INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

DRAFT ICSA Best Practices for Regulatory Consultation

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ICSA International Council of Securities Associations

The members of the International Council of Securities Associations[1] understand that transparent regulatory systems are essential for the development and stability of capital markets for several reasons. First, regulatory transparency can enhance the effectiveness of regulatory policies because it allows financial market participants to better understand the goals and instruments of those policies, thereby greatly strengthening the potential for cooperation between regulators and market participants. Second, by enabling market participants and other stakeholders to provide feedback on proposed regulations, regulatory transparency improves the decision making process of securities regulators while also reducing the risk that new policies will have unintended, and negative, consequences for financial markets. Third, regulatory transparency creates credibility for regulatory decisions since it helps to ensure that the rules and regulations introduced into financial markets are unbiased. Finally, by encouraging input from regulators and market participants based in other jurisdictions, regulatory transparency can also help to ensure that regulations that have an extraterritorial or cross-border impact are consistent both with existing regulations in the home jurisdiction as well as with regulations in other jurisdictions where they may have an impact. This last issue is particularly important at the current time, given the importance of ensuing that regulations in different jurisdictions for the same financial markets and products are as consistent with one another as possible.

An effective and structured consultation process is a crucial component of and contributor to a transparent regulatory system. An effective and structured consultation process, defined as one which includes a genuine invitation from regulators for comments from market participants and other stakeholders and appropriate consideration of the comments that have been received, will help to ensure that proposed regulations are subject to a transparent, informed review.[2] The dialogue

1. ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. 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. More information about ICSA is available at: www.icsa.bz

2. The term 'regulator' is intended here to cover all bodies that are authorized pursuant by law to play a role in the licensing and supervision of the activities of financial services firms, financial markets and financial services products, as

established through an effective consultation process helps to improve the quality and efficiency of the rules and regulations that are finally adopted as well as encouraging greater cooperation between regulators, market participants and other stakeholders.[3] Finally, by involving a broad range of stakeholders in consultations, regulatory consultations strengthen the legitimacy of the regulations that are eventually issued.

Given the importance of regulatory consultation, ICSA members have endorsed the enclosed set of "best practices" for the regulatory consultation process. These best practices are based in part on an earlier document issued by ICSA in 2004.[4] The best practices in the current document, however, reflect the important policy changes that have taken place since the onset of the global financial crisis in 2007. This has included most critically the involvement of G20 leaders in setting goals for the implementation of globally consistent regulatory standards for financial markets, the emergence of the Financial Stability Board (FSB) to both develop those standards and coordinate the work of national financial authorities and the global standard setting bodies, and the more prominent role that has been assumed by the global standard setters themselves, specifically the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision.

ICSA members strongly support the high level objectives guiding the work being done by the FSB and the international standard setters, particularly the stress on encouraging global consistency in regulatory policies. However, since the new global standards are being issued at the same time

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well as the bodies that formulate rules, regulations and policies relating to such firms, markets and products. This includes at the national level certain non-governmental entities, such as a self-regulatory organizations, where the legislature or authorized regulator has delegates all or part of its authority to that entity. In addition, since financial regulation is increasingly being set at the global level by the FSB and the international standard setters, is assumed that the best practices set forth in ICSA's *Best Practices for Regulatory Consultation* would also be relevant for those entities even though they are not technically regulatory bodies.

3 At the international level, regulatory consultation was recognized as a critical part of the regulatory process as early as 1955 when the OECD published its *Recommendations on Improving the Quality of Government Regulation*, which contained the OECD *Reference Checklist for Regulatory Decision-Making*. Item 9 of that ten point checklist states that, "Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interests groups, or other levels of government". See OECD (1955), *Reference Checklist for Regulatory Decision-Making*, pg. 2. The OECD's more recent *Policy Framework for Effective and Efficient Financial Regulation*, published in 2010 and oriented specifically toward financial market regulation, reaffirms the importance of appropriate regulatory consultation at every stage of policy implementation. See OECD (2010), *Policy Framework for Effective and Efficient Financial Regulation*, page 31. Similarly, IOSCO's *Methodology for Assessing Implementation of IOSCO's Objectives and Principles of Securities Regulation* states that regulators should, "… have a process for consultation with the public, including those who may be affected by the policy". See IOSCO (2010), *Methodology for Assessing Implementation of IOSCO's Objectives and Principles of Securities Regulation*, page 34.

4. *ICSA Statement of Regulatory and Self-Regulatory Consultation Practices* (October 2004).

that many jurisdictions are introducing their own major regulatory reforms, in many cases market participants and other stakeholders have been faced with the need to comment on a large body of proposed new regulations, some of which may have a major impact at both the national and global level. At the same time, because of time frames imposed by the G20 and/or national legislators, the amount of time allocated for consultation on proposed regulatory reforms has been compressed in many jurisdictions, even those with long standing consultation policies. As a result, there has often been insufficient time allowed for respondents to comment appropriately on proposed regulatory reforms and for regulators to take those comments into account so that the proposed reforms could be sufficiently modified before they were implemented.

In light of these experiences, ICSA's Best Practices for Regulatory Consultation emphasize several key aspects of the consultation process. The first is the importance of allocating sufficient time for the consultation process, particularly for consultations on major reforms that are likely to have significant impact on one or more financial markets. Without an appropriate period of time for research and reflection, it is virtually impossible for market participants and other stakeholders to provide the type of comments necessary in order for proposed regulations to be sufficiently "vetted". Similarly, regulators also need an appropriate period of time to assess the comments that they have received and modify proposed reforms accordingly. Conversely, when the time allocated for the consultation process is curtailed, as has been the case a number of times over the past several years, the value of the consultation is reduced and regulatory transparency is curtailed.

The revised best practices also emphasize the need for proposed reforms to have well designed policy objectives and to be written in a clear and precise manner so that market participants and other stakeholders are able to provide comprehensive comments on the proposed measures. In addition, the best practices emphasize the need for regulators to ensure to the greatest extent possible that any proposed new regulations are consistent and coherent with the existing regulatory framework. This particular issue has become extremely important in recent years, as regulators have sought to introduce broad new reforms which, in some cases, were not consistent with the existing regulatory framework. In such circumstances, it is extremely difficult for market participants and other stakeholders to provide as complete a commentary as would be needed.

Another element emphasized in the best practices is the importance of impact assessments. ICSA members recognize that conducting an impact assessment for a proposed regulation can be a challenging task. At the same time, however, the information from an impact assessment is critical in order for industry participants and other stakeholders to comment in a sufficiently comprehensive manner on any proposed reforms. Similarly, impact assessments are also important for regulators and policy makers so that they have an understanding of the costs of the proposed reforms along with benefits.

Finally, the best practices for regulatory consultation encompass the entire consultation cycle. This cycle begins with the establishment of a comprehensive consultation program which is then put into practice and concludes with a commitment on the part of regulators to review the impact of major policy reforms once they have been fully implemented. This final best practice is based on the understanding that regulation in an area as dynamic as financial markets will always be more of an art than a science. This is particularly true during a period of time when a large number of major regulatory reforms are being implemented, at both the national and international level. In these circumstances, it is difficult to assess *ex ante* the effect of any reform since financial markets and market participants will also be impacted by other regulatory reforms taking place at the same time. Therefore, the commitment to carry out post-implementation reviews is critical in order to ensure that the major regulatory reforms that have been consulted on and put into place actually meet their stated objectives. Otherwise, there is a danger that a large body of regulations could be implemented without a detailed understanding of the impact that those regulations were actually having in financial markets.

Based on the above considerations, the members of the International Council of Securities Associations propose the following best practices as a framework for regulatory consultation policies:

ICSA Best Practices for Regulatory Consultation

Best Practice 1: Developing a formal consultation program

Regulators should develop a formal consultation program to ensure that the consultation process is managed in a transparent and accountable manner

Key considerations:

Regulators should develop a formal consultation program in order to ensure that the consultation process is managed in a transparent and accountable manner. This includes developing a written document detailing the various aspects of the consultation program that is easily assessable by market participants and other stakeholders. Once a formal consultation program is developed, implementing and maintaining the program will require that the regulator provides appropriate staff and other resources and ensures that there is a demonstrated commitment to consultation by the top level of management.

Best Practice 2: Sequencing and prioritizing consultations on major reforms

Regulators should clearly prioritize among planned reforms in order to ensure that consultations on all major reforms are appropriately sequenced

Key considerations:

It is critical that where possible, regulators both prioritize among their proposed reforms and appropriately sequence consultations on major reforms, so that market participants and other stakeholders are able to develop comprehensive responses which take into account the entire reform program. Prioritizing among the various elements of the reform program is important since it allows regulators and stakeholders alike to focus their resources on the most important reforms. Appropriately sequencing consultations on major reform proposals is equally important since it allows market participants and other stakeholders to assess the impact of the proposed regulations within the context of other related regulatory changes that have been implemented or proposed and/or are likely to be proposed in the near future.

These objectives can be accomplished by:

a. Identifying through a ratings system or similar methodology the proposed reform that would result in major policy changes, defined as policy changes that would affect a large number of consumers and/or segments of the securities market and/or are likely to be controversial or high-profile;

b. Publishing an annual work program that sets out specific timetables for consultation on and implementation of the full range of proposed reforms; and,

c. For reforms requiring both legislative changes and associated rulemaking, ensuring that consultations on proposed rules are completed well before the legislative changes come into effect.

Best Practice 3: Clearly defining the scope and policy objectives of proposed regulations

Regulators should ensure that regulatory proposals have a clearly defined policy objective and scope and to the greatest extent possible are compatible with the existing regulatory framework

Key considerations:

Policy proposals need to have a well designed policy objective and be clearly scoped so that market participants and other stakeholders are able to provide comprehensive comments on the proposed measures. This is essential at all times, since it helps to ensure that respondents are able to focus their resources on the most important issues raised in proposed reforms. However, it is particularly important during a period of time when major financial sector reforms are being contemplated, since these types of reforms by definition require respondents to allocate more resources to developing their responses. Regulators should clearly explain the policy objectives that the proposed measures are intended to achieve and also ensure to the greatest extent possible that any proposed regulations are consistent and coherent with the existing regulatory framework. This issue is significant since it is extremely difficult for market participants and other stakeholders to appropriately comment on proposed reforms when those reforms would be inconsistent with the existing regulatory framework within their jurisdiction.[5]

These objectives can be accomplished by:

a. Including in the consultation document(s) a clear explanation regarding why a new policy measure is necessary along with a comprehensive analysis setting out the market failure that the proposed reform is intended to correct; and,

b. Including in the consultation document(s) a comprehensive impact assessment setting out the estimated costs and operational implications of the proposed regulations, including their projected impact on small firms.

Best Practice 4: Undertaking pre-consultation with stakeholders

Regulators should initiate preliminary informal consultation with market participants and other stakeholders on proposed measures as early and as widely as possible

Key considerations

To the greatest extent possible, regulators should engage in pre-consultation as early as possible in the process. Pre-consultation is useful as it allows regulators to "test out" various ideas in a forum that allows for the free exchange of opinions and information with market participants and other stakeholders, before conclusions have been drawn and while key proposals can still be radically altered or even abandoned. This can be accomplished by:

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5. Some of the reforms that have been proposed since the onset of the 2008 financial crisis have not been consistent or coherent with the existing regulatory framework in the jurisdiction(s) where the reforms have been proposed. The lack of consistency may have been due in part with the need to adhere more closely to global standards than had been the case previously. ICSA members strongly support the development of consistent global standards for regulating securities markets. At the same time, however, it is important for regulators to ensure that any new regulations that are proposed do not represent such a sharp divergence from the existing regulatory framework that, if implemented, the new regulations would create excessive compliance burdens or complications for firms’ ability to comply with already existing regulations.

a. Organizing informal discussions at an early stage with a cross section of experts and those most likely to be directly affected by the proposed regulations and producing a representative analysis of the replies received in a feedback statement.[6]

b. Formally publishing initial tentative proposals in a preliminary form such as discussion documents in order to invite a wide public debate on whether the proposed objectives are appropriate, desirable, and supported by the likely costs and benefits; and,

c. Allowing stakeholders to provide comment and feedback prior to final implementation of new or materially amended regulation when exigent circumstances force regulators to file or publish for comment well developed rules on policy proposals without the benefit of early consultation.

Best Practice 5: Encouraging broad participation in the consultation process

Once a formal consultation is initiated, regulators should consult with market participants and other stakeholders and, where appropriate, with stakeholders and regulators in other jurisdictions as widely and effectively as possible

Key considerations:

A structured and effective consultation program includes measures to target and invite submissions from the full range of interested parties in as open a manner as possible. In a world when national regulations increasingly have international implications, this may include providing the opportunity to comment for market participants from other jurisdictions and, where appropriate, consulting with regulators in other jurisdictions. These objectives can be accomplished by:

6. These discussions might also take place through established industry committees, including committees composed of representatives of regulatory organizations and industry member participants. Such committees allow regulators the opportunity to discuss proposed or contemplated policy changes with market participants prior to the formal consultation process.

a. Making consultation proposals widely known and available to the full range of interested parties, including market participants, consumers and end-users at the national and international level through all appropriate means, including public hearings, face-to-face meetings, roundtable discussions, written and internet consultations;

b. In cases where proposed regulations are likely to have an extraterritorial impact, making a specific effort to consult with regulators from other jurisdictions;

c. Establishing working consultative groups composed of market professionals and others who are knowledgeable about the specific topic in order to evaluate proposals where appropriate;

d. Ensuring that proper and complete documentation for the proposed regulation is available at the beginning of the formal consultation period; and,

e. Ensuring that all consultation documents are written in a clear and coherent manner using plain and easily assessable language so that the documents can be understood and therefore commented upon by a wide range of stakeholders.

Best Practice 6: Allowing adequate time for a full consultation

Regulators should ensure that there is adequate time for the entire consultation process so that respondents have sufficient time to prepare their responses and regulators have time to analyze the responses that they have received

Key considerations:

An effective consultation policy requires a genuine dialogue between regulators and all stakeholders, including market participants. It is critical, therefore, that regulators allow adequate time for the consultation process so that stakeholders have the ability to adequately evaluate the full consequences of the proposed regulations. This is particularly true for consultations on major regulatory reforms, since in those cases it will take longer for respondents to develop their submissions. Similarly when proposed regulations have a broad extraterritorial impact it may be necessary for regulators as well as market participants from other jurisdictions to comment on the proposed regulation, which may necessitate an additional period of time for the consultation process to be completed. Finally, it is critical that regulators have time to adequately and comprehensively assess the responses that they have received so that they can make appropriate changes to the proposed regulations as necessary.

These objectives can be accomplished by:

a. Beginning the formal consultation process at a sufficient early stage so that respondents have time to adequately prepare their submissions;

b. Allowing meaningful time frames for the comment period, which among other things includes acknowledging the importance of established holidays. For major proposed reforms or where the proposed regulations involve more than one country, the issues are novel or wide-ranging or where organizing a coherent response amongst market participants would require significant fact-finding and research, regulators should consider extending the normal time frame for consultations; and,

c. Informing interested parties about regulators' thinking at various stages of the consultation process, including through the use of concept releases and feedback statements.

Best Practice 7: Responding to the feedback received during the consultation process

Regulators should take full account of the responses received during the consultation, ensure that all responses are placed in the public domain and publish a feedback or policy statement explaining the rationale for the decisions taken

Key considerations:

For there to be a truly effective dialogue between regulators, market participants and other stakeholders, it is critical that the feedback that regulators receive during the consultation process is, to the greatest extent possible, incorporated into the regulations that were the subject of the consultation. This can be best done by ensuring that regulators fully understand the main comments that have been received. At the very least, therefore, regulators should ensure that:

a. A summary of the responses received is published along with a feedback or policy statement addressing all the major points raised in the responses to the consultation along with the reasons why the most important proposed changes suggested by market participants and other stakeholders were or were not adopted; and,

b. All responses to the consultation are put in the public domain unless the respondents request confidentiality.

Best Practice 8: Consulting more than once when necessary

Regulators should ensure that additional consultations are held if the proposed reforms are substantially changed after the initial consultation and/or there is a significant time lag between the conclusion of the initial consultation and implementation of the measures

Key Considerations

If proposals for regulatory reforms are changed substantially after the initial consultation, either in response to the comments received or for other reasons, a second consultation should be held so that stakeholders have the opportunity to comment on the revised proposal. Similarly, follow-up consultations should be held in the event that a substantial period of time has or will lapse between the initial consultation and the implementation of the new regulations. This is important since comments submitted during the first consultation may no longer be relevant due to changes in technology, business practices as well as the overall business and regulatory environment that have taken place since the initial consultation was held. In these circumstances, regulators and stakeholders alike will benefit from having one or more additional consultations.

Best Practice 9: Implementing regulations on an emergency basis

> ***Regulators should ensure that any regulations implemented on an emergency basis are considered temporary until a formal consultation is carried out***

Key Considerations

From time to time, regulators may find that new regulations need to be implemented on an emergency basis without prior consultation. This may be the case, for example, when there is a significant threat to the stability of the financial system and/or to the welfare of consumers, which in turn requires urgent interventions by regulators. Regulators need to develop a formal policy regarding the circumstances under which regulations can be implemented without proper consultation and ensure that any regulations implemented on an emergency basis are regarded as temporary until a formal consultation is held and the regulator has had sufficient time to evaluate the feedback received. Whenever there is a significant departure from the regulators' own consultation policy, regulators should publish their reasons for the measures taken and ensure that there is time for a full and comprehensive consultation on the regulations as soon as possible.

Best Practice 10: Assessing the effectiveness of major reforms

> ***Regulators should engage in a periodic review of their regulatory program in order to assess the extent to which major reforms that have already been implemented have achieved their stated objectives***

Key Considerations

A periodic post-implementation review of major regulatory reforms is a critical element of the consultation cycle. The information provided from a post-implementation review allows regulators, market participants and other stakeholders to understand how new regulations have impacted the market and market participants and if the new regulations have met their stated objectives. Furthermore, this information will allow regulators to assess if the measures have been properly implemented and whether or not additional regulatory reforms are needed in order to meet specific policy objectives.

These objectives can be achieved by:

a. Developing focused, measurable 'success' indicators for major reforms that can be tracked in order to assess the benefits of the measures, including non-economic outcomes that were not necessarily covered in the initial impact assessment;

b. Developing shorter-term indicators which will allow regulators to know if the new measures have been properly implemented; and,

c. Carrying out an analysis comparing the benefits from the reform to the costs of the new measure.

Annex

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Best Practice 4: Undertaking pre-consultation with stakeholders

Regulators should initiate preliminary informal consultation with market participants and other stakeholders on proposed measures as early and as widely as possible

Best Practice 5: Encouraging broad participation in the consultation process

Once a formal consultation is initiated, regulators should consult with market participants and other stakeholders and, where appropriate, with stakeholders and regulators in other jurisdictions as widely and effectively as possible

Best Practice 6: Allowing adequate time for a full consultation

Regulators should ensure that there is adequate time for the entire consultation process so that respondents have sufficient time to prepare their responses and regulators have time to analyze the responses that they have received

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Regulators should take full account of the responses received during the consultation, ensure that all responses are placed in the public domain and publish a feedback or policy statement explaining the rationale for the decisions taken

Best Practice 8: Consulting more than once when necessary

Regulators should ensure that additional consultations are held if the proposed reforms are substantially changed after the initial consultation and/or there is a significant time lag between the conclusion of the initial consultation and the planned implementation of the measures

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