensuring timely access to information is key to the regulation of trading in secondary and other markets. Timely access to relevant information about trading in secondary and other markets allows market participants to assess the terms on which they can trade, and the quality of the execution that they receive, and thereby to look after their own interests, and also reduces the potential for manipulative, or other unfair trading practices.[338]

2. Where a market authority permits some derogation from the objective of real-time transparency, either pre-trade or post-trade, the conditions should be clearly defined and the market authority (being either, or both, the exchange operator and the regulator) should have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives.[339]

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[336] See *Principles for Dark Liquidity,* supra, p. 27.

[337] See *Transparency and Market Fragmentation*, IOSCO Report of the Technical Committee of IOSCO, November 2001, pp. 4–5, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD124.pdf. See also *Transparency of Structured Finance Products*, Final Report, Report of the Technical Committee of IOSCO, July 2010, p. 21, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD326.pdf. *Principles for Dark Liquidity*, supra, p. 26.

[338] Discussed in *Transparency on Secondary Markets: A Synthesis of the IOSCO Debate*, Report of the Technical Committee of IOSCO, December 1992, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD27.pdf, in Sections 3 and 4 on the content of information. For a discussion of practice in member jurisdictions, see *Transparency of Corporate Bond Markets*, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf.

[339] See, for example, *Transparency of Structured Finance Products*, supra, p. 25, for a list of non-prescriptive factors that regulators may wish to consider in developing a post-trade transparency regime for structured financial products.

3. Transparent orders should have priority over dark orders at the same price within the same trading venue.

4. Information on completed transactions should be provided on an equitable basis to all market participants including those transactions executed in dark pools, or as a result of dark orders entered into a transparent market.

5. Regulators should periodically monitor the development of dark pools and dark orders in their jurisdictions to seek to ensure that such developments do not adversely affect the efficiency of the price formation process, and take appropriate action as needed.

Key Questions

1. Does the regulatory framework include:

   a. Requirements or arrangements for providing pre-trade (e.g., posting of orders[340]) information to market participants?

   b. Requirements or arrangements for providing post-trade information (e.g., last sale price and volume of transaction) to market participants on a timely basis?

   c. Requirements or arrangements that information on completed transactions be provided on an equitable basis to all market participants?

2. Where derogation from the objective of real-time transparency is permitted:

   a. Are the conditions clearly defined?

   b. Does the market authority (being either, or both, the exchange operator and the regulator) have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives?

[340] Orders do not include non-binding offers.

c. Does the regulator have access to adequate information to monitor the development of dark trading[341] and dark orders?

d. Do transparent orders have priority over dark orders?

e. Do dark pools, and transparent markets that offer dark orders, provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed?

Explanatory Notes

690. Market transparency is generally regarded as central to both the fairness and efficiency of a market, and in particular to its liquidity and quality of price formation.[342] For example, as stated in IOSCO's report *Principles for Dark Liquidity*, the price and volume of firm orders and information regarding trades should generally be transparent to the public. Regulators should support the use of transparent orders, which should have priority over any dark orders at the same price within a trading venue. Regulators should be able to access information regarding dark orders. Market participants should have sufficient information so that they are able to understand the manner in which their dark orders are handled and executed. Regulators should periodically monitor the development of dark pools and dark orders in their jurisdictions.

691. As noted above, the degree of transparency of a market can be measured as a deviation from a real-time standard. However, there is no single standard of "timeliness." Most exchanges and regulatory systems provide for a certain degree of deviation from a real-time standard, such as: permitting some degree of opaqueness of quote information for block transactions; adopting different definitions of "real-time"; adopting a "promptness" standard that varies from several minutes to a longer time; allowing exceptions to real-time based on the size of the trade, type of trade (dealer mediated rather than auction market), or type of dealer and market model. Indeed, each type of market microstructure delivers market fairness, efficiency and transparency in slightly different ways.

[341] If dark trading inflicts harm on market participants and compromises the transparency of the market, it would mean that it is not a Sharīʿah-compliant practice and should be avoided.
[342] See *Transparency and Market Fragmentation,* supra, p. 3.

692. Any derogation to the general requirements relating to post-trade transparency should be explained.[343] Reasonable derogations should not prompt the assignment of the jurisdiction to a lower rating but should be documented. For markets whose participants are largely institutional investors, different transparency standards may be appropriate for the execution of large orders that expose intermediaries to risk and could affect the integrity of the price formation process, liquidity, or the orderly conduct of the market.

693. In all cases, the market authority (being either, or both, the exchange operator and the regulator) should, in any such event, have access to the complete information to be able to assess the need for derogation and, if necessary, to prescribe alternatives. Under any circumstance, the market's regulator should, in carrying out its supervisory role, be aware of the market's transparency decisions. In addition, it is important that regulators monitor the development of dark pools to ensure that they do not adversely impact on the price discovery process of transparent markets. Where regulators are concerned that the development of dark trading [344] may adversely impact the price discovery process they should take appropriate action to address such a distortion.

694. In practice, except for wholesale and certain over-the-counter transaction venues, most markets seek to have post-trade price reporting and publication as close as possible to real-time. Assessments are focused on regulated/organised markets, but any assessment must consider the prevailing structure of markets within the jurisdiction when addressing transparency.

695. In the end, the final approach to transparency - and the degree of timeliness-— is a policy decision, taken at the level of each individual jurisdiction, on how to weigh the conflicting interests of the different market players (small investors, institutions, intermediaries and exchanges).[345] The regulator should provide information, as to the basis for these decisions, and as to how they meet the objectives stated in the Key Issues.

[343] Where derogations are permitted, regulators may have policies aimed at mitigating any adverse effects, generally by post-trade transparency requirements and by imposing limitations on the way in which dark trading, or the execution of dark orders, may take place. This may be achieved through, for example:
(a) ensuring that transparent orders receive execution priority over dark orders at the same price within a trading venue;
(b) ensuring that dark pools provide price improvement over the national best bid/offer (NBBO) to small orders;
(c) ensuring limited scope for waivers to pre-trade transparency;
(d) referencing prices within the dark pools to those of the national securities exchange; and
(e) trade through protection.
Principles for Dark Liquidity, supra, pp. 20–21.

[344] See footnote 341.

[345] See *Transparency on Secondary Markets: A Synthesis of the IOSCO Debate,* supra, pp. 23–24 and 30.

Benchmarks

Fully Implemented

696. Requires affirmative responses to all applicable Questions.

Broadly Implemented

697. Requires affirmative responses to all applicable Questions except to Question 2(c) and/or to Question 1(a), in a primarily institutional trading market.

Partly Implemented

698. Requires affirmative responses to all applicable Questions except to Questions 1(a), 2(c), 2(d) and 2(e) as specified above and Questions 1(b) and 1(c) post-trade information is not available on an equitable basis to all participants in an institutional market.

Not Implemented

699. Inability to respond affirmatively to one or more of Questions 1(a), 1 (b), 1(c), 2(a), 2(b) if applicable, subject to the departures permitted above, or post-trade information on concluded transactions is not available either on a timely or on an equitable basis in a market accessible to retail investors.

CPICM 37: **Regulation should be designed to detect and deter manipulation and other unfair trading practices. (IOSCO 36)**

700. Market manipulation (or attempts at manipulation), misleading conduct, insider trading and other fraudulent or deceptive conduct, may distort the price discovery system, distort prices and unfairly disadvantage investors.[346]

701. Such conduct could be addressed through a number of mechanisms, which, might include: direct surveillance; inspection; reporting; product design requirements; position limits on Sharīʿah-compliant trades; settlement price rules; or market halts, complemented by vigorous enforcement of the law and trading rules.

702. An effective market oversight programme should have a mechanism for monitoring compliance with the securities laws, regulations and market rules, operational competence requirements, and market standards.

703. The regulator must ensure that there are in place arrangements for the continuous monitoring of trading. These arrangements should trigger inquiry whenever unusual and potentially improper trading occurs.

704. Particular care must be taken to ensure that regulation is sufficient to cover cross-market conduct. For example, conduct in which the price of a Sharīʿah-compliant equity product is manipulated in order to benefit through the trading of options, warrants or other structured products, which may not be Sharīʿah-compliant and may be traded on a different market, or where there are multiple markets, not all of which employ a Sharīʿah screening methodology, trading the same product[347].

705. Regulators should continue to assess the impact of technological developments and market structure changes on market integrity and efficiency, including algorithmic and high frequency trading[348]. Based on this, regulators should seek to ensure that suitable measures are taken to mitigate any related risks to market integrity and efficiency, including

[346] See *Investigating and Prosecuting Market Manipulation*, Report of the Technical Committee of IOSCO, May 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf; and *Principles for Financial Benchmarks*, Report of the Board of IOSCO, July 2013, pp. 7–8, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[347] Some of the instruments referred to here are not Sharīʿah-compliant, but may nevertheless be listed on exchanges or other trading systems that do not themselves claim Sharīʿah compliance. In these circumstances, it is necessary to prevent manipulation of the price of one Sharīʿah-compliant instrument through trading in another that is not Sharīʿah-compliant.

[348] Refer to footnote 316.

any risks to price formation or to the resiliency and stability of markets, to which such developments give rise.[349]

Key Issues

1. The regulation of trading in secondary and other markets should prohibit: market manipulation (or attempts at manipulation), misleading conduct, insider trading, and other fraudulent or deceptive conduct, and apply adequate, proportionate and dissuasive sanctions.[350]

2. The regulator should ensure that there are in place arrangements for the continuous monitoring of trading. These arrangements should trigger inquiry whenever unusual and potentially improper trading occurs. Market authorities should have rules, compliance programmes, sanctioning policies and powers to prohibit, detect, prevent and deter abusive practices on their markets, including manipulation (or attempts at manipulation) of the market.

3. Regulation should cover cross-market conduct where, for example, the price of a Sharīʿah-compliant equity product could be manipulated through the trading of options, warrants or other structured products that may not be Sharīʿah-compliant.[351] The regulator should also work collectively and take any steps that would be appropriate to strengthen its cross-border surveillance capabilities.[352]

4. There must be adequate information sharing between relevant regulatory authorities, sufficient to ensure effective enforcement.[353]

Key Questions

1. Does the regulatory system prohibit the following with respect to products admitted to trading on authorised exchanges and regulated trading systems:

[349] See Recommendation 4 in *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, p. 47.
[350] See *Investigating and Prosecuting Market Manipulation*, supra, pp. 5–6. See also CPICM 12 and 13.
[351] See footnote 347.
[352] See *Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools*, Final Report, Report of the Board of IOSCO, April 2013, p. 37, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD412.pdf.
[353] See *Indexation: Securities Indices and Index Derivatives*, Report of the Technical Committee of IOSCO, February 2003, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD143.pdf, at pp. 35–40 regarding enhanced inter-market and cross-border cooperation.

a. Market or price manipulation (or attempts at market or price manipulation)?

b. Misleading information?

c. Insider trading?

d. Front running?

e. Other fraudulent or deceptive conduct and market abuses?

2. Does the regulatory approach to detect and deter such conduct include an effective and appropriate combination of mechanisms drawn from the following:

a. Direct surveillance, inspection, reporting, such as, for example:

i. securities listing, or product design requirements (where applicable);

ii. position limits on Sharīʿah-compliant trades;

iii. audit trail requirements;

iv. quotation display rules;

v. order handling rules;

vi. settlement price rules;

vii. market halts, complemented by enforcement of the law and trading rules; or

b. Effective, proportionate and dissuasive sanctions for violations?[354]

3. Are there arrangements in place for:

a. The continuous collection and analysis of information concerning trading activities?

b. Providing the results of such analysis to market and regulatory officials in a position to take remedial action if necessary?

[354] Compare to requirements under CPICM 11, 12 and 13.

c. Monitoring the conduct of market intermediaries participating in the market(s)?

d. Triggering further inquiry as to suspicious transactions or patterns of trading?

4. If there is potential for domestic cross-market trading, are there:

a. inspection;

b. assistance; and

c. information-sharing, requirements or arrangements in place to monitor and/or address domestic cross-market trading abuses?

5. If there are foreign linkages, substantial foreign participation, or cross listings, are there cooperation arrangements with relevant foreign regulators, and/or markets, that address manipulation, or other abusive trading practices?

6. Does the market authority have the organisational and technical capabilities to monitor effectively the trading venues it supervises, including the ability to identify market abuse and activities that may impact the fairness and orderliness of trading on such venues?[355]

Explanatory Notes

706. An effective and credible market oversight programme should include robust powers over fraud, market manipulation or attempts at such manipulation. These powers might be general in their application or they might relate more specifically to a particular topic of manipulation or attempted manipulation. For example, it might include manipulation or attempts at manipulation of a benchmark referenced in a financial contract or financial instrument.

707. Essential elements of monitoring compliance include:

- monitoring the day-to-day trading activity in the markets (through a market surveillance programme);

[355] *Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools,* supra, p. 32.

- monitoring the conduct of market intermediaries (through examinations of business operations); and

- collecting and analysing information gathered from these activities.[356] Techniques may differ for securities markets. The regulator should be invited to explain how its approach operates to detect, deter and sanction misconduct.

708. The overall framework for market surveillance and enforcement within a jurisdiction should be structured to provide for active and coordinated detection and enforcement action against manipulative or abusive schemes that might affect trading on multiple markets, including organised trading facilities and OTC markets, as well as the underlying physical commodity markets.

709. The following are examples of some cases when cross-market surveillance information is relevant: when the underlying Sharīʿah compliant instrument is traded in a jurisdiction other than the one where a derivative instrument, which is not Sharīʿah compliant is traded, or where identical products are traded in two jurisdictions, there may be increased potential for fraud or manipulation because of the difficulty of a regulator in one jurisdiction to monitor market activity directly or to conduct complete investigations of market activities in another jurisdiction.[357] It is also relevant if the product is traded on multiple markets.[358]

710. The regulator can make use of an exchange or trading system surveillance system provided that the regulator has reviewed it under CPICM 35 above.

711. Market authorities should have authority to seek access to information in foreign jurisdictions. Market authorities should at a minimum map and be aware of the extent of any gaps in their cross-border surveillance capabilities.[359]

712. Market authorities should monitor for novel forms or variations of market abuse that may arise as a result of technological developments and take action as necessary. They should also review their arrangements (including cross-border information sharing arrangements) and capabilities for the continuous monitoring of trading (including transactions, orders entered or orders cancelled) to help ensure that they remain effective.[360]

[356] *Supervisory Framework for Markets,* supra, p. 9.
[357] See footnote 347.
[358] See *Multi-Jurisdictional Information Sharing for Market Oversight,* supra, p. 13.
[359] See *Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools,* supra, p. 37.
[360] See Recommendation 5 in *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency,* supra, p. 48.

Benchmarks

Fully Implemented

713. Requires affirmative responses to all applicable Questions.

Broadly Implemented

714. Requires affirmative responses to all applicable Questions except to Questions 4 and 5, provided that there is no substantial cross-border or cross-market activity, and cooperation in fact occurs.

Partly Implemented

715. Requires affirmative responses to all applicable Questions except that if Questions 4 and 5 are applicable, there is evidence of cross-market and cross-border cooperation and information sharing, although no formal arrangements for cooperation may be in place.

Not Implemented

716. Inability to respond affirmatively to one or more of Questions 1(a), 1(b), 1(c), 1(d), 1(e), 2(a), 2(b), 3(a), 3(b), 3(c), 3(d) or 6 (if applicable), or 7 or if Questions 4 or 5 are applicable, there is no evidence of cross-border cooperation whether or not there are formal arrangements for cooperation in place.

CPICM 38: Regulation should aim to ensure the proper management of large exposures, default risk and market disruption. (IOSCO 37)

717. Risk taking is essential to an active market and regulation should not unnecessarily stifle legitimate risk taking. Rather, regulators should promote and allow for the effective management of risk, also with a view to fostering market resilience and stability, and ensure that capital and other prudential requirements: are sufficient to address appropriate risk taking; allow the absorption of some losses; and check excessive risk taking. An efficient and properly structured clearing and settlement process that is supervised and uses effective risk management tools is essential. The legal system also must support effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction. This may also need consideration of issues surrounding insolvency provisions in the light of Sharī'ah rules and principles and the extent to which these are considered within the jurisdiction's legal and regulatory framework. Insolvency law must support isolating risk, and retaining and applying margin previously paid into the system, notwithstanding a default, or commencement of an administration or bankruptcy proceeding. Margin is considered as a trust held by the exchange or clearing house that can only be utilised in cases of default, negligence or misconduct, and shall be returned to its owner once he finally exits the market.

718. Instability may result from events that occur in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

Key Issues

Monitoring of Large Exposures

1. Market authorities[361] should have mechanisms to monitor open positions, or credit exposures, on unsettled trades that are sufficiently large to pose a risk to the market or to a clearing firm (i.e., large exposures)[362] and for this purpose:

[361] The term "market authority" is used, for purposes of large exposures, to refer to the authority in a jurisdiction that has statutory or regulatory powers with respect to the exercise of certain regulatory functions over a market. The relevant market authority, depending on the jurisdiction, may be a regulatory body, an SRO and/or the market itself. *Report on Cooperation between Market Authorities and Default Procedures*, supra, p. 2.

[362] The expression "large exposure" refers to an open position that is sufficiently large to pose a risk to the market or a clearing firm.

a. Establish trigger levels appropriate to their markets and continuously monitor the size of positions on their markets.[363]

b. Have access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries' members.[364]

c. Have authority to take appropriate action where a direct market participant does not make requested market information available to the market authority.

d. Have the power to take appropriate action, such as requiring the market participant to reduce exposures, increase margin, or deposit additional collateral.

e. Promote mechanisms that facilitate the sharing of information on large exposures through appropriate channels.

Default Procedures- Transparency and Effectiveness

2. Market authorities should make relevant information concerning market default procedures available to market participants.

3. Regulators should ensure that the procedures relating to defaults, and permitted corrective actions, are effective and transparent.

4. Market authorities for related products should consult with each other, as soon as practicable, with a view to minimising the adverse effects of market disruptions.

Key Questions

Monitoring of Large Exposures

[363] The assessor should request empirical evidence of an evaluative procedure before concluding that there is effective ongoing monitoring.

[364] A broker's direct (i.e. immediate) client who signed the account documentation in reality may be operating on behalf of an unknown person who controls the account (the beneficial owner). A market authority must be able to identify such a beneficial owner in order to aggregate positions, for example. See also id, p. 66.

1. Does the market authority have a mechanism in place that is intended to monitor and evaluate continuously the risk of open positions, or credit exposures, that are sufficiently large to expose a risk to the market, or to a clearing firm, that includes:

a. Qualitative, or quantitative, trigger levels appropriate to the market for the purpose of identifying large exposures (as defined by the market authority), continuous monitoring, and an evaluative process?[365]

b. Access to information, if needed, on the size and beneficial ownership of positions held by direct customers of market intermediaries?

c. The power to take appropriate action against a market participant that does not provide relevant information needed to evaluate an exposure (e.g., require liquidation of positions, increase margin requirements and/or revoke trading privileges)?[366]

d. The general power to take appropriate action, such as to compel market participants carrying, or controlling, large positions to reduce their exposures or to post increased margin?

2. Do arrangements, whether formal or informal, exist to enable markets and regulators to share information on large exposures of common market participants, or on related products:

a. In the domestic jurisdiction?

b. In other relevant jurisdictions?[367]

Default Procedures- Transparency and Effectiveness

3. Does a market authority make its default procedures available to market participants, including, specifically, information concerning:

a. The general circumstances in which action may be taken?

b. Who may take it?

[365] See *Report on Cooperation between Market Authorities and Default Procedures,* supra, p. 3, para. 4.
[366] Id, p. 4, para. 8.
[367] Id, p. 4, para. 8 regarding the promotion of formal/informal mechanisms. See also *Report on Trading Halts and Market Closures*, supra, pp. 23–24.

c. The scope of actions which may be taken.

4. Do default procedures, and/or national law, permit markets, and/or the clearing and settlement system(s), to promptly isolate the problem of a failing firm by addressing its open proprietary positions, and positions it holds on behalf of customers; or otherwise protect customer funds and assets, from an intermediary's default under national law?

5. Is there a mechanism by which market authorities for related products can consult with each other in order to minimise the adverse effects of market disruptions?

Explanatory Notes

"Large Exposure" Monitoring

719. Market authorities should closely monitor large exposures and share information with one another in order to permit the appropriate assessment of risk. The approach to large exposure monitoring contained in this Methodology reflects, as noted in the Secondary and Other Markets Methodology Preamble that "regulation may differ according to market structure, market participant or product…". Accordingly, assessment of the related Key Questions should recognise the different regulatory structures in place and the characteristics of markets.

720. For example, the Methodology recognises that the large exposure monitoring function itself may be performed by a regulatory body, an SRO, and/or the market itself (i.e., a "market authority").

721. Similarly, in stating that "trigger levels" (which are qualitative, or quantitative, criteria that are used to identify a large exposure) should be established, the CPICM and Key Question 1 makes clear that they should be "appropriate" to the markets in question. In this regard, the determination of what constitutes a "large exposure" will be made by the relevant "market authority" acting within its discretion. It therefore follows that not every market will have the same large exposure monitoring needs, trigger levels, or approach to monitoring. These levels will necessarily vary between different markets and contracts, and should be subject to regular review to ensure that they are appropriate for current market conditions.

722. To perform this monitoring function market authorities should have access to information on the size and beneficial ownership of positions held by "direct" customers of market members (i.e., the customers with whom the market member deals). Market

authorities can then take the appropriate action, such as requiring the member to reduce the exposure, or increasing margin requirements.

723. Market authorities should promote mechanisms that facilitate the sharing of the above information through appropriate channels. Where a market member does not make the relevant information available to the market authority, the authority should be able to take appropriate action - while taking into account the mechanisms already provided by the CCP, such as: imposing limitations on future trading by the member; requiring liquidation of positions; increasing margin requirements; or revoking trading privileges.

The Market and Financial Integrity Objectives of Large Exposure Monitoring

724. The monitoring programme itself should be appropriate not only for the type of market, but also for the monitoring objective – i.e., market integrity or financial integrity.

Defaults

725. *Effective and Transparent* - Regulators should ensure that the procedures relating to defaults are effective and transparent. Market authorities should make relevant information concerning market default procedures available to market participants.

726. *Consultation and Information Sharing* - Market authorities for related products should consult with each other, as soon as practicable, with a view to minimising the adverse effects of market disruption. The information that may be needed includes contingency plans, contact persons, and structural measures to address market disruption; and information about market conditions (such as actions taken by market authorities, prices, trading activities and aggregate market data).

727. Instability may result from events that occur in another jurisdiction or occur across several jurisdictions, so regulators' responses to market disruptions should seek to facilitate stability domestically and globally through cooperation and information sharing.

728. *Insolvency Law* - The legal system must support effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction. Insolvency law must support isolating risk, and retaining and applying margin previously paid into the system, notwithstanding a default or commencement of an administration or bankruptcy proceeding.

729. For example, the following mechanisms can be relevant to addressing a financial failure or market disruption; however, other mechanisms also may be adequate if the

objectives of: isolating risk; and protecting funds from being taken to cover the intermediary's default, are achieved.

- National insolvency laws that specifically accommodate market default procedures.

- Sharīʿah-compliant guarantees by the central bank.

- The use of the defaulting firm's proprietary funds and assets to meet its obligations to market counterparties.

- The transfer or liquidation of customer positions at the defaulting firm under market rules without interference from bankruptcy law.[368]

- The transfer of customer funds and assets, or use of a protection system.

- Where customer positions or funds are to be transferred, arrangements for distinguishing firm and customer positions, deposits and accruals.

730. The regulator should identify any concerns with respect to applicable bankruptcy law.

Benchmarks

Fully Implemented

731. Requires affirmative responses to all applicable Questions taking into account that the combination of mechanisms enumerated in Question 5 available in the jurisdiction are sufficient to reduce the impact of any failure and in particular to isolate risk to the failing institution.[369]

Broadly Implemented

[368] Liquidation is acceptable in cases where the nature of the position makes transfer impracticable, or where a customer may not have completed the documentation necessary for the transfer or the applicable regulation does not allow for transfers. See also *Report on Cooperation between Market Authorities and Default Procedures*, supra, para. 6(3). The market, however, should not be required to maintain open unsettled transactions once a direct participant has defaulted.

[369] The responses to market disruption should seek to facilitate stability domestically and globally through cooperation and information sharing.

732. Requires affirmative responses to all applicable Questions, subject to an evaluation of the mechanisms in Question 5, except to Questions 1(a), 1(b), 1(c), 2(b), 3(a), provided that other measures are in place to address cross-market risks.[370]

Partly Implemented

733. Requires affirmative responses to all applicable Questions except to Questions 1(a), 1(b), 1(c), 2(b), 3(a), 5.

Not Implemented

734. Inability to respond affirmatively to one or more of Questions 1(d), 2(a) if applicable, 3(b), 3(c), 4.

[370] Exception reporting based on a surveillance programme is consistent with the monitoring contemplated by Key Question 1(a).

BIBLIOGRAPHY FOR PRINCIPLES RELATING TO SECONDARY MARKETS AND OTHER MARKETS

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1	*Mechanisms for Trading Venues to Effectively Manage Electronic Trading Risks and Plans for Business Continuity*, Final Report, Report of the Board of IOSCO, December 2015, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD522.pdf.	34 35	
2	*Post-Trade Transparency in the Credit Default Swaps Market*, Final Report of the Board of IOSCO, August 2015, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD499.pdf	36 37	
3	*Regulatory Issues Raised by Changes in Market Structure*, Final Report of the Board of IOSCO, December 2013, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD431.pdf.	34 35	
4	*Principles for Financial Benchmarks*, Report of the Board of IOSCO, July 2013, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf	37	7

	Document	CPICM	Other CPICM
5	*Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools*, Final Report, Report of the Board of IOSCO, April 2013, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD412.pdf	37 37	
6	*Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency*, Report of the Technical Committee of IOSCO, October 2011, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD361.pdf.	Pream 34 34 35 38	
7	*Principles for Dark Liquidity*, Final Report, Report of the Technical Committee of IOSCO, May 2011, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD353.pdf.	34 36	
8	*Principles for Direct Electronic Access to Markets*, Final Report, Report of the Technical Committee of IOSCO, August 2010, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD332.pdf	32 32 34	
9	*Transparency of Structured Finance Products*, Final Report, Report of the Technical Committee of IOSCO, July 2010, available at	36	

	Document	CPICM	Other CPICM
	https://www.iosco.org/library/pubdocs/pdf/IOSCOPD326.pdf		
10	*Principles Regarding Cross-Border Supervisory Cooperation, Final Report*, Report of the Technical Committee of IOSCO, May 2010, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf.	34 35	14 15 16
11	*Principles on Outsourcing by Markets*, Final Report, Report of the Technical Committee of IOSCO, July 2009, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD299.pdf.	34	
12	*Multi-Jurisdictional Information Sharing for Market Oversight, Final Report*, Report of the Technical Committee of IOSCO, April 2007, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf.	34 35 37	14
13	*Regulatory Issues Arising from Exchange Evolution, Final Report*, Report of the Technical Committee of IOSCO, November 2006, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD225.pdf.	34 35	

	Document	CPICM	Other CPICM
14	*Policies on Error Trades*, Final Report, Report of the Technical Committee of IOSCO, October 2005, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD208.pdf.	34	
15	*Transparency of Corporate Bond Markets*, Report of the Technical Committee of IOSCO, May 2004, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf	36	
16	*Indexation: Securities Indices and Index Derivatives*, Report of the Technical Committee of IOSCO, February 2003, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD143.pdf,	37	
17	*Report on Trading Halts and Market Closures*, Report of the Technical Committee of IOSCO, November 2002, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD138.pdf.	35 35 38	
18	*Transparency and Market Fragmentation*, Report of the Technical Committee of IOSCO, November 2001, available at	36	

	Document	CPICM	Other CPICM
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19	*Investigating and Prosecuting Market Manipulation*, Report of the Technical Committee of IOSCO, May 2000, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf.	37	
20	*Supervisory Framework for Markets*, Report of the Technical Committee of IOSCO, May 1999, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf	34 35 37 38	
21	*Report on Cooperation between Market Authorities and Default Procedures*, Report of the Technical Committee of IOSCO, March 1996, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD49.pdf	38 38	33
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23	*Transparency on Secondary Markets: A Synthesis of the IOSCO Debate*, Report of the Technical Committee of IOSCO, December 1992, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD27.pdf	36	
24	*Coordination between Cash and Derivative Markets*, Report of the Technical Committee of IOSCO, October 1992, https://www.iosco.org/library/pubdocs/pdfdocs/IOSCOPD22.pdf.		

APPENDIX

CPICM	IOSCO PRINCIPLES	Islamic Finance Specificities addressed by new additions / changes	New/modified Key Issues	New/modified Key Questions
PRINCIPLES RELATING TO THE REGULATOR				
CPICM 1	Principle 1	Retained with Explanatory Addition	–	–
CPICM 2	Principle 2	Addition to account for regulator's accountability on matters of Sharī'ah compliance where the regulator has functional responsibility and power in relation to this.	KI 6 KI 7	KQ 6(a) KQ 7(a)(b) (c)
CPICM 3	Principle 3	Addition to factor in sufficiency of the powers, resources and competence of the regulator on matters of Sharī'ah compliance where the regulator has functional responsibility and accountability in relation to this.	KI 3	KQ 7
CPICM 4	Principle 4	Retained with Explanatory Addition	–	–
CPICM 5	Principle 5	Retained	–	–
CPICM 6	Principle 6	Retained with Explanatory Addition	–	–
CPICM 7	Principle 7	Retained	–	–
CPICM 8	Principle 8	Retained with Explanatory Addition	–	–

PRINCIPLE RELATING TO SELF-REGULATION				
Preamble	**Preamble**	Explanatory Addition		
CPICM 9	Principle 9	Addition in relation to oversight of any Sharī'ah governance mechanism in place within the SRO	–	KQ 3(d)
PRINCIPLE RELATING TO *SHARĪ'AH* GOVERNANCE				
CPICM 10	**No equivalent**	**New Principle on Sharī'ah Governance**		
PRINCIPLES RELATING TO THE ENFORCEMENT OF SECURITIES REGULATION				
Preamble	**Preamble**	Explanatory Addition	–	–
CPICM 11	Principle 10	Retained	–	–
CPICM 12	Principle 11		–	–
CPICM 13	Principle 12	Explanatory Addition	–	–
PRINCIPLES RELATING TO COOPERATION IN REGULATION				
Preamble	**Preamble**	Explanatory Addition	–	–

CPICM 14	Principle 13	Explanatory Addition	–	–
CPICM 15	Principle 14	Retained	–	–
CPICM 16	Principle 15	Addition to include ability of the regulator to offer effective and timely assistance to foreign regulators in obtaining obtain reports from a competent Sharī'ah authority on Sharī'ah compliance of the underlying asset/project that is backing a security sold/listed/issued cross-border	–	KQ 1(d)
PRINCIPLES FOR ISSUERS				
Preamble	**Preamble**	Explanatory Addition	–	–
CPICM 17	Principle 16	Addition for *ṣukūk* listing by foreign issuers to be consistent with IFSB-19's *Guiding Principles on Disclosure Requirements* – specifically, section 2.2 for *ṣukūk* disclosures	–	KQ 9
CPICM 18	Principle 17	Retained	–	–
CPICM 19	Principle 18	Explanatory Addition	–	–
CPICM 20	**No Equivalent**	**New Principle on *Ṣukūk***		

PRINCIPLES FOR AUDITORS, CREDIT RATING AGENCIES AND OTHER INFORMATION SERVICE PROVIDERS				
CPICM 21	Principle 19	Explanatory Addition	–	–
CPICM 22	Principle 20	Retained	–	–
CPICM 23	Principle 21	Retained	–	–
CPICM 24	Principle 22	Addition in relation to CRAs that claim to have a specialised approach for ICM assessment, with regard to appropriate recognition criteria for such CRAs and in relation to consistency and comparability of methodologies used	KI 4	KQ 1(a) KQ 4(a)(iii)
CPICM 25	Principle 23	Retained	–	–
PRINCIPLES FOR ISLAMIC COLLECTIVE INVESTMENT SCHEMES				
Preamble	**Preamble**	Explanatory Addition	–	–
CPICM 26	Principle 24	Addition in relation to eligibility criteria for ICIS operators and Sharī'ah compliance arrangements in line with IFSB-6	KI 1 KI 5	KQ 2(f) KQ 2(g) KQ 5
CPICM 27	Principle 25	Retained	–	–
CPICM 28	Principle 26	Addition related to disclosure requirements for ICIS in line with IFSB-19	KI 7	KQ 13 KQ 14 KQ 15

CPICM 29	Principle 27	Exclusion of content on stable NAV MMFs	–	KQ 5
No Equivalent	Principle 28	Removed		
PRINCIPLES FOR MARKET INTERMEDIARIES				
Preamble	**Preamble**	Explanatory Addition		
CPICM 30	Principle 29	Additional KQ in relation to authorisation or licensing requirements for market intermediaries involved in Islamic capital market activity with respect to Islamic finance and Sharīʿah principles	KI 2(b) KI 2(d)	KQ 2(d) KQ 2(f)
CPICM 31	Principle 30	Retained as it is without additions because capital adequacy requirements for market intermediaries have not been well-studied thus far, from an Islamic capital market perspective	–	–
CPICM 32	Principle 31	Additional KQ with respect to ensuring continuing compliance of the market Intermediary with the rulings of a Sharīʿah board or similar body	KI 1(a)	KQ 1(b)
CPICM 33	Principle 32	Retained	–	–
PRINCIPLES FOR SECONDARY AND OTHER MARKETS				
Preamble	**Preamble**	Explanatory Addition	–	–
CPICM 34	Principle 33	Addition with respect to the operator of an exchange that is responsible for determining Sharīʿah compliance of a product in relation to the requirement for necessary resources, competency and knowledge	KI 1 KI 3	KQ 2(e) KQ 2(f)

CPICM 35	Principle 34	Retained	–	–
CPICM 36	Principle 35		–	–
CPICM 37	Principle 36	Exclusion of KI and KQ on commodity derivatives markets	–	–
CPICM 38	Principle 37	Changes to KQ with respect to short selling; and exclusion of KQs on commodity derivatives markets	KI 5 KI 7	KQ 6
PRINCIPLES RELATING TO CLEARING AND SETTLEMENT				
No Equivalent	Principle 38	Removed	–	–

DEFINITIONS

The following definitions are intended to assist readers in their understanding of the terms used in this Standard. The list of definitions provided is by no means exhaustive.

Fatwā	A juristic opinion given by the Sharīʿah board on any matter pertinent to Sharīʿah issues, based on the appropriate methodology.
Institutions offering Islamic financial services (IIFS)	Institutions offering Islamic financial services that include Islamic banks, Islamic insurance/*takāful* institutions, Islamic windows and Islamic collective investment schemes.
Islamic collective investment scheme	Any structured financial scheme that, fundamentally, meets all the following criteria: a. Investors have pooled their capital contributions in a fund (whether that fund is in a separate legal entity, or is held pursuant to a contractual arrangement) by subscribing to units or shares of equal value. Such units or shares constitute, in effect, claims of ownership of the undivided assets of the fund (which can consist of financial or non-financial assets), and give rise to the right or obligation to share in the profits or losses derived from those assets. Whether or not the Islamic collective investment scheme is managed by the institutions that established or sponsored it, it is financially accountable separately from those institutions (i.e. it has its own assets and liabilities profile), but excluding *ṣukūk.* b. The fund is established and managed in accordance with Sharīʿah rules and principles.
Kafālah	A contract where the guarantor conjoins the guaranteed party in assuming the latter's specified liability.
Sharīʿah	The practical divine law deduced from its legitimate sources: the Qur'ān, Sunnah, Consensus (ijmāʿ), Analogy (qiyās) and other approved sources of the Sharīʿah.
Sharīʿah board	An independent body set up or engaged by the institution offering Islamic financial services to supervise its Sharīʿah compliance and governance system.
Sharīʿah non-compliance risk	An operational risk resulting from non-compliance of the institution with the rules and principles of Sharīʿah in its products and services.
Ṣukūk	Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity.