FINANCIAL SECTOR ASSESSMENT PROGRAM

UNITED STATES OF AMERICA

THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

REPORT ON STANDARDS AND CODES (ROSC)

JULY 2010

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

Contents Page

Glossary 3

I. Introduction and Methodology 4

II. Preconditions for Effective Securities Regulation 5

III. Main Findings 5

IV. Authorities' Response to the Assessment 17

Tables
1. Summary Implementation of the IOSCO Principles 9
2. Recommended Action Plan to Improve Implementation
of the IOSCO Principles 14

Glossary

ATSs	Alternative Trading Systems
BDs	Broker Dealers
BSA	Bank Secrecy Act
CEA	Commodity Exchange Act
CFMA	Commodity Futures Modernization Act of 2000
CFTC	Commodity Futures Trading Commission
CIS	Collective Investment Schemes
CPSS	Committee on Payment and Settlement Systems
CPOs	Commodity Pool Operators
DCM	Designated Contract Market
DOJ	Department of Justice
EBOTs	Exempt Boards of Trade
ECM	Exempt Commercial Market
FCM	Futures Commission Merchant
FINRA	Financial Industry Regulatory Authority
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
IAs	Investment Advisers
IBs	Introducing Brokers
IG	Inspector General
IOSCO	International Organization of Securities Commissions
IOSCO MMOU	IOSCO Multilateral Memorandum of Understanding
MOU	Memorandum of Understanding
NFA	National Futures Association
NMS	National Market System
OCIE	Office of Compliance, Inspections, and Examinations (SEC)
OIG	Office of Inspector General
OTC	Over-the-Counter
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission
SROs	Self-regulatory Organizations

I. Introduction and Methodology

1. **An assessment of the United States securities and futures market regulatory system was conducted by Susanne Bergsträsser, Richard Britton, and Tanis MacLaren from October 7 to November 3, 2009 as part of the Financial Sector Assessment Program (FSAP).**[1] The assessment was conducted based on the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation and the associated methodology adopted in 2003.[2]

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

3. **The assessment was carried out in a post-crisis environment, which had an impact on the findings.** The financial crisis of 2008 exposed a number of underlying issues in the U.S. financial markets, some of which were causally related to the crisis—such as the lack of ability of U.S. investment banks to withstand shocks to liquidity—while others arose as a result of secondary effects of the crisis—such as the exposure of a giant fraud because of the sharp contraction of investment flows. As a result, the regulatory and supervisory framework was tested to an unusual degree, revealing weaknesses that might otherwise have gone undetected.

4. **The assessment also benefited from the uncommon level of transparency in the United States.** The mission had access to a wide range of official reports, internal evaluations of the regulatory framework, and information on regulatory practice. Moreover, the U.S. system is subject to a considerable degree of high quality and critical analysis from the private sector, which also informed the assessment.

5. **The legislative framework in the jurisdiction provides a comprehensive, but complex, framework for the activities undertaken in the public markets**. The responsibility for regulation of the markets at a federal level is split between two agencies. The Commodity Futures Trading Commission (CFTC) is responsible for the supervision of futures markets—the futures exchanges, intermediaries and products offered in the public markets. The Securities and Exchange Commission (SEC) regulates securities markets, issuers, and participants. In addition, there are state securities regulators involved in both licensing and enforcement activities. Further, other law enforcement agencies, such as the

---

[1] For further discussion see the accompanying Financial System Stability Assessment (FSSA), (www.imf.org).

[2] The underlying Detailed Assessment Report was published in May 2010 and is available at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23867.0.

Department of Justice (DOJ) and state Attorneys General, participate in enforcement activities. The CFTC and SEC rely to a significant degree on self-regulatory organizations (SROs) for the regulation of the markets and their participants, including exchanges, clearing organizations, and securities or futures associations, each of which has authority over their members' activities.

II. Preconditions for Effective Securities Regulation

6. **The general preconditions for effective securities regulation in the United States are present.** There are no significant barriers to entry and exit for market participants. Competition is encouraged and foreign participation is welcomed. The legal and accounting system supports the implementation of requirements and effective regulation of market participants. The commercial law is up-to-date and is capable of supporting the demands posed by cross-border trade, modern financial instruments, and current corporate governance standards. The legislation regarding bankruptcy, insolvency, and winding up in the jurisdiction and the professionals associated with those matters are sophisticated.

III. Main Findings

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

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

9. **Issues related to complexity and the need for reform manifest themselves both in specific areas and at a system-wide level.** The specific areas of concern include the enforcement function and the regulation of over-the-counter derivatives markets; but the overarching issue is the need to work toward simplification of internal and institutional structures. Within the agencies, better internal management structures and improved communication between departments should be established to facilitate a regulatory culture of continuous learning and response.

10. **Principles relating to the regulator (Principles 1–5):** The responsibilities of the CFTC and SEC are clearly stated in law. However, there are gaps in coverage of the wide

range of activity in the U.S. markets and in the scope of authority of both agencies and there are differences between the futures and securities regimes in how similar instruments are regulated. There are also gaps between the authority of the SEC and the Federal Reserve with respect to the regulation and oversight of investment bank holding companies, which adds to the fragility of the overall system. The legal system grants the CFTC and SEC sufficient protection for their independence and the agencies operate independently on a day-to-day basis, and there is a strong system of accountability to Congress. However, neither agency has sufficient funding nor sufficient assurance of continuing funding levels to be able to commit to long-term capital projects, such as building new market surveillance systems, which are necessary to keep pace with changes in the industry. The CFTC and SEC activities and processes are transparent and there is public consultation regarding their regulations and CFTC and SEC staff and commissioners are subject to codes of ethics and other requirements to ensure a high standard of conduct.

11. **Principles relating to self-regulation (Principles 6–7):** SROs play a significant role in the supervision of markets and their participants. Exchanges and clearing organizations and registered associations all perform important self-regulatory functions. SROs are subject to an authorization regime based on eligibility criteria that address issues of integrity, financial viability, capacity, governance, and fair access—although the regimes are different for exchanges in the securities and futures markets. The CFTC has insufficient authority regarding exchanges following the coming into force of the Commodity Futures Modernization Act of 2000 (CFMA). Moreover, the CFTC has limited ability to intervene in the introductions of a new product or changes in rules, such as those governing trading and there is no opportunity for stakeholders to have their views taken into account in advance of a new product listing or rule change. These deficiencies have been recognized and are now being addressed via recommendations for legislative change.

12. **Principles relating to enforcement of securities regulation (Principles 8–10):** Both agencies have extensive enforcement authority.The anti-fraud provisions under the U.S. federal securities laws, as enforced by the SEC via Rule 10b–5[3] and supported by the courts, have proved to be a very effective tool for prosecuting offences under the securities laws. Private litigation is also an unusually powerful tool for securing compliance and obtaining redress in case of breach. The CFTC and SEC can conduct on-site inspections without prior notice and can obtain information of all types without the need for a court order. The agencies also have broad enforcement powers, including the power to seek injunctions, bring

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

an application for civil proceedings, and compel information and testimony from third parties. They also can impose administrative sanctions and refer matters to criminal authorities. The CFTC and SEC have substantial compliance and enforcement programs in place. Although the assessment identified significant shortcomings in the SEC enforcement program, the SEC's extensive and wide-ranging program to implement the Inspector General (IG)'s recommendations and other changes are beginning to generate improvements. Such efforts should be brought to a conclusion as a matter of high priority. Further, resources dedicated to the examination of SEC-registered Investment Advisers (IAs) (a program currently conducted solely by the SEC) are insufficient, thus reducing the effectiveness of the program.

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

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

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

16. **Principles for market intermediaries (Principles 21–24):** There are minimum entry standards for all market intermediaries that include criteria relating to integrity. Capital and internal control requirements apply to futures commission merchants and broker dealers; these requirements are assessed prior to licensing by the SROs. Advisers are not subject to capital requirements or to operational capacity assessments prior to licensing. The applicable capital requirements vary by the chief risks undertaken by the intermediary (largely market and credit risk). The ability of the prudential requirements (capital formulae and risk

management requirements) to address the full range of risks present in some business models (funding, liquidity, reputational, and affiliate risks) appears to need improvement. The crisis brought to light weaknesses in the framework governing investment bank holding companies, but the conversion of the remaining entities into bank holding companies has eliminated the practical need for the securities regulators to address these problems immediately. There are procedures in place at both agencies to address failures of intermediaries, and these have been tested in practice.

17. **Principles for the secondary market (Principles 25–30):** Securities and futures exchanges are subject to authorization and oversight. Under the CEA, there are categories of futures trading systems that are exempt from authorization, although recent legislative amendments have enabled the CFTC to strengthen oversight of operational Exempt Commercial Markets (ECMs) where appropriate. In the securities markets, post-trade transparency (details of completed transactions) is comprehensive, as is publicly displayed liquidity or pre-trade transparency (best bids and offers). However, roughly a quarter of liquidity is not publicly displayed (i.e., dark pool Alternative Trading Systems (ATSs) and broker dealer internalization of trading on behalf of clients). The SEC's concern that a two-tier market may be emerging—that provides valuable order information on the best prices for National Market System (NMS) stocks only to selected market participants—is justified. Any proposed rule changes should be supported by independent factual evidence.

18. **Market surveillance by the securities and futures exchanges and Financial Industry Regulatory Authority (FINRA) is effective and has kept pace with technological developments in markets.** A comprehensive surveillance system for securities trading to be used by the exchanges, ATS, and the SEC (such as exists in the futures markets) would be beneficial for the detection of market abuse and also for identifying indicators of developing stress points. Market manipulation is generally well policed in both markets. Insider trading legislation should be more comprehensive in futures markets although the approach to insider trading for securities and futures should be different given the differences in the nature of the markets. Whether additional expansion of coverage is warranted, should be studied. While the IOSCO Principles do not require all markets in financial products to be transparent, the opacity of the over-the-counter (OTC) derivatives market contrasts with the relative transparency of OTC securities markets for equities and bonds.

Table 1. Summary Implementation of the IOSCO Principles

Principle	Assessment
Principle 1. The responsibilities of the regulator should be clearly and objectively stated.	The responsibilities of the CFTC and SEC are clearly stated in the laws. However, there are gaps in coverage of products and services in the market, differences in treatment of similar products, and gaps in the scope of each agency's authority.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.	The CFTC and SEC are operationally independent. There is a strong system of accountability to Congress. The funding method for the authorities does not provide funding sufficient to meet their regulatory and operational needs on a long-term basis.
Principle 3. The regulator should have adequate powers, proper resources, and the capacity to perform its functions and exercise its powers.	Both authorities have extensive powers over their areas of responsibility, but there are gaps. The CFTC and SEC need additional resources in order to supervise the very large and complex U.S. securities and futures markets.
Principle 4. The regulator should adopt clear and consistent regulatory processes.	The CFTC and SEC are subject to a high degree of transparency including public consultation regarding their regulations. They are active on investor education.
Principle 5. The staff of the regulator should observe the highest professional standards.	The CFTC and SEC have developed codes of ethics. These include investment limitations on staff and, in the case of the SEC, reporting obligations. There are mechanisms to monitor compliance.
Principle 6 The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.	The effectiveness of the regulatory regime is to a large degree dependent on the skills and resources of the SROs. They play a very significant role in the supervision of markets and their participants. Exchanges and clearing agencies perform important self-regulatory functions as do registered associations.
Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	Following the coming into force of the CFMA, the CFTC has had insufficient authority over exchanges. This deficiency is now being addressed via recommendations for legislative change.
Principle 8. The regulator should have comprehensive inspection, investigation, and surveillance powers.	The CFTC and SEC have broad investigative and surveillance powers over regulated entities, exchanges, and regulated trading systems. They can conduct on-site inspections without prior

Principle	Assessment
	notice. They can obtain books and records and request data or information without a court order.
Principle 9. The regulator should have comprehensive enforcement powers.	The CFTC and SEC have broad enforcement powers. These include the power to seek injunctions, bring an application for civil proceedings, and compel information, documents, records, and testimony from third parties in the course of their investigations. They can impose administrative sanctions and refer matters to criminal authorities.
Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance, and enforcement powers and implementation of an effective compliance program.	Significant shortcomings were identified in the SEC enforcement program. However the current extensive and wide-ranging program of change is beginning to generate improvements. Important elements, such as the restructuring of complaints handling processes remain "work in progress." The resources for the examination of registered IAs by the SEC are insufficient, thus reducing the effectiveness of this program. Resources for criminal prosecution of securities fraud are too limited.
Principle 11. The regulator should have the authority to share both public and non-public information with domestic and foreign counterparts.	The CFTC and SEC have broad authority to share information with both domestic and foreign regulators and both agencies have shared information extensively with international counterparties.
Principle 12. Regulators should establish information-sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	The CFTC and SEC are signatories of the IOSCO Multilateral Memorandum of Understanding (MMOU). They also have bilateral MOUs with other regulators.
Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	The CFTC and SEC have authority to assist foreign regulators in obtaining information, even when that information that is not in their files, and regularly do so.
Principle 14. There should be full, timely, and accurate disclosure of financial results and other information that is material to investors' decisions.	There is extensive initial and ongoing disclosure for most public issuers. However, there is limited direct authority over municipal government. On-going disclosure requirements do not apply to all public issuers.
Principle 15. Holders of securities in a company should be treated in a fair and equitable manner.	Holders of voting securities of a public issuer generally are treated fairly.
Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality.	U.S. GAAP is widely recognized as an acceptable accounting standard for use by public issuers and the generally accepted auditing standards (GAAS) of the U.S. Public Company Accounting Oversight Board (PCAOB) also are widely accepted globally.
Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to	Operators and marketers of CIS are subject to registration requirements but eligibility criteria

Principle	Assessment
market or operate a collective investment scheme.	are not comprehensive. In addition, at present the resources and internal controls of a CIS would be subject to an examination by the regulator only sometime after the fund began operation, but are not preconditions to the original approval. Resources at the SEC, CFTC, and National Futures Association (NFA) do not allow routine examination of the operators to take place with sufficient frequency.
Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	There are requirements governing the legal form of Collective Investment Schemes (CIS) and addressing protection of client assets. Notice of changes that affect investor rights should be given prior to the effective date of the change, whether or not investor approval is required. The material change requirements set out in the CEA are not timely. The custodian of a CIS's assets is not required to be an arm's length party.
Principle 19. Regulation should require disclosure, as set out under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	The disclosure required for public commodity pools and securities CIS is extensive and is updated throughout the period when the CIS is offering its securities to the public. However, the CEA requirements regarding updating the Disclosure Documents are not timely. The information disclosed is sufficient for investors to assess suitability and the value of their investments in the CIS.
Principle 20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme.	Assets of CIS are valued in accordance with U.S. GAAP and verified by an independent auditor at least annually. The prices of the instruments are made available to the investors periodically. No guidance is provided on how pricing errors in commodity pools should be addressed.
Principle 21. Regulation should provide for minimum entry standards for market intermediaries.	There are minimum entry standards for market intermediaries but only some types of intermediaries are subject to standards relating to financial capacity or assessed with respect to their internal controls, risk management, and supervisory systems in place before licensing.
Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries	Capital requirements apply to Futures Commission Merchants (FCMs), non-guaranteed Introducing Brokers (IBs,) and BDs that vary by

Principle	Assessment
undertake.	certain of the risks undertaken by the firm. The capital formulae and other prudential requirements do not address fully the complete range of risks to which a firm may be exposed.
Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.	There are standards of conduct and internal control requirements for the protection of clients and intermediaries. The risk management expectations for broker dealers (BDs) and FCMs should be reexamined, particularly with regard to management of liquidity, funding, and reputational risks under stress.
Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	There are procedures in place at both the CFTC and SEC to address failures and these have been put to the test.
Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	Securities and futures exchanges and trading system operators are subject to authorization and oversight. However, under the CEA, there are categories of trading systems which are exempt from authorization and are not registered with, or designated, recognized, licensed, or approved by the CFTC. The authorization of so called “dark pool” alternative trading systems under Regulation ATS, whereby they are not required to publicly display their best-priced orders in NMS stocks, does not provide for adequate pre-trade transparency of trading interests. Thus, the consultation currently being conducted by the SEC on equity market structure, including issues related to “dark pools,” is timely.
Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	The ongoing supervision of ECMs is an excessively light-touch regime, although the CFTC has recently sought and obtained regulatory change which has enabled it to strengthen oversight where appropriate. CFTC needs explicit statutory authority to impose financial resource requirements on designated contract markets (DCMs). A more holistic approach to capital adequacy requirements for exchanges is preferable.
Principle 27. Regulation should promote transparency of trading.	The CEA and CFTC regulations have not been updated to reflect modern concepts of transparency. However, the practice in futures markets, consistent with the Principle, is real time publication.

Principle	Assessment
	Transparency in the securities markets is comprehensive. There is public display of pre-trade best bids and offers and liquidity. However, 25 percent of liquidity is not publicly displayed (i.e, dark pool ATSs and broker dealer internalization of trading on behalf of clients).
Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	Insider dealing law is too narrowly focused in the derivatives markets. Changes already have been proposed, but additional study is recommended to consider whether further restrictions would be appropriate. Market surveillance is carried out to a high standard by the exchanges and FINRA, and is particularly comprehensive in the futures markets. The SEC and CFTC are constrained by technology limitations.
Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	The timely and comprehensive information flows available in futures markets provide for effective early warnings. In securities markets, tracking large exposures and other potential sources of market disruption is more difficult.
Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and designed to ensure that they are fair, effective, and efficient and that they reduce systemic risk.	A separate CPSS-IOSCO assessment was conducted for the securities markets. Arrangements in the futures markets were not assessed.

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

Principle	Recommended Action
Principles relating to the regulator (Principles 1–5)	Decisions should be taken promptly on the recommendations of the Joint Report to enhance investor protection and improve cooperation between the CFTC and SEC. Legislative and regulatory gaps identified in the Joint Report should be closed. Funding of both authorities needs to be increased and the method of funding should be reviewed. The annual appropriations process seems inadequate to meet the needs for funding necessary long term projects. Annual funding makes it difficult to commit to major investments in software development which takes place over several years. Consideration should be given to moving to direct self-funding (i.e., ability to capture fee income for own funding rather than remitting it to general government revenue and relying on a government budget). The total fee income at the SEC presently generated from its activities far exceeds the combined budgets of the SEC and the CFTC. Taking into account the size and complexity of the markets and the number of registrants they oversee, both agencies need more resources—human, informational and technological—to fulfill their regulatory functions efficiently and effectively.
Principles relating to self-regulation (Principles 6–7)	As recommended in the Joint Report, the CEA should be amended to provide the CFTC with greater powers over product and rules approval of the futures exchanges and to provide greater scope for public consultation prior to their introduction. Corrective measures should recognize the need to balance prior product or rule approval with the exchanges' ability to benefit from their innovative endeavors in a competitive market. The CFTC should remain aware of industry concerns regarding the retention of member regulation by demutualized DCMs. The SEC should consider delegating sole registration authority for BDs to FINRA.
Principles relating to enforcement of securities regulation (Principles 8–10)	Although many improvements have been made or are under way within the SEC, the current program in the Enforcement Division and Office of Compliance, Inspections and Examinations (OCIE) to implement the 21 recommendations set out in the 2009 report of the Office of Inspector General (OIG) and other improvements should be completed as a matter of high priority. The SEC also may want to consider adding enforcement staff with more accounting and economics backgrounds. Mixed teams with different skill sets and experience in the Enforcement Division could enhance its performance.

Principle	Recommended Action
	The number of staff dedicated to the periodic examination of registered IAs (whether at the SEC alone, or in combination with FINRA and/or state regulators) should be increased at least to a level where the percentage of IAs examined annually matches the percentage of BDs examined by the SEC and FINRA. The enforcement division of the CFTC would benefit from more resources. Given the current limited scope of its remit and the integrated market surveillance systems it operates in close cooperation with the DCMs this is not a pressing problem though it will become one if its remit is expanded (e.g., to include OTC derivatives). The securities unit of the fraud section in the criminal division of the DOJ should be given additional resources to prosecute securities fraud.
Principles for issuers (Principles 14–16)	Continuous disclosure requirements should apply to all public issuers. The SEC should have the power to mandate both initial disclosure requirements and on-going obligations directly on municipal government issuers.
Principles for collective investment schemes (Principles 17–20)	The eligibility criteria for CIS and their operators should include the human and technical resources to carry out the required functions, the appropriate financial capacity and adequate internal management and controls. These should be assessed before a CIS or its operator is permitted to begin operations. The resources at the relevant regulators (statutory or SRO) for routine examinations of operators and CIS should be increased. Commodity Pool Operators (CPOs) should be required to have policies in place to avoid or mitigate conflicts. Notice of changes that affect investor or participant rights should be given prior to the effective date of that change, whether or not prior approval is required. Prompt changes to commodity pool disclosure documents should be required when material changes occur. Consideration should be given to requiring the custodian of a CIS's assets to be an arm's length party. Requiring an auditor of a CIS to have relevant prior experience might also be considered. The CFTC should provide guidance to the industry on how to address pricing errors in the valuation of commodity pools.
Principles for market intermediaries (Principles 21–24)	The threshold for review of the fitness of control persons of an intermediary should be the same under the CEA and Exchange Act; the lower 10 percent threshold should be adopted. There should be an assessment of the back-office capabilities, internal controls and policies and procedures of all futures intermediaries and IAs prior to the grant of registration. FINRA should have clear authority to examine and address all securities-related activities of members, including their registered IA

Principle	Recommended Action
	activities. Consideration should be given to requiring that the custodian be at arm's length to the IA. The proposed changes to the futures capital rules to address gaps relating to cleared OTC derivatives and improve the sensitivity of the formula to the actual risks undertaken by the firm should be implemented promptly. The capital rules and other prudential requirements, such as risk management standards, should be reexamined to ensure all risks, including funding, reputational, liquidity and affiliate risks are addressed fully. The regulators should strive to ensure that both capital and risk management requirements adequately address risks posed when firms are under stress. Consideration should be given to reviewing the rules governing BD custody of client assets. The CFTC should have authority to review and approve/disapprove margin requirements set by the DCMs.
Principles for the secondary market (Principles 25–30)	In addition to pursuing legislative change to secure the enhanced powers as set out in the Joint Report the CFTC should consider seeking an authorization power over entities seeking to set up ECMs and Exempt Boards of Trade (EBOTs). However ongoing legislative initiatives are considering the abolition of the ECM and EBOT market categories. The SEC's current broad review of equity market structure to determine whether the rules have kept pace with changes in trading technology and practices should be prioritized with a view to encouraging the broadest public debate while reaching actionable conclusions promptly. It will be essential that the review be conducted on the basis of comprehensive and independent evidence in order to establish accurately the needs of investors of all classes. The recommendations in the Joint Report regarding insider dealing and Chinese Walls in derivatives markets should be implemented. The CFTC should undertake a study to consider whether expansion of the insider trading prohibition in the futures markets beyond the recommendation in the Joint Report is warranted given the current state of the markets, contracts and investors. Such a study would complement the current debate in Europe as to the appropriate coverage of insider trading laws in derivatives markets. The SEC should review the extent to which the absence of additional offences of insider trading is a limiting factor in the SEC's enforcement effort in this area. Current discussions among the securities exchanges and FINRA on creating a consolidated surveillance structure to oversee the consolidated market should be given greater priority with a view to reaching a positive conclusion in a timely manner.

Principle	Recommended Action
	Consideration should be given to amending the regulations to provide the SEC and the securities exchanges with accurate and timely information on large holders of and traders in securities as the CFTC and the futures exchanges have in their markets. This would support surveillance and identify emerging market stress points in a timely fashion. The SEC should join the CFTC in considering the introduction of an explicit and comprehensive financial resource requirement for exchanges.

IV. Authorities' Response to the Assessment

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

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

21. The financial crisis left regulators with enormous challenges and a heightened interest in strengthening regulation. Perhaps most importantly, as the Report recommends, comprehensive regulatory reform of the OTC derivatives marketplace is essential. The financial crisis highlighted how opaque markets can threaten the financial system and the broader public. The U.S. authorities agree with the Report's strong recommendation for increased resources for the CFTC and the SEC should the U.S. Congress expand the agencies' missions to include the regulation of OTC derivatives. The CFTC and SEC

additionally need greater resources to keep up with the growth of securities and futures markets in the United States. The U.S. authorities also agree with the assessment that the CFTC and SEC should enhance cooperation and coordination and already have taken steps to do so.

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

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

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

25. In particular, the Report suggests that only systems that call for review of the "fitness and properness" of CIS operators are acceptable. The Report finds that the regulatory framework in the United States does not address the adequacy of the CIS operators' human

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

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

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

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

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

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

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

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