



ICSA

INTERNATIONAL COUNCIL OF SECURITIES ASSOCIATIONS

May 25, 2007

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

Re: Comment on IOSCO's *Market Intermediary Management of Conflicts that Arise in Securities Offerings*

Dear Ms. Rijk:

We are writing on behalf of the members of the International Council of Securities Associations ("ICSA") which is composed of the trade associations and self-regulatory associations active in the world's major securities markets.¹ We would like to thank the members of Technical Committee for the work that they have done to produce the Consultation Report on *Market Intermediary Management of Conflicts that Arise in Securities Offerings* ("the Report") that was released in February of this year. We welcome the opportunity to comment on the Report.

ICSA represents organisations from a diverse range of jurisdictions and markets, each of which has its own tradition and regulatory distinctions. Because the Report addresses a relatively narrow subject in a detailed manner, this necessarily limits our capacity to provide comments on all of the specific issues that are raised in the Report. Instead, this letter will provide general comments on some aspects of the approach adopted in the Report. Individual ICSA members will provide their own more detailed comments on the Report, as appropriate.

¹ The members of the International Council of Securities Associations (ICSA) represent and/or regulate the overwhelming majority of the world's equity and fixed income markets. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members.

General Principles Preferable to Prescription

Our first general comment is that the Report appears to promote an overly prescriptive, rule-based approach to managing conflicts of interest at market intermediaries arising from securities offerings. In our view the nature of conflicts of interest is such that it is not possible to mandate specific and detailed rules for their management that would adequately cover all of the potential risks. Moreover, given the wide differences that exist between regulatory regimes in different jurisdictions, ICSA members believe that if IOSCO were to contemplate principles in this area, it should focus on promoting general principles for managing conflicts of interest rather than specific rules. That approach would allow regulators in each jurisdiction to implement the principles in a manner that was consistent with their own regulatory philosophy, their domestic legal framework and the specific nature and characteristics of the securities markets that they regulate.

ICSA members are also concerned about the narrow focus of the Report, which looks only at conflicts of interest that arise in the IPO process. Conflicts of interest can arise in a wide range of circumstances in the provision of financial services and if IOSCO were to adopt a set of rules for each one of those situations it would lead to a great deal of unnecessary and costly regulation. Consequently, we are concerned that the Report might be a precursor to the consideration of detailed rules for the other activities of financial intermediaries. As noted above, ICSA members generally believe that conflicts of interest at market intermediaries should be addressed with broad principles that are directed toward the key risks.

Finally, if on the basis of the responses to the Report, IOSCO were to develop principles for the market intermediary management of conflicts of interest that arise in securities offerings, we believe that IOSCO should conduct a second consultation with the private sector specifically on those specific principles. We remain concerned, as noted above, that principles of this nature would be quite detailed and the Report does not explain, nor does it seem likely to elicit reasons, why such principles would be required as an alternative to allowing individual jurisdictions which have developed or are developing principles and/or rules for the management of conflicts of interest to implement those principles and/or rules within the framework of their own domestic legal and regulatory regimes. We believe that this issue needs to be considered in advance of more detailed work on global principles for managing conflicts of interest at market intermediaries.

Defining a Conflict of Interest

The definition of “conflict of interest” is a threshold issue for any form of regulatory guidance on the effective management of conflicts of interest. We note that the definition of conflict of interest used in the Report makes no reference to client relationships in the context of an intermediary with a diverse financial services business. Specifically, the

Report states that, “a conflict arises where the interests of a market intermediary may be inconsistent with, or diverge from, those of its clients, investors, or others.”

We believe that the definition of conflicts of interest used in the Report is incomplete since it omits potential prejudice to the client arising from a conflict of interest between the client and the market intermediary. Accordingly, we would suggest that the definition of a “conflict of interest” in the Report should be refined to reflect material conflicts of interest where a registrant has a duty of care to the client under its regulatory or common law obligations. One already developed definition of conflicts of interest that includes this broader concern is contained in the MiFID Level 2 Directive (2006/73/EC), Recital 24, which states that:

The circumstances which should be treated as giving rise to a conflict of interest should cover cases where there is a conflict between the interests of the firm or certain persons connected to the firm or the firm’s group and the duty the firm owes to the client; or between the differing interests of two or more of its clients, to whom the firm owes in each case a duty. It is not enough that the firm may gain a benefit if there is not also a possible disadvantage to a client, or that one client to whom the firm owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such client.

While IOSCO may not want to use this specific definition for conflicts of interest, we would urge the Technical Committee to develop a more focused and meaningful definition of “conflicts of interest” than the one that is used in the Report.

Different Market and Client Characteristics

As noted above, ICSA members believe that IOSCO should develop global principles for managing conflicts of interest at market intermediaries, and those principles should be set at a general level. If IOSCO believes prescriptive rules are required, ICSA members would suggest that IOSCO should make it clear that the implementation of those rules in different jurisdictions would need to take into account the differences between different types of markets and clients, which may include behavioural and structural differences.

For example it would be important for any proposed rules to distinguish between debt and equity markets. In practice, the institutional and structural differences between these markets affect the form and content of conflicts of interest that may arise between market intermediaries and their clients. For example, in many jurisdictions, debt security issues do not exhibit the same degree of post-offer price volatility as equity issues, which may limit the risk of under or over pricing of those assets.

In addition, as the Report recognises, retail consumers of financial services generally require a much higher level of regulatory protection than wholesale clients, who are more sophisticated and better placed to assess and protect their own interests. Therefore it is important that rules or principles directed toward the management of conflicts of interest at market intermediaries specifically recognise the distinction between retail and wholesale clients, which is a cornerstone of an efficient regulatory system. Significant economic loss would result if retail consumer protection regulation were to be imposed on the wholesale market.

The Role of Robust Information Barriers

Information barriers (“Chinese walls”) are an essential tool for the proper and efficient management of conflicts of interest by market intermediaries. Therefore, it is appropriate that the Report acknowledges the important role that is played by effective and robust information barriers in the management of conflicts of interest. However, the manner of their application in given circumstances is not a matter that would warrant prescriptive guidance by IOSCO.

Importance of Brand or Reputation Risk

We would suggest that IOSCO should also incorporate into its analysis the effect of brand or reputation risk on the actions of market intermediaries. While reputation risk obviously does not obviate the need for regulation, nor will its presence eliminate scandals, it can assist the regulatory process by operating as an incentive to senior management to implement and enforce rigorous internal systems and controls to secure the adequacy of firms’ management of conflicts of interest, especially for conglomerates and large businesses that have significant market reputations and long-term business relationships to protect. In our experience investment banks can on occasion go to exceptional lengths to protect their reputations, to the extent of placing restrictions on their activities above and beyond those that are strictly required by regulations. Firms take these actions out of self-interest, since bad publicity or client discontent from inappropriate behaviour can provoke a negative customer reaction and harm revenue streams. However, regulators can leverage off this aspect of “market discipline” to optimise the efficiency of the regulatory system, in particular when dealing with the management of conflicts of interest.

In closing, once again we would like to thank the members of IOSCO’s Technical Committee for the work that they have done to produce the consultation report on *Market Intermediary Management of Conflicts that Arise in Securities Offerings*. We welcome the opportunity to comment on that report.

Representatives from the ICSA Task Force on Conflicts of Interest would be pleased to meet with IOSCO members to discuss any of the matters set forth in this letter, or to assist in any other way that would be helpful for its consideration of this issue.

Sincerely,

A handwritten signature in cursive script that reads "Marilyn Skiles".

Marilyn Skiles
Secretary General