

**1.1.6 OSC Staff Notice 11-745 IOSCO Publishes for Consultation Best Practice Standards on Anti-Market Timing and Anti-Money Laundering Guidance for Collective Investment Schemes**

**OSC STAFF NOTICE 11-745**

**IOSCO PUBLISHES FOR CONSULTATION BEST PRACTICE STANDARDS ON ANTI-MARKET TIMING AND ANTI-MONEY LAUNDERING GUIDANCE FOR COLLECTIVE INVESTMENT SCHEMES**

On February 17, 2005, Standing Committee 5 (SC5)<sup>1</sup> of the Technical Committee of the International Organization of Securities Commissions (IOSCO) published two Consultation Reports concerning collective investment schemes<sup>2</sup> (CIS): *Best Practice Standards on Anti-Market Timing and Associated Issues for CIS* and *Anti-Money Laundering Guidance for CIS*.

**Proposed Best Practice Standards on Anti-Market Timing**

In May 2004, the Technical Committee asked SC5 to examine the steps being taken by regulators to address issues arising from market timing<sup>3</sup> with a view to developing best practice standards for regulators in this area. SC5 commenced this project by conducting a survey of regulatory approaches to market timing in SC5 members' jurisdictions. Using the results of this survey, SC5 prepared the Consultation Report, which describes market timing, explains how it can occur and why it can detrimentally affect CIS investors, and proposes three high-level standards that regulators should incorporate into their regulatory schemes to deal with market timing and associated issues (such as late trading):

- 1 CIS operators should act in the best interests of CIS investors.
- 2 CIS operators should ensure that their operations and disclosure in respect of market timing and late trading are consistent with Standard 1.
- 3 The regulatory regime should allow operators appropriate flexibility in addressing the risk of detriment to investors arising from market timing.

Each of the three high-level standards is accompanied by more detailed guidance as to what the standard means and how it can be implemented.

The Consultation Report concludes by noting that regulators should act pro-actively to look for evidence of market timing and related issues in other pooled products that are marketed to the general public, such as unitized investment funds linked to life insurance policies.

**Proposed Anti-Money Laundering Guidance for CIS**

IOSCO has adopted a high-level principle that regulators should require market intermediaries to have policies and procedures designed to minimize the use of the intermediary's business as a vehicle for money laundering.<sup>4</sup> IOSCO has also developed *Principles on Client Identification and Beneficial Ownership for the Securities Industry* (CIBO Principles),<sup>5</sup> which provide guidance as to the kinds of "client due diligence" (CDD) processes that securities firms should employ to verify the identity of their clients and the underlying beneficial owners of client accounts, learn about and monitor their clients' circumstances and investment objectives, and maintain appropriate records about this information. The CDD standards described in the CIBO Principles complement the *40 Recommendations* on combating money laundering and the financing of terrorism developed by the Financial Action Task Force.<sup>6</sup>

Responding to a request from the Technical Committee, SC5 has published for comment draft guidance on how the high-level global standards described in the preceding paragraph should be applied to the operation of CIS. The proposed guidance in the

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<sup>1</sup> The Commission is a member of IOSCO, the Technical Committee and SC5. More information about IOSCO and the Commission's participation in IOSCO can be found on the Commission's website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca) (International Affairs – Who's Who).

<sup>2</sup> The term "collective investment schemes" encompasses open-ended funds that redeem units or shares, closed-end funds whose units or shares are traded in securities markets, unit investment trusts, and collective investment vehicles based on contractual models and the European UCITS (Undertakings for Collective Investments in Transferable Securities) model.

<sup>3</sup> Market timing involves short-term trading of investment fund securities to take advantage of short-term discrepancies between the price of the collective investment scheme's securities and the stale values of the securities within the CIS' portfolio.

<sup>4</sup> See paragraph 8.5 in IOSCO, *Objectives and Principles of Securities Regulation* (February 2002) (IOSCO Public Document #125). This document can be downloaded from IOSCO's On-Line Library at [www.iosco.org](http://www.iosco.org).

<sup>5</sup> The CIBO Principles can be downloaded from IOSCO's On-Line Library at [www.iosco.org](http://www.iosco.org) (Public Document #167). The Summer 2004 edition of the Commission's International Update contains a summary of the CIBO Principles (go to the International Affairs – International Updates page on the Commission's website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca)).

<sup>6</sup> The 40 Principles can be downloaded from FATF's website at [www1.oecd.org/fatf/](http://www1.oecd.org/fatf/).

Consultation Report focuses on open-ended CIS because they often deal directly with investors (e.g. opening accounts and/or processing purchase or redemption requests), thereby providing CIS operators with an opportunity to engage in CDD.

After describing variations in the legal, management and distribution structures of open-ended CIS, the Consultation Report:

- provides guidance as to the types of anti-money laundering (AML) policies and procedures, employee training programs, independent audit programs and compliance management arrangements open-ended CIS (including CIS that are part of larger financial groups) should have;
- explains who has responsibility for performing CDD processes;
- specifies when a client's identity should be verified;
- describes the lower-risk circumstances in which it is appropriate to use simplified CDD processes and describes what those simplified processes should involve; and
- discusses the circumstances in which it is appropriate for a CIS to sub-contract the performance of CDD processes or rely upon an authorized securities service provider to perform CDD procedures.

### Responding to the Request for Comments

Copies of the Consultation Reports have been posted on the Ontario Securities Commission's website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca) (International Affairs – Current Consultations) and on the website of the International Organization of Securities Commissions at [www.iosco.org](http://www.iosco.org). (Library – Public Documents 188 and 189).

The Commission encourages the Canadian investment funds industry to comment on the Consultation Reports. In particular, the Commission encourages industry to consider, in light of the way CIS are marketed and managed in Canada, the practical impact of the proposed *Anti-Money Laundering Guidance for CIS* on the division of responsibility for CDD on a day-to-day basis.

The comment period for each Consultation Report will remain open until May 18, 2005. Please submit comments by email to [mail@oicv.iosco.org](mailto:mail@oicv.iosco.org). Please include in the subject line of the email "Public Comment on Consultation Report: *Best Practice Standards on Anti-Market Timing for CIS*" or "Public Comment on Consultation Report: *Anti-Money Laundering Guidance for CIS*", as appropriate.

Please do not submit comments to the Commission.

Questions may be referred to:

Susan Silma  
Director, Investment Funds  
Ontario Securities Commission  
Tel: (416) 593-2302  
Fax: (416) 593-3699  
email: [ssilma@osc.gov.on.ca](mailto:ssilma@osc.gov.on.ca)

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