Securities Industry and Financial Markets Association

WRITTEN STATEMENT OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

TESTIMONY BEFORE THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

"U.S. INTERESTS IN REFORM OF CHINA'S FINANCIAL SERVICES SECTOR"

JUNE 6, 2007

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Before the Committee on Financial Services
United States House of Representatives

Hearing on U.S. Interests in Reform of
China's Financial Services Sector

June 6, 2007

Mr. Chairman, and Members of the Committee:

The Securities Industry and Financial Markets Association[1] is pleased to submit this testimony on China's capital markets and the benefits for U.S. financial services firms and both the U.S. and Chinese economies of opening China's financial markets. Our testimony will focus on the goals and objectives of the U.S. securities industry in our growing relationship with China's economy. As such, this testimony delves into some key issues related to China's capital markets. This hearing is especially timely and provides us with an opportunity to outline progress made to date on expanding opportunities in China for non-Chinese financial services firms as well as areas for continued attention.

SIFMA has long supported more open, fair and transparent markets, and has strongly advocated liberalization in U.S. multilateral and bilateral trade in financial services. The economic benefits of financial services sector liberalization reverberate throughout the world in the form of higher growth and greater opportunities. Financial services liberalization leads to new entrants, innovative products and services, and capital markets with greater depth and efficiency.

In the global economy, openness and fairness are essential to ensuring that markets operate efficiently so that capital can move seamlessly across borders and investors can easily and quickly buy and sell securities anywhere, while businesses can access capital at the lowest cost. The international financial system has been a major contributing factor in the marked increase in living standards of those countries that participate in it.

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

China's WTO accession commitments for financial services, and more specifically for the securities industry, demonstrated a reluctance to open this sector fully to foreign competition. China's reluctance to open its securities markets fully to foreign investment has stymied the interest of foreign securities firms, and has slowed the pace of reforms in China's capital markets. Since China's accession to the WTO, nearly $24 billion has been committed to China's financial services sector, and according to SIFMA estimates less than $600 million of this total has found its way to China's securities firms. We believe China should improve and accelerate its financial sector reform so that it will have the financial tools necessary to sustain and improve the quality of its economic growth.

We also wish to take this opportunity to commend the U.S. Treasury Department for its continuing work and active engagement in seeking open and fair markets for securities firms in China. Through the formation of the U.S.-China Strategic Economic Dialogue ("SED"), and the establishment of a Treasury Financial Attaché in Beijing, Treasury has put in place the framework for continued and active advocacy on behalf of the U.S. financial services sector.

Expanding Business Opportunities for U.S. Financial Services Firms

Many of SIFMA's leading member-firms have identified China as the largest single emerging market opportunity in the next few decades, with some measures indicating that China will be the world's largest economy within the next 40 years.[2] To achieve this, China will need an enormous supply of capital and a market that can efficiently allocate savings. Analysts predict that over the next five years China will need to invest more than $1.5 trillion in improvements to physical infrastructure. Moreover, as China's economy continues to move from planned to market-based, decisions on capital allocation will become increasingly complex, and it will be ever more important to have efficient capital markets to ensure capital is allocated to where it is needed and will be used most efficiently.

At the same time, China will accelerate its ambitious reform program even while its nascent pension system begins to address the needs of a huge and rapidly aging population. In 2005, 7.6 percent of China's population was over 65; by 2025 that number is projected to reach roughly 14 percent. The country's infrastructure, privatization, and social welfare demands will require an increasingly more efficient and sophisticated deployment of capital.

To meet these demands, China will need to modernize its capital markets more rapidly. Currently, banks intermediate nearly three-quarters of all capital in the Chinese economy. For China to meet its financing needs, increase the products and services available to investors, provide companies with new funding options, and enhance financial stability it will need to transition to a financial system less dependent on bank lending and more

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[2] Goldman Sachs' Global Economics Weekly, Issue 03/34, 1st October 2003.

focused on capital markets financing. China's first modern stock market only opened in 1990. Between 1998 and 2000, market capitalization more than doubled from $231 billion to $581 billion; by the end of 2006, market capitalization rose to more than $917 billion. In less than two decades China's stock market stands as the largest in the emerging market world.[3] However, the need for China to further develop its capital markets is illustrated when compared to other developing markets. A McKinsey & Company study found that in 2005, equity market capitalization, excluding non-tradable, state-owned shares, was 17 percent of GDP. This is the smallest market capitalization to GDP ratio in emerging Asia, where the ratio averages 70 percent.[4]

The government of the Peoples Republic of China (PRC) has acknowledged the need to reform the securities industry and has stated that it wants foreign investors and foreign firms to participate. China's domestic capital markets will benefit from the entry of U.S. securities firms and their technology, capital, innovation and best practices. As local firms prepare for this increased competition, they will adopt new technologies and improve the quality of products and services they offer. More competitive and efficient capital markets will also improve the allocation of capital to borrowers and users, facilitate the hedging and diversifying of risk, and assist the exchange of goods and services.

Importantly, increased competition will create incentives and opportunities for niche players to enter the market and provide financial services on a regional basis, offer expertise in specific product areas, and produce new and innovative products that respond to consumer demands for risk management and retirement products, for example.

As China's capital markets develop, Chinese firms will be able to raise more capital at lower costs to grow their businesses and create more products, services, and jobs. Since financial markets are inextricably linked to increased investment and economic growth, it is estimated that financial sector reforms could boost China's GDP annually by up to $321 billion.[5] To put that number in perspective, as of 2005, only 20 countries have total GDP that exceeds $321 billion.[6]

China's private and public sectors alone cannot mobilize the massive financial resources, advice and expertise that are necessary to sustain its economic growth. Much of the infrastructure development will, by necessity, be funded through foreign sources, and this opportunity has generated substantial interest by the U.S. securities industry. Indeed, despite difficulties entering and operating in China, numerous U.S. securities firms have established offices in China and have participated in China's international securities offerings.

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[3] However, according to McKinsey Global Institute, once these figures are adjusted for nontradable shares, China's stock market capitalization as a percent of GDP is among the world's smallest, about 17 percent. Corporate debt issuance lags too, with issuance equal to about only 1 percent of GDP. "How Financial System Reform Could Benefit China," 2006 Special Edition: Serving the New Chinese Consumer, *The McKinsey Quarterly.*

[4] Similarly, corporate bond issues by non-financial companies amounted to between 2 and 3 percent of GDP, compared with a typical 50 percent in other emerging Asian markets.

[5] Putting China's Capital to Work: The Value of Financial System Reform, May 2006, McKinsey & Company.

[6] World Bank, World Development Indicators database, World Bank, 23 April 2007.

U.S.-China Strategic Economic Dialogue

SIFMA is an enthusiastic supporter of the Strategic Economic Dialogue (SED) and we commend Treasury Secretary Paulson, Ambassador Holmer, their Treasury colleagues, and the Administration, for this important undertaking. Our view is that the SED has the potential to play a key role in advancing the US-China economic relationship. The SED provides a forum where—with a single, unified voice—the Administration can underscore the importance to China of an open, fair and transparent market for financial services. Consequently, SIFMA has urged the Administration to engage in a results-oriented discussion that leads to the reduction and elimination of barriers that continue to obstruct global financial services firms in China. Eliminating burdensome barriers to entry will benefit the economies of both nations. While we detail our agenda for reform below, we believe there are a number of steps the Chinese should take in the short-term that will help it to reach its stated economic goals and reinforce the political sustainability of the SED.

First, China should lift the de facto moratorium on foreign securities firm joint ventures that has been in place since December 2005. Importantly, removal of the moratorium will bring China back into compliance with its WTO commitments. We are pleased that during the May 22-23, 2007 SED meeting, China took a critical first step towards this goal by lifting the moratorium imposed on foreign investment in Chinese securities firms. It is important to note, however, that the moratorium is to be lifted sometime in the second half of 2007, rather than by a specific date.

Second, China should put in place a precise and transparent roadmap, on an agreed to timetable, that would result in providing foreign securities firms with the right to own 100 percent of a PRC financial services firm and the ability to engage in a full range of securities activities. No progress was made on this issue during the recent SED.[7]

China's WTO Commitments For Foreign Securities Firms

China's 2001 World Trade Organization (WTO) entry commitments in the securities and asset management sectors marked the country's first step toward liberalizing its capital markets. The commitments permit foreign firms to participate in the securities sector only through joint ventures (JVs) in which foreign ownership is capped at 33 percent—although as more fully described below the scope of securities activities in which these joint ventures can participate is limited. China's WTO commitments also limit foreign participation in China's asset management sector to ownership of no more than 49 percent of domestic fund management firms.

[7] That being said, Tu Guangshao, vice chairman of the China Securities Regulatory Commission, was quoted by state media as saying China will raise the ceiling for foreign investment banks' stake holdings in domestic brokerages and joint ventures before the year-end. Reuters, Shanghai, Wednesday, May 30, 2007.

These WTO commitments make no provision for further increases in foreign ownership in either securities or asset management firms. Instead, the commitments suggest that without a change in policy, foreign investors will remain minority shareholders in local securities firms for the foreseeable future. Indeed, China remains as one of the few markets of interest to the securities industry where majority ownership is not permitted.

China's WTO commitments in the securities sector also limit these minority owned JVs to underwriting the A shares of Chinese corporations, and to underwriting and trading government and corporate debt, B shares and H shares. The fundamental ability to trade in A shares was not conferred on these minority JVs. (A shares are Renminbi (RMB)-denominated shares limited to domestic investors, foreign financial firms with qualified foreign institutional investor (QFII) status, and foreign strategic investors. B shares are foreign-currency denominated shares listed on PRC exchanges and are open to both domestic and foreign investors. H shares are shares of PRC companies listed in Hong Kong.).

Though foreign industry involvement can improve many aspects of the securities industry, we would urge China to move forward in two distinct, but reinforcing, areas to modernize and strengthen its capital markets. First, improvements in market access would improve the ability of foreign securities firms to compete in a fair manner with local firms. Second, steps in market reform would better regulate the industry and increase transparency.

However, there remain significant market access barriers. SIFMA strongly urges China to make the following additional commitments, in the context of the ongoing WTO financial services discussions, in other trade forums, or government-to-government discussions:

1) Permit Full Ownership and the Right to Choose Corporate Form

> China should put in place a precise and transparent roadmap, on an agreed to timetable, that would result in providing foreign securities firms with the right to own 100 percent of a PRC financial services firm, including the ability to engage in a full range of securities activities, including underwriting, secondary trading of government and corporate debt and all classes of equity, hybrid mortgage products, derivatives trading, and asset management. We do note, however, that one of the results of the recent SED was that the Chinese will announce before the next SED meeting that foreign securities firms will be permitted to expand their operations in China to include brokerage, propriety trading and fund management.
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> The right to enter a market and establish a wholly owned presence in a form of the firm's own choosing is relatively common in today's global markets. Currently, foreign investors can enter China's securities markets in two ways: by establishing a new JV with a Chinese partner or by taking a stake in an existing brokerage, the path that a number of foreign securities firms have chosen. Because in most cases the negotiations that result in a JV or a foreign stake are opaque, however, potential entrants have little available in the way of guidance on how to arrange such JVs. Similarly, foreign asset management firms should be permitted to manage money for Chinese investors, both retail and institutional, as

well as to sell internationally diversified mutual funds to individuals through qualified local distributors.

2) Liberalization of Qualified Foreign Institutional Investors (QFII) Standards

China's decision to permit foreign investment in A shares through QFIIs beginning in 2003 was a landmark step in the development and liberalization of China's capital markets. More recently, PRC authorities have taken steps to increase the number of QFIIs and the amount invested by QFIIs.[8] Nevertheless, a few QFII requirements are onerous and have substantially limited the utility of the program, as well as the number of investors that can take advantage of it.

Along with the QFII program, China has recently taken steps to allow certain large foreign investors to purchase shares in domestic companies. These new rules will allow foreign investors to buy stock in Chinese companies that have completed the share-reform program (exchange of nontradable shares to common A shares). Foreign investors that meet certain government standards can buy existing shares or purchase new shares that might be issued. But requirements that an investor purchase at least 10 percent of the company, and hold the stake for at least three years, could limit the desirability of the program.

China would make its securities markets more attractive to investment through the liberalization of QFII restrictions. Such progressive liberalization, done in consultation with foreign and domestic capital markets participants, would almost certainly result in greater foreign investment in China's securities markets, deepen and broaden trading in those markets, and increase capital availability to Chinese issuers.

3) Implement a QDII program

China is in the process of launching its long-awaited qualified domestic institutional investor (QDII) program to promote Chinese investment in foreign stocks and bonds. The People's Bank of China (PBOC) announced the launch of the program in April 2006, and the PBOC, the China Banking Regulatory Commission, and the State Administration of Foreign Exchange released interim measures that permit qualified commercial banks to pool RMB from domestic institutions and individuals and convert them into foreign exchange for investment overseas in fixed-income securities. Other implementation rules will eventually expand the program to qualified mainland insurance companies, fund management firms, and securities brokerages to convert RMB into foreign currency, raise funds in RMB or foreign currency, and invest in overseas securities. Such a program

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[8] China will raise the quota for Qualified Foreign Institutional Investors from $10 billion to $30 billion, SED Financial Sector Reform Fact Sheet, May 23, 2007.

will further liberalize China's capital accounts. It may also help familiarize Chinese domestic investors with international corporate and brokerage practices and give them access to top-quality research under conditions that would respect officials' concerns about currency flows. China recently lifted restrictions prohibiting Chinese banks from buying foreign equities, and will allow banks to invest up to 50 percent of the QDII funds in overseas stocks. Previously, QDII banks were restricted to buying bonds, money-market products and fixed-income derivatives.[9]

4) Promote Regulatory Transparency

A transparent industry is generally one in which the public and industry participants have the opportunity to be involved in the rulemaking process, access information about proposed rules, question and understand the rationale behind draft rules, and have sufficient opportunity to review and comment on them. Transparent and fair regulatory systems play an integral role in the development of deep, liquid capital markets that attract participants, increase efficiency, and spur economic growth and job creation. The absence of transparency in the implementation of laws and regulations can seriously impede the ability of firms to compete fairly and often distorts the market. Though China's securities regulator, the China Securities Regulatory Commission (CSRC), has improved its policies on prior consultation and has presented many proposed regulations for public comment, much progress is still needed. Short comment periods are insufficient to review complex new regulations, particularly those intended to affect foreign firms whose ability to comment is hampered by distance and language.

SIFMA has published a paper (attached as an Appendix) that serves as a blueprint for a transparent regulatory regime. The paper underscores the key guiding principles of fair and transparent regulations as follows: 1) rules, regulations and licensing requirements should be considered and imposed, and regulatory actions should be taken, only for the purpose of achieving legitimate public policy objectives that are expressly identified; 2) regulation should be enforced in a fair and non-discriminatory manner; 3) regulations should be clear and understandable; 4) all regulations should be publicly available at all times; and 5) regulators should issue and make available to the public final regulatory actions and the basis for those actions.

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[9] QDII's will still be prohibited from, "…no investment in commodities-based derivative products, hedge funds and debt securities with credit ratings below BBB as assigned by an international credit rating agency." Notice of the Adjustments to the Offshore Investment Scope of Overseas Wealth Management Business of Commercial Banks on behalf of Their Clients (promulgated on May 10, 2007), http://www.cbrc.gov.cn/english/home/jsp/docView.jsp?docID=20070511425E7E3A4547640AFFE563AD79AEB000.

5) Liberalize Derivatives Regulation

> Interim derivative rules, which took effect in March 2004, have prohibited securities firms from creating and distributing derivative products. The inability of securities firms to engage in these activities hampers the development of these markets. Foreign firms hope that China's newly revised Securities Law will lead the State Council to formulate measures on the issuance and trading of derivatives.

Continued liberalization of China's capital markets has clear benefits for China and the global economy. Long-established U.S. policy seeks to promote economic growth through open financial services markets. Global economic integration facilitates the importation of capital and intermediate goods that may not be available in a country's home market at comparable cost. Similarly, global markets improve the efficient allocation of resources. Countries gain better access to financing, and the suppliers of capital—institutional investors or individual savers—receive better returns on their investments.

The most reliable and expedient way for China to meet its massive capital demand is to access the larger pools of capital available in the global markets. Foreign securities firms can contribute to the development of China's financial markets by sharing their expertise on the infrastructure needed to effectively serve a sophisticated and globally oriented client base. Foreign players can also provide new financial products and services that meet the changing needs of Chinese investors, demonstrate the benefits of high corporate governance standards, and consult on legal issues that must be addressed to help domestic equity and capital markets flourish. Ultimately, the modernization of China's financial system, especially its capital markets, will benefit both China and the world.

Finally, open, fair markets help to increase living standards. We look forward to working with the Congress and the Administration to further expand the U.S. securities industry's access to China through the use of bilateral and multilateral trade forums. A coordinated U.S. government effort, including all relevant agencies, will be critical in helping U.S. securities firms to gain full access to these crucial markets.

We appreciate the opportunity to present this statement today and we look forward to working constructively with this committee on issues related to the global financial markets in the future.

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PROMOTING FAIR AND TRANSPARENT REGULATION

DISCUSSION PAPER

I. Setting The Foundation for Open and Fair Securities Markets

Deep and liquid capital markets are the essential building blocks of today's economy, supplying the funds for economic growth and job creation. The firms that participate in the markets price risk, allocate capital, provide investors with advice and investment opportunities, and supply the liquidity needed to make markets work efficiently.

Just as capital markets underpin economic growth and job creation, transparent and fair regulatory systems are essential to the development of deep and liquid capital markets. A system of regulation that is transparent to market participants instills the confidence needed to attract both the suppliers and users of capital to make the best use of the markets.

Governments, regulators and the international financial institutions have undertaken substantial projects designed to improve the quality of the financial systems world-wide. Attention is now focused on building fair and transparent regulatory systems – grounded in the principles of market integrity and investor protection – to oversee those markets. Consistent with those goals and the principles of prudential regulation, discriminatory practices and considerations, such as the nationality of individuals or the place of origin of firms, should not be permitted to influence regulatory policies or actions.

This paper is based on the assumption that a country's relevant laws should promote fair and transparent regulation. The principles outlined in this paper are not intended to prevent a regulator from taking measures for prudential or legitimate public policy reasons recognized under the World Trade Organization, including protecting investors, ensuring that markets are fair, efficient and transparent, and reducing systemic risk.

A consensus view, supporting the development of active, sound and efficient markets based upon established principles for capital market regulation, is rapidly emerging. In September 1998, the International Organization of Securities Commissions (IOSCO) issued a paper entitled "The Objectives and Principles of Securities Regulation" that urged the adoption by all regulators of processes and regulations that are:

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

The International Monetary Fund ("IMF") is developing a broad-based "Code on Good Practices and Transparency in Monetary and Financial Policies" that complements IOSCO's work.

The securities industry, which today operates on a global basis, supports the IMF and IOSCO efforts to establish principles of fair and transparent regulation. The securities industry strongly believes that by making regulation and the operation of regulators accessible and transparent and by treating foreign and domestic licensed market participants fairly and equitably, governments, regulators and international financial institutions will promote the best markets for investors throughout the world.

Building on the emerging regulatory consensus, this paper provides the views of the securities industry on fundamental regulatory principles and practices that will provide a fair and level playing field for market participants. It also sets the foundation for building strong and vibrant markets worldwide. Moreover, we strongly believe that the principles promoting fair and transparent markets are broadly applicable to all financial services firms participating in the global capital markets. In this regard, we are actively seeking the support of financial services firms worldwide in promoting these principles.

II. Guiding Principles of Fair and Transparent Regulation

A. *Rules, regulations and licensing requirements should be considered and imposed, and regulatory actions should be taken, only for the purpose of achieving legitimate public policy objectives that are expressly identified, including, for example, investor protection, maintaining fair, efficient, and transparent markets, and reducing systemic risk.*

B. *Regulation should be enforced in a fair and non-discriminatory manner.*

1. *Regulations and regulators*[1] *should not discriminate among licensed market participants on the basis of the nationality or jurisdiction of establishment of the shareholders of a market participant or the jurisdiction of establishment of any entity that owns or controls the equity or indebtedness of a market participant.*

2. *The relationship between a regulator and a licensed market participant should be governed by the standards set forth in relevant rules and regulations, and should not be subject to political or other extraneous or improper considerations*.

3. *The introduction of new securities products and services by firms should be governed by the standards set forth in relevant rules and regulations*

C. *Regulations should be clear and understandable*. Clear and understandable regulations and rulings provide market participants with the predictability and necessary knowledge to comply with regulations. Opaque or ambiguous regulations and rulings create uncertainty among investors and licensed market participants.

D. *All regulations should be publicly available at all times*. All regulations should be made, and at all times remain, publicly available, including requirements to obtain, renew or retain authorization to supply a service. Disciplinary actions should not be taken based on violations of regulatory standards that were not in effect at the time the relevant activity took place.

[1] The term "regulator" is intended to cover all bodies that are authorized pursuant to law to play a role in the licensing and supervision of the activities of financial services firms, as well as the bodies that formulate rules, regulations and policies relating to such firms. Where the legislature or authorized regulator delegates its authority to a non-governmental entity such as a self-regulatory organization or trade association, the term is intended to encompass such an entity.

E. *Regulators should issue and make available to the public final regulatory actions and the basis for those actions, in order to enhance public understanding thereof.*

III. Rulemaking and Implementation

A. *The rulemaking process*

1. *Regulators should utilize open and public processes for consultation with the public on proposals for new regulations and changes to existing regulations.* A reasonable period for public comment should be provided. Any hearings at which formal promulgation or adoption of new regulations or changes to existing regulations are considered, if open to a member of the public, should be open to all members of the public. Regulators should not take arbitrary regulatory action against those who participate in the consultation process.

2. *In considering whether rules, regulations, licensing requirements or actions are necessary or appropriate, regulators should also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.*

B. *Communicating and implementing new rules*

1. *New rules and regulations that provide advice for market participants should be made available to them and the public in a timely and efficient manner.* Such changes should be made available, in writing, by electronic media or other means of distribution so that all market participants have reasonable access to such material.

2. *Market participants should be given a reasonable period of time to implement new regulations.* The effective date of a new regulation should provide a reasonable period for market participants to take the steps needed to implement the new regulation under the circumstances.

C. *Interpretations of rules*

1. *Regulators should establish a mechanism to respond to inquiries on rules and regulations from market participants.* The titles and official addresses of the relevant regulatory offices should be provided.

2. *Interpretations and the grants or denials of regulatory relief or exemptions should be made available to the public.* Such interpretations, relief or exemptions should generally apply or should be applied upon proper request, to substantially similar licensed market participants and new products. Under limited circumstances it may be appropriate to delay the publication of individual grants of relief for reasonable periods of time to address legitimate competitive concerns.

IV. Licensing and New Product Procedures

A. *Procedures for licenses and introduction of new securities products and services.*

1. *Criteria governing licensing of firms and the introduction of new securities products and services by firms should be in writing and accessible, and should be the basis on which decisions are made.* All regulations and related explanatory materials governing the consideration and issuance of licenses to firms and the introduction of new securities products and services by firms should be reduced to writing and made publicly available to potential applicants upon request. No licensee should be denied a license, and no new securities product or service should be prohibited, on the basis of any factor not identified in such written regulations or explanations.

2. *The introduction of new securities products and services by firms should be governed by the standards set forth in relevant rules and regulations.* Where particular requirements are established in connection with the introduction of a product or service, such requirements should govern the introduction of complying products and services. In order to promote flexibility and efficiency in the capital markets, such standards and requirements

should enable firms, to the maximum possible degree consistent with principles of prudence and investor protection, to introduce complying new products and services on the basis of sound internal procedures for compliance without additional regulatory review.

3. *Information supplied by applicants as part of an application process should be treated confidentially. Such information should be disclosed only in accordance with existing rules permitting public disclosures, such as those that may be triggered by the granting of a license or product approval.*

4. *Regulators should promptly review all applications by firms for licenses and required product or service approvals and should inform the applicant of any deficiencies.* No application for a license or approval that provides all information required pursuant to regulation and is made in good faith by an applicant that meets required criteria should be refused review and action by the relevant regulator. Action on all applications received should be taken within a reasonable period. Licenses should enter into force immediately upon being granted, in accordance with the terms and conditions specified therein.

5. *Where an examination is required for the licensing of an individual, regulators should schedule such examinations at reasonably frequent intervals.* Examinations should be open to all eligible applicants, including foreign and foreign-qualified applicants.

6. *Fees charged in connection with licenses and the introduction of new securities products and services should be fair and reasonable and not act to prohibit or otherwise unreasonably limit licensing requests or the introduction of new product and services*.

B. *Licensing of entities and their employees*

1. *An applicant's competence and ability to supply the service should be the criteria used for licensing entities and employees.* The terms and conditions for granting licenses should be made explicit, including education, experience, examinations and ethics. Procedures and criteria should not unfairly distinguish between domestic and foreign applicants. In addition, there should be no quantitative limits on the number of licenses to be granted to a particular class of market participants who are otherwise qualified.

2. *When imposing licensing requirements, regulators should endeavor to give consideration to comparable testing or other procedures confirming the qualifications of an applicant that already have been completed in another jurisdiction.* The ability of qualified and experienced market professionals to provide services in a foreign jurisdiction may be promoted where testing or other procedures used in the professional's home jurisdiction may satisfy all or part of the foreign jurisdication's licensing requirements.

C. *Denials of licenses and product and service approvals*

1. *When denying an application for a license or a required securities product or service approval, regulators should, upon request, provide an explanation for that action.* Any total or partial denial of any application for a license or a required new product or service approval should, upon request, be accompanied by a written statement of explanation from the relevant regulator detailing the reasons for the denial, including the particular requirements of the regulations governing the issuance of such license or required approval that were not satisfied. Applicants should be given the opportunity to resubmit applications or to file additional or supplementary materials in support of their applications.

2. *Applicants should be afforded meaningful access to administrative or judicial appeal of a denial of a license or a required product or service approval (or failure to act on an application).*

3. *An appeal of a denial of a license or a required product or service approval should be decided within a reasonable time period after the appeal is filed*. An applicant's decision to pursue an appeal (whether formal or informal) should not prejudice its existing licensed operations.

V. Implementation of Regulatory Standards

A. *Inspections, audits, investigations and regulatory enforcement proceedings*[2]

1. *All inspections, audits, investigations and regulatory enforcement proceedings should be conducted pursuant to established regulatory and judicial standards and should not arbitrarily discriminate based on improper or other extraneous criteria like nationality*.

2. *All inspections, audits, and investigations should be conducted in a manner that does not impinge on the rights of licensed market participants and their directors, officers and employees.*

2. *A regulatory authority*[3] *should not publicly disclose the fact that it is conducting an enforcement related inspection, audit or investigation of a particular entity until a determination has been made by the regulatory authority to take remedial or other enforcement-related action, unless otherwise subject to a legally enforceable demand unless made in connection with a generally applicable disclosure requirement imposed on the entity*. The inspection, audit or investigation should be conducted at all times with due attention to the privacy and confidentiality concerns of all affected parties, including licensed market participants, their directors, officers, employees, and clients.

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[2] The term "regulatory enforcement proceedings" means administrative or judicial action authorized by the relevant regulatory authority and is intended to cover civil, administrative or criminal proceedings that involve a financial services firm and/or its employees based on their financial services activities.

[3] The term "regulatory authority" is intended to cover all regulatory bodies involved in the inspection, auditing, investigation or prosecution of the activities of financial services firms. Depending on the system, the term may encompass criminal and judicial authorities as well as non-governmental entities such as self-regulatory organizations.

B. *Regulatory proceedings to impose a sanction*

1. Notice and opportunity to be heard

a. *Notice of applicable law and regulation*. A regulatory proceeding to impose a sanction should only be instituted based on the violation of laws or regulations that were in effect at the time that the relevant activity occurred and where the subject of the proceeding had timely notice of them.

b. *Notice of determination to take action*. Licensed market participants should be notified in a timely manner both when: 1) a determination has been made to hold a regulatory proceeding concerning the conduct of that participant; and 2) a decision in, or on the status of, that proceeding has been made.

c. *Opportunity to be heard*. Except in situations where emergency temporary relief is necessary, in all regulatory proceedings, licensed market participants should be given a reasonable opportunity to be heard and to submit, on the record, position papers and other documentary evidence.

2. Representation by counsel and access to evidence

a. *Right to legal counsel*. The subjects of a regulatory proceeding should have the right to have legal counsel of their choice represent them in all meetings with, and interviews by, regulatory authorities. A regulatory authority should not suggest or imply that the attendance of counsel will in any manner alter the character of the proceedings being conducted, the level of supervisory review to be undertaken, or the manner in which the regulatory authority carries out its functions.

b. *Access to evidence*. The subjects of a regulatory proceeding should, upon request, be permitted reasonable access to all documents and records that are relevant to the subject matter involved in the pending regulatory action. Documents and records to which access is denied based on privileges generally recognized in such proceedings should not be admissible in evidence in such regulatory proceeding.

c. *Burden of proof*. The burden of proof to demonstrate that a licensed market participant has not conducted its business in accordance with the relevant law and regulation should rest with the regulatory authorities.

3. Sanctions and Appeals

a. *Sanctions*. Sanctions by a regulatory authority should be imposed in a fair and nondiscriminatory manner based on the relevant facts and with an effort to treat similarly situated persons and entities in a similar manner. The basis for any decision to impose sanctions by a regulatory authority should be explained in a writing that is made available to the subjects of the proceeding.

b. *Appeals*. The subjects of a regulatory proceeding should have available to them a forum for appealing the decisions rendered and sanctions imposed. The body considering a particular level of appeal should be separate from that which made the decision or imposed the sanction that forms the basis of the appeal. Appeals to a regulatory authority should be decided in a timely manner and appeal determinations should be explained in a writing that is made available to the subjects of the proceeding.

For information and/or comments contact:

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