CROSS-BORDER REGULATION FORUM (CBRF)

KEY ISSUES AND CHALLENGES RELEVANT TO THE REGULATION OF CROSS-BORDER BUSINESS IN FINANCIAL SERVICES

28 MAY 2014

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EXECUTIVE SUMMARY

The IOSCO Task Force on Cross-Border Regulation distributed a questionnaire in advance of the industry round-tables held by it in Hong Kong, London and Washington in April this year. In introducing each of the round-tables, the Chairman of the Task Force summarised the findings of a survey in which it had sought the views of IOSCO's member commissions on the challenges to establishing a more coherent framework of regulation of cross-border business. This report, which draws on a number of case studies and worked examples, is the response of the Cross-Border Regulation Forum (CBRF) to that questionnaire and based on our current understanding of the findings of the survey conducted by the IOSCO Task Force.

In drafting its response, the CBRF has drawn on the views of its member organisations as to the overarching principles and mechanisms which they believe are necessary to establish more effective cross-border regulation, and the benefits a more coherently regulated and more open international marketplace.

In general terms, the CBRF has concluded that:

- While there are examples of where cross-border approaches to regulation have been successful, in many cases they have failed to achieve their aims.
- The costs of unsuccessful regulatory approaches can range from the neutralisation of the original policy objective of the underlying regulation, to putting market participants in a position whereby abiding by one law puts them into direct conflict with another.
- A direct consequence of ineffective and/or unaligned/disjointed regulatory requirements is market fragmentation, increased barriers to entry and a reduction in the products available to end users, and in market liquidity, efficiency and viability.
- Unaligned rules that are extraterritorial in reach can also result in the restructuring of the businesses of market participants for regulatory reasons which, in some cases, may have a serious adverse impact on the commercial efficiency of those businesses and their ability to cater for clients' needs.
- The combined impact of the consequences of regulatory conflict and confusion and a restrictive approach on the ability to trade in non-domestic markets and products is likely to undermine the risk management capability of end users and the pro-growth policies that are now being introduced by many governments.

For these reasons, the development of a more coherent and coordinated approach to the regulation of cross-border business is critical to market integrity, investor protection and business efficiency. To that end, the CBRF believes that IOSCO is well placed to play a key role (i) in reviewing the 'tools' for establishing greater regulatory coordination and coherence; (ii) developing implementation guidance on any principles and standards of measurement introduced by it for assessing regulatory recognition; and (iii) providing the mechanisms and processes to facilitate closer regulatory collaboration. The CBRF also believes that the industry should have a key role to play in providing input on an ongoing basis as an essential part of that process.

In terms of the principles and/or structures needed to support a more coherent approach to cross-border regulation, the CBRF has put forward for consideration a number of recommendations, including:

- Developing closer coordination between regulatory authorities in the regulation and supervision of cross-border business, including more timely and comprehensive information sharing.
- Adopting a consensual interpretation of what is meant by 'equivalence' based on equivalent regulatory outcomes rather than a line-by-line comparison of different legislative acts. This requires developing common processes and criteria for measuring whether or not jurisdictions are sufficiently compatible to be recognised for regulatory purposes.
- Establishing a more proactive approach towards facilitating cross-border trading and investment.
- Developing shared principles of regulation to facilitate the convergence of regulatory policies, rules and processes of regulators in different jurisdictions, including an express objective to seek to avoid regulatory duplication, conflict and complexity.
- Taking into better and earlier account the need for regulatory policy development and rules formation to facilitate growth and the commercial benefits of cross-border business.
- Establishing mechanisms to facilitate earlier negotiation between authorities on future changes in regulatory policy, practice and rules and, as appropriate, for carrying out reviews of rules.

In general terms, the CBRF believes that addressing these issues and establishing new structures to facilitate a more coherent approach to cross-border regulation will generate greater inter-jurisdictional confidence between regulatory authorities and avoid unnecessary duplication and costs. This will benefit not just the consumers and providers of financial services, but also the regulatory authorities themselves. For these reasons, the CBRF would reiterate the view expressed in its earlier key issues paper to the IOSCO Task Force that the need for regulatory coherence must become part of the G20's agenda, and that the G20 should reaffirm its commitment to open markets and expressly support the role and work of IOSCO in this area.

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CROSS-BORDER REGULATION FORUM (CBRF)

KEY ISSUES AND CHALLENGES RELEVANT TO THE REGULATION OF CROSS-BORDER BUSINESS IN FINANCIAL SERVICES

1. BACKGROUND AND INTRODUCTION

1.1 IOSCO Task Force, the CBRF and the April round-tables

1.1.1 In June 2013, the International Organisation of Securities Commissions (IOSCO) formed the IOSCO Task Force on Cross-Border Regulation (Task Force) to address the growing need for a coherent and coordinated approach to the regulation of cross-border business. This initiative has come at a time when trade, investment and risk management needs have to be met globally, and when governments are introducing their pro-growth policies. These require the support of more open global markets and services which can be delivered on a cross-border basis and which are effectively and coherently regulated.

1.1.2 The Cross-Border Regulation Forum (CBRF), which is an international industry grouping formed in response to the establishment of the IOSCO Task Force, is strongly supportive of the Task Force's focus on:

- Developing a 'toolkit' of cross-border regulatory approaches, including regulatory recognition, exemptive relief, and substituted compliance.

- Considering the need for guidance in order to harmonise implementation of the 'toolkit' across IOSCO's member commissions.

1.1.3 The CBRF appreciated the opportunity to discuss the industry's experience of cross-border regulation at each of the Task Force 'round-tables' held in Hong Kong, London and Washington in April 2014, and to hear the results of the survey conducted by IOSCO of its members which identified some 80 different approaches to cross-border regulation and the challenges faced by them in trying to develop a more coordinated approach. The latter included:

- Inadequate inter-jurisdictional processes and mechanisms for addressing cross-border issues, coordinating on proposed rule changes, and facilitating coordinated actions.

- Differentiated approaches in overarching legislation, political policies and priorities.

- Insufficient confidence in shared principles of good regulation and objectives, which in turn prompts low levels of confidence in foreign regulatory authorities.

- International standards that are insufficiently granular/detailed, and a lack of guidance on the implementation of these standards.

- The absence of an agreed definition of what is meant by 'equivalence' or, as it has otherwise been described, 'comparability', or on standards of measurement for assessing eligibility for regulatory recognition.

- Insufficient legal clarity, particularly around cross-border enforcement.

- Legal constraints on the ability of authorities to access data that they consider essential.

1.1.4 In developing this response to the Task Force's questionnaire, the CBRF has:

- Taken into account the findings of the IOSCO survey (see section 1.1.3 above).
- Sought to reflect the key principles, objectives and processes identified by its members as being critical to establishing a coherent regulatory framework for cross-border business (see section 2.1.1 below).
- Sought to evidence the conclusions in this paper with a set of case studies produced by the CBRF's Case Study Working Group (see Annex I).
- Reflected its view that IOSCO is well placed to address the conclusions set out in this paper (see sections 1.2.2 and 2.1.2 below).

1.1.5 The CBRF hopes that this report, together with its analysis of the suite of case studies, will inform the Task Force's upcoming consultation paper.

1.1.6 A full list of the CBRF's growing international membership, which is drawn from a cross-section of financial services trade associations, investment banks, brokerage houses, market infrastructure operators and consumers of financial services, can be found in Annex II.

1.2 Previous CBRF work

1.2.1 On 25 March 2014, the CBRF produced an initial key issues paper '*Regulatory Recognition: processes and criteria for measuring and determining inter-jurisdictional compatibility*', which was written in anticipation of the April round-tables. In it, the CBRF expressed strong support for the efficient and coherent regulation of cross-border business, the work of the international standard setters and the need for harmonised implementation of global regulatory standards and principles. More particularly, the paper expressed specific support for the G20 agenda, and put forward for consideration the kind of factors and criteria which the CBRF believed should be taken into account by IOSCO when setting standards for measuring inter-jurisdictional regulatory compatibility and strengthening supervisory cooperation. A copy of the paper can be found in Annex III.

1.2.2 As noted in our previous submission, the CBRF believes that IOSCO is particularly well placed to set international standards of common measurement for determining regulatory compatibility and to encourage the emergence of a more coherent and efficient framework of regulation for cross-border business. The recommendations set out in this paper urging an extension to IOSCO's current responsibilities would be a natural and logical evolution of its existing role, in that:

- IOSCO has considerable experience in building consensus across its member commissions with regard to the development of global regulatory standards and principles.
- IOSCO is the only organisation that can access the breadth of regulatory knowledge and experience that is necessary to deliver a consensual and workable approach to the regulation of market and financial services delivered on a cross-border basis. The scope of this paper and the CBRF membership is broader than securities markets.

2 RECOMMENDATIONS

2.1 Overarching principles and mechanisms necessary to establish more effective cross-border regulation

2.1.1 In drafting this response to the issues, challenges and questions posed by the IOSCO Task Force at its round-table meetings with invited stakeholders in Hong Kong, London and Washington, the CBRF would commend the following principles, objectives and processes to the Task Force and the G20, which the CBRF believes are essential for the creation of a more coherent framework for cross-border regulation

These include:

a. The establishment of a more coordinated approach to the regulation and supervision of cross-border business (including more timely and comprehensive information sharing between authorities). This is critical for establishing more effective and efficient regulation of cross-border business, improving regulatory transparency and reducing costly duplication in the regulatory process, which will benefit end users – as well as enhancing the capability of governments and regulatory authorities to identify the build-up of any threats to the financial system and economic stability. As this approach is developed, regulatory initiatives that are likely to be extraterritorial in application – such as those concerned with margining, client protection, governance or transparency – should be prioritised.

b. The development of (i) an internationally and consensually agreed interpretation of what is meant by key terms such as 'equivalence' (ii) a common approach to scope, particularly with regard to instruments, activities and exemptions; and (iii) agreed processes and criteria for measuring whether or not jurisdictions are sufficiently compatible to be recognised for regulatory purposes. This is essential in order to prevent a multiplicity of different interpretations resulting from multiple sets of bilateral negotiations. Ultimately equivalence should be based on shared outcomes and avoid being associated with numerous conditions that would force a line-by-line compliance with the rules of any issuing jurisdiction.

   The development of a more granular approach to drafting and implementing high level standards and guidelines, will reduce the risk of differentiated implementation of international standards across individual jurisdictions.

c. The need for a more proactive approach towards facilitating cross-border trading and investment. While some restrictions on rights of access to non-domestic markets, products and services are justifiable in the interests of public policy, a more proactive approach will help to expand the range of products and services and so enable institutional and corporate market users to better meet their capital-raising, risk management and trading needs in a global market, facilitate business recovery and economic growth, and reduce the risk of liquidity fragmentation.

d. Deeper inter-jurisdictional reliance between regulatory authorities, particularly with regard to home state authorisation and regulation. This will enhance regulatory transparency, reduce compliance complexity (and the risk of inadvertent compliance breaches) and mitigate undue legal risk to the advantage of both financial services providers and consumers.

e. Shared principles of good regulation, including an express objective to avoid regulatory duplication, conflict and complexity in the development of rules and guidance. These would help to establish a shared approach to regulatory policy, rules and processes and rebuild inter-jurisdictional confidence.

f. A requirement to take into full account the commercial benefits of cross-border business – which is supported by the financial services industry – when formulating rules and guidance. This would enhance choice and overall market competitiveness.

g. The establishment of mechanisms to facilitate earlier negotiation between authorities on future changes in regulatory policy, practice and rules. Such mechanisms would encourage common regulatory approaches, reduce the possibility of rule divergence, and facilitate reappraisal and convergence of past regulatory approaches and requirements.

2.1.2 The CBRF believes there is an urgent need for a formal international framework of mechanisms and processes to address the issues identified in this paper and to reduce the cost and complexity of regulating cross-border financial services business, particularly for end users, but without undercutting the need for increased regulatory effectiveness and efficiency. Such a framework could be readily provided by IOSCO, but the CBRF recognises that this may require a staged approach. The dialogue between prudential regulators, which is conducted within colleges of supervisors, may provide a useful precedent – but how this structure could be adapted to apply to the development of conduct of business regulation would need to be given further consideration, given many market conduct issues require a consistent approach between firms and market infrastructure.

2.2 Aligning the recommended principles and mechanisms to the case studies.

2.2.1 The importance of implementing the principles and structures identified above is evidenced by the case studies detailed in Annex III.

a. The need for a more coordinated approach to regulation and supervision of cross-border business (including more timely and comprehensive information sharing between authorities) is supported by:

- The case study on Futures Exchanges (case study No.6). This highlights that IOSCO could facilitate information sharing between overseas exchanges and home jurisdictions by standardising the scope, frequency and other aspects of regulatory reporting required to maintain recognitions or exemptions. This would also level expectations concerning the types of information to be shared and frequency of data delivery, which would in turn help to simplify compliance and negotiations concerning recognition. This is equally necessary in the case of CCP clearing of OTC derivatives.

- The case study on the conflicts between derivative reporting requirements and local statutes on confidentiality (case study No.4). This suggests that these types of conflicts could be best prevented if regulators consulted with each other, leveraging multilateral groups like the OTC Derivatives Group (ODRG) or IOSCO.

- The emergence of trade repositories (TRFs) in most countries suggests that IOSCO should consider developing a common model/process for receiving, categorising and disseminiating data to regulatory authorities.

- The case study on Private Fund/AIF reporting (case study No.3). This highlights that close cooperation between regulators and mutual recognition of each other's forms would significantly reduce processing time and allow for timelier and more consistent regulatory dialogue.

- The case study on SEFs (case study No.1). This calls for the coordination of implementation dates for rules impacting global markets, or workable relief mechanisms during transition periods. This is equally necessary for TRs and the CCP clearing of OTC derivatives.

  In addition, the CRBF believe that the application of rules on an extra-territorial basis could exacerbate systemic risk if they have an adverse impact on the recovery and resolution of market infrastructures.

NB The CBRF is currently working on a case study that should help to illustrate the above points raised by the case studies on Futures Exchanges and SEFs (case studies No.6 and No.1) are equally relevant to OTC derivatives cleared by central counterparties.

b. <u>The need for (i) international and consensually agreed interpretation of what is meant by 'equivalence'; and (ii) agreed processes and criteria for measuring whether or not jurisdictions are sufficiently compatible to be recognised for regulatory purposes</u>, are supported by:

   - The case study on Securitisation (case study No.5). This puts forward, as one of several solutions, the need to address retention on a global basis through, perhaps, the recognition of different regimes.

   - The case study on Futures Exchanges (case study No.6). This clearly calls for the need to develop principles for recognition of overseas futures exchanges and guidelines for equivalence assessments, based on equivalent outcomes.

   - The cases studies on SEFs and Volcker (case studies No.1 and 2). These both point to the need for the recognition of third-country regimes based on 'outcomes' and consistency with standards, rather than through a line-by-line comparison.

   - The fact that Asian CCPs, SEFs and TRs often have their own individually tailored requirements which could be complicated by an exacting approach by, for example, European and US regulatory authorities towards 'equivalence' where they will have to introduce additional rules to secure regulatory recognition (e.g. the Interest Rate swap market in India represents less than 0.1% of global markets and is fully domestic in nature, but each CCP or execution platform operator will require CFTC approval based on an exacting standard of equivalence in order to be able to offer their services to a US person).

c. <u>The need for a more proactive approach towards facilitating cross-border trading and investment.</u> The CBRF believes that the economic justification for such a fresh approach is, in a global trading environment, self-evident, but it is implied by:

   - The case study on Private Fund/AIF reporting (case study No.3). This points to the impact of the proliferation of reporting templates, formats, definitions and

marketing requirements on the ability of fund managers to offer a single fund wrapper that can be marketed to investors in multiple jurisdictions.

- Also, derivative reporting rules following the G20 derivative reforms have been implemented without regulators agreeing to share data, despite G20 commitments to the contrary. This has led to extraterritorial rules that can conflict with local rules on data privacy.

d. <u>The need for deeper inter-jurisdictional reliance between regulatory authorities, particularly with regard to home state authorisation and regulation, is suggested by:</u>

- The case study on Private Fund/AIF reporting (case study No.3). This highlights the need to balance the objective of data collection for systemic risk analysis with the individual firm and fund data for supervisory purposes (which also need to respect data privacy and commercial confidentiality). It also suggests that standardised data reporting would lead to more effective evidence-based regulation and increased trust between regulators.

- The case study on Futures Exchanges (case study No.6). This (positively) highlights that host market regulators currently rely on home state supervision where they recognize and exempt foreign exchanges from many domestic requirements. However, the case study also argues that more timely, transparent, and standardized recognition processes and cooperative arrangements should be developed, to improve both the availability of recognition as well as trust between authorities.

e. <u>The need for shared principles of good regulation, including an express objective to avoid regulatory duplication, conflict and complexity in the development of rules and guidance.</u> Some jurisdictions have adopted such principles either in the overarching legislation establishing their regulatory authorities or in their rules. The need for a specific objective to avoid regulatory duplication, conflict and complexity is illustrated by:

- Some of the solutions proposed in the case study on Private Fund/AIF reporting (case study No.3). For instance, with regard to regulatory reporting templates, it calls for the need to move from a 'close fit' to a 'direct match' of data fields between jurisdictions so that the collecting and reporting of data is exactly the same for the vast majority of data collected. It also suggests standard identifiers, definitions and FAQs. Similarly the suggestion for central data reporting would also be underpinned by the requirement to avoid regulatory duplication.

- The case study on definitions and the FX example (case study No.7) highlights where the lack of a common definition across the EU, for various FX instruments – i.e. definitions of FX spot versus FX forward versus FX derivative – is giving rise to reporting challenges and operational challenges that would have been avoided, if the underlying regulation had been guided by a principle to avoid conflicts and complexity. In this particular example the industry has recommended that FX spot be defined as T+2, except for scheduled or unscheduled holidays (i.e. two good business days from trade date) and that FX security conversions also be included as FX spot. (An FX security conversion is an FX trade entered into to fund the +/- of a foreign security, with the FX trade settling at the same time as the security (this could be up to T+7 for the settlement of South African securities).

Extra-territorial application of definitions can also cause issues of complexity and confusion where compliance is required and there is no clear correlation to local market practice or law. For example, several European rules require the EMIR counterparty definition (FC/NFC+/NFC-) to be applied to non-European counterparties.

f. A requirement to take into full account the commercial benefits of cross-border business – which is supported by the financial services industry – when formulating rules and guidance.

- IOSCO will be familiar with the need for vigilance in ensuring that a proper balance is struck between facilitating the essential trade, investment, capital-raising and risk management needs of customers, with the public policy objectives for delivering efficient and comprehensive regulation. The CBRF would emphasise that the industry is well placed to identify where regulation is impairing delivery of those benefits, (which are necessary to fulfil the pro-growth policies of governments), without adequate public policy justification.

- The case study on Volcker (case study No.2) illustrates where any cost-benefit analysis undertaken was flawed. Costs are being incurred, but with no clear benefit to the regulator, end users or and the marketplace at large.

g. The need to establish mechanisms to facilitate earlier negotiation between authorities on future changes in regulatory policy, practice and rules is evidenced by the growing burden of differentiated rules implementing the common high-level standards that have been developed by the international standard setters in spite of rules being designed to achieve similar outcomes. By way of example:

- The case studies on SEFs and Volcker (i.e. case study No.1 and 2). The explicit communication of the extraterritorial impact of these rules, through, say, IOSCO, at the consultation and implementation stages would help to ensure that the potential extraterritorial impacts were more fully understood, leading to a conclusion as to whether they were justifiable on the basis of a cost-benefit analysis.

- The case study on securitisation (case study No.5) suggests the need for the cumulative impact of prudential and non-prudential requirements on securitisations to be considered in light of the requirements set for comparable instruments.

These mechanisms would enable regulatory authorities to formally reappraise and allow future jurisdictional regulatory changes – and, where deemed appropriate, past regulatory approaches and requirements – to converge, and so allow regulations to be realigned to ensure that, for example, similar products are treated in a similar way.

3 CBRF RESPONSES TO ISSUES AND CHALLENGES RAISED BY THE IOSCO TASK FORCE DURING THE INDUSTRY ROUND-TABLES HELD IN HONG KONG, LONDON AND WASHINGTON

3.1 Introductory remarks: the CBRF case studies

3.1.1 In responding to the IOSCO Task Force's questions (which are reproduced below), the CBRF is very conscious of the fact that there are continuing negotiations on the scope and extent of substituted compliance and other 'tools' designed to facilitate a more coordinated approach to the regulation of cross-border business. On that basis, the CBRF anticipates that it may look to issue a supplementary response either at a later stage or as part of the

response to the Task Force's upcoming consultation document to address the outcome of those negotiations.

3.2 CBRF response to five questions on: key issues, challenges and potential implications

Question 1: What are the most successful and also the least successful cross-border regulatory approaches?

3.2.1 The CBRF has identified two approaches which have been relatively successful. The first is a global one and the second is passporting.

3.2.2 Global approach: Benchmarking example

- A successful example of a global approach – where IOSCO took a leadership role in the development of an international, principles-based regulatory framework – is the IOSCO Principles for Financial Benchmarks which were published in July 2013. The IOSCO Principles represent an important step forward in improving benchmark practices and promoting the integrity of financial benchmarks that will enhance investor confidence in these indices. IOSCO's emphasis on sound governance, a transparent benchmarking process and a robust control environment, represent the right path forward for enhancing financial benchmarks. We believe that IOSCO has appropriately tailored its Principles to cover the broad scope of benchmarks across major asset classes while also avoiding a 'one size fits all' approach, with the specific application of the Principles tailored to the nature of individual benchmarks and with the greatest regulatory oversight reserved for widely used benchmarks with systemic significance.

3.2.3 Global approach: OTC margining rules

- As highlighted at the Hong Kong round-table, final OTC margining rules are an example of successful cross-border coordination leading to consistent treatment of FX and cross-currency swaps.

- Nonetheless, it was also noted that the rules are not yet finalised. There is, therefore, a significant risk of inconsistent and/or conflicting rules being implemented. For example, the draft EU regulatory technical standards (RTSs) have differential treatments for the collection of variation margin for EU and non-EU counterparties.

3.2.4 Passporting: UCITS example

- As discussed at the London round-table meeting, passporting, as perhaps best illustrated by Undertakings for Collective Investment in Transferable Securities (UCITS), has been a relatively successful regulatory approach.

- However, passporting also has its limits. First, its success in the EU is largely due to the harmonisation of EU laws which support a cross-border regime that is essentially a form of mutual recognition that is motivated by a more harmonised approach to investor protection, and a general recognition of the wider regional investment and growth agenda. This intra-regional characteristic is not unlike mutual recognition in Asia. However, outside of these regions, cross-border business/regulation faces obstacles associated with sovereignty issues.

- Moreover, even in the EU, barriers to passporting can be limited by national tax and insolvency regimes (which are not harmonised).

3.2.5 Other examples of approaches to cross-border regulation – exemptive relief, substituted compliance and equivalence – that have been less successful.

3.2.6 Exemptive relief: Volcker

- As outlined in case study No.2, the Volcker rule prevents FDIC-insured depository institutions – as well as foreign banks that control a US subsidiary, branch, or agency of commercial lending – from undertaking proprietary trading or investing in or sponsoring private equity or hedge funds ('covered funds'). However, it also includes exemptions. One of these is a narrowly drafted exemption applying to foreign banking entities trading outside the US and another applies to certain covered funds outside the US (noting that non-US funds are themselves subject to Volcker, if controlled by a bank subject to Volcker itself).

- Volcker is a new rule – substantive compliance is not required until July 2015 – so while it is unclear how these exemptions will work in practice, they have not prevented damaging extraterritorial application to certain non-US funds. Moreover, the rule does not contemplate the recognition of other regimes designed to achieve the same outcome (be they EU or UK rules on bank structure).

3.2.7 Substituted compliance: Rules relating to Swap Executive Facilities (SEFs)

- As documented by case study No.1, SEFs is an example that shows that substituted compliance has not worked. In summary, compliance with US SEF rules can only be achieved by following US rules.

- The Commodity Futures Trading Commission (CFTC) was the first regulator to bring in rules that reflected the G20 commitment to move the trading of liquid derivatives onto exchanges, and its SEF rules required platforms to register as SEFs from October 2013 and mandated SEF trading rules apply to any trade with a US person and to trades between non-US swap dealers entities guaranteed by US affiliates progressively from February 2014. There was considerable confusion in the market in October 2013, particularly outside the US where trading platforms with US members were required to register as SEFs. Although the CFTC issued a no action letter in February to allow mandatory trading to also take place on EU Qualifying Multilateral Trading Facilities (MTFs), subject to certain conditions, this relief was too late and, in substance, required MTFs to comply with SEF rules (in spite of the relief).

3.2.8 Substituted compliance/mutual recognition: Futures exchanges

- As documented in case study No.6, the G20 reforms have made a functioning cross-border regime critical for the operators of futures exchanges. This is largely a consequence of the regulatory status of exchange-traded products being tied to the recognition of trading venues in some jurisdictions.

- The CFTC's Foreign Board of Trade (FBOT) regime offers a regulatory framework for non-US futures exchanges and their products with direct access to US participants. This framework provides for substituted compliance for many regulatory requirements required of US futures exchanges (which must register as a Designated Contract Market (DCM)). However, registration as an FBOT is subject to a range of particular CFTC requirements, an assessment of the comparability of the FBOT's regulatory regime,

specific requirements relating to contracts which reference the settlement prices of DCMs, and increased scrutiny of the FBOT by the CFTC.

- In comparison, the EU regime governing futures exchanges is seen as less final and more complex being characterised by multiple recognition requirements. For example, different national licences are required for each of the 28 member states as there is no single EU point-of-entry or 'passport regime' available. Also, under MiFID I non-EU futures exchanges must be deemed equivalent by the European Commission for their products to be designated as 'exchange traded derivatives' as opposed to OTC under the European Market Infrastructure Regulation (EMIR). Finally, MiFID II/MiFIR introduce further equivalence provisions.

3.2.9 Substituted compliance/mutual recognition: Securitisation

- Case study No.5 points to where neither substituted compliance nor mutual recognition has worked particularly well. Market participants seeking to place transactions on a cross-border basis will need to navigate through the different regulatory regimes applicable in different jurisdictions. There is also general confusion among US and European investors as to what cross-border securitisations they can invest in. In particular, European investors are concerned about new retention rules and disclosure requirements and how to treat legacy investments in transactions which have become non-compliant, as well as how to carry out and prove due diligence.

3.2.10 Mutual recognition and exemptions: Definitions (the FX example)

- As highlighted above, the EU's use of passporting – as a regulatory approach to cross-border supervision – has been relatively successful. However, passporting is a form of mutual recognition, and for mutual recognition to be successful, a common set of definitions at the very least is needed. Case study No.7 examines how the lack of a common definition for FX derivatives has given rise to a number of issues. More specifically, Annex 1 (C4) of MiFID 1, which drives the definition of a financial instrument under the MiFID, refers to derivative contracts relating to currencies, but does not explicitly mention forwards. Moreover, because MiFID is a directive, and therefore subject to national interpretation, variances have arisen across the EU with regard to: (i) the inclusion of FX forwards and (ii) the tenor split between FX spot and FX forwards. This particular question of definition has also had a bearing on EMIR's implementation (because EMIR cross-references to MiFID 1), and more specifically, in relation to its requirement that both parties to a transaction (in scope) must report their side of a trade and these must match in a trade repository or across trade repositories. With differing member states applying different definitions to FX instruments, the consequence will be mismatches of trade data at the trade repository and incomplete reporting to national authorities and ESMA.

- Case No.7 also points to inconsistencies in the regulatory treatment of FX products between the US and Europe. Under Dodd-Frank, FX forwards and swaps are explicitly exempted from any clearing and execution regime, while they remain open to this in Europe under EMIR as potential MiFID instruments.

- A similar problem arises in connection with the definition of physical forward commodity contracts where there is some differentiated approach within the EU member states and a more significant difference between the US and the EU insofar as all physical forward commodity contracts are exempted from regulation in the US.

Question 2: Provide examples of challenges (e.g. costs, risks, gains and losses) across business lines (e.g. asset management, ECM, DCM (FICC), corporate finance/underwriting, advisory, private banking etc.) with respect to cross-border business.

3.2.11 Unaligned cross-border regulatory requirements take several guises. They can also be costly, undermine the policy objectives of the regulation in place, and put market participants in a position whereby abiding by one law puts them into direct conflict with another.

3.2.12 For example, the proliferation of templates, formats, and definitions effectively undermines any meaningful aggregation of data and therefore regulatory oversight.

- Case study No.3 (Private Fund/AIF reporting) illustrates how the adoption and expansion of the IOSCO high-level reporting template by national authorities has resulted in a myriad of templates, formats and definitions. The consequence of this is that the reporting requirements in different jurisdictions do not align/match. For instance, an examination of the US SEC PF form and the EU AIFMD requirements found that about 30% of the requirements overlap, 40% of the requirements are a close fit and 30% of the requirements differ completely.

- This directly limits the ability of regulators to share data on a cross-border basis. So while the reported information is designed to drive local or regional systemic risk analysis (e.g. to ESRB/ESMA in the EU), there is limited scope to provide a feedback loop to the market on global trends and potential risks. The challenges for fund managers and regulators are particularly illustrated where fund managers use a single fund wrapper to market to investors in multiple jurisdictions. In doing so they face the operational complexities of reporting using different templates in each separate jurisdiction.

- Similarly, case study No.7 (definitions) also highlights where differences in the definition of FX derivatives will give rise to: (i) increases in reporting costs and operational risk for market participants; and (ii) less effective regulatory oversight.

3.2.13 The legal and operational costs/risks of unaligned regulatory requirements can also be significant.

- Case study No.4 highlights the possible legal implications for market participants of the cross-border impacts of reporting requirements that do not contemplate how they align to rules concerning confidentiality. In response to the G20 commitment to the mandatory reporting of OTC derivative transactions to trade repositories, the US authorities – in relation to swap data repositories – and the EU authorities – in relation to exchange traded and OTC derivatives – both brought rules into effect which require those counterparties that are subject to the requirements to report counterparty information. However, this reporting requirement often conflicts with restrictions on the same information in other jurisdictions.

- Case study No.7 (definitions) also points to where – in the context of FX – the required matching of trade reporting is undermined by the lack of a common definition which, in turn, may mean that market participants will have an increasing number of trade repository breaks. That is, given that trade reporting to the repository is dual-sided in nature, there will be mismatches that occur due to one participant not being required to submit their side of the trade. The implication for the party that has reported is that their submission will never pair (i.e. will create a break on the exception report), and will need to be investigated and resolved – the implications for inefficiency in the reporting process are clear.

- Case study No. 6 demonstrates that the regulatory status of futures products – for instance, whether or not a derivative is OTC or exchange-traded under EMIR – can be linked to broader cross-border recognition processes, and that delays can lead to market disruptions as the status of products affects the costs of their use.

Question 3: Provide examples of the effects of regulatory duplication, gaps or conflicts (e.g. EMIR, Dodd-Frank, SEF rules, etc.) including restructuring and regulatory costs.

3.2.14 Market fragmentation and the restructuring of business are a direct consequence of ineffective and/or unaligned/fragmented regulatory requirements.

3.2.15 Market fragmentation is evidence by:

- Trades can have different compliance obligations in the US and the EU.

- This is also illustrated in the case studies on SEFs and the conflict between derivative reporting requirements and local statutes limiting financial disclosure (i.e. case studies No.1 and No.4 respectively). The CFTC SEF requirements are fragmenting the market between trades conducted on (i) SEF platforms (largely trading involving US persons and non-US persons swap dealers) and (ii) non-SEF platforms (with non-US persons In addition, the conflict arising between derivative reporting requirements and local statutes limiting financial disclosure will discourage cross-border business on the basis of legal risk.

- Case study No.7 also points to concerns that inconsistencies in the regulatory treatment of FX products between the US and EU may result in future fragmentation in the market.

3.2.16 With market fragmentation also comes increased barriers to entry:

- This is well-illustrated by the case study on Private Fund/AIF reporting (No.3) where the lack of any high single common denominator that meets the needs of all main regulators increases the costs associated with accessing multiple markets for clients.

3.2.17 Fragmentation also leads to higher costs and where costs become prohibitive the product range offered to end users is reduced.

- The contraction of the Securitisation market in the EU (case study No.5) where other products – such as covered bonds – receive beneficial regulatory capital, liquidity and reputational treatment perhaps highlights this outcome most starkly.

3.2.18 Fragmented markets also lead to a reduction in market liquidity, efficiency and viability.

- The Securitisation case study (No.5) is an example where there is a real concern that fragmented markets will lead to a reduction in the liquidity, efficiency and viability of securitisation transactions.

3.2.19 Unaligned rules that are extraterritorial in reach can also result in market participants restructuring their businesses.

- Case study No.2 highlights this with the Volcker rule which captures trades – between say two UK-incorporated and regulated entities – that do not present any systemic risk to the US, but fall into scope because the trading decision is deemed to be made in the US under

the rule. This feature of the rule is prompting banks to restructure their business, but given that the rule is new, the final impact on market liquidity is currently unclear.

Question 4: Provide examples of regulatory arbitrage that your firm has encountered in securities markets which can have systemic implications

3.2.20 The CBRF is aware of firms (both buy and sell side) rearranging business to be subject to rules that are more appropriate to their activity and jurisdiction (e.g. Latin American or Middle Eastern firms – such as a Brazilian exporter or manufacturer – should not be subject to Dodd-Frank title 7 rules on derivative reform).

3.2.21 Where firms have been asked by clients to re-book trades through non-US/EU entities to avoid US/EU regulation, it is a rational response by clients. This does not represent regulatory arbitrage in light of the jurisdiction of the client and their compliance with rules deemed appropriate by their local regulators.

Question 5: To what extent can regulatory differences (due to local conditions and varying stages of market development), be justified and/or accommodated?

3.2.22 In some instances, regulatory difference can be justified and there should be scope for their accommodation in rules/guidance, but this accommodation needs to be governed by clear criteria. For example, the systemic risk posed by specific market segments or elements of market infrastructure may justify graduated approaches across different jurisdictions.

3.2.23 One of the most sensitive areas is that of retail consumer protection and the need to ensure consumers are able to seek effective redress using domestic channels, e.g. via national compensation schemes. The inability of the Icelandic deposit guarantee scheme to meet depositor claims after defaults within the Icelandic banking system meant that other national governments had to step in to protect the interests of their national consumers. While we support investor choice across borders, we recognise the need for effective mechanisms for supervision, enforcement and redress. Working together, regulators have a key role to play in ensuring these mechanisms are put in place and function effectively in a crisis.

3.2.24 Where new rules change current access arrangements for cross-border business, then appropriate transitional arrangements will need to be provided. (The third-country provisions in MiFIR, Articles 47 and 54, seek to address this.)

3.3 CBRF response to two further questions on: establishing a strong base for cross-border regulatory coordination (looking) forward

Question 6: How can cross-border regulatory approaches be made to work in a more coordinated and effective manner, including at the level of regulatory authorities? In what areas could international standards enhance coordination, effectiveness and efficiency?

3.3.1 An international framework is needed to support coordination, but it will take time to evolve, so it will be necessary to consider what steps can be taken immediately towards such a framework against those steps that necessarily imply a longer-term vision that would warrant further discussion.

3.3.2 Such a framework would also need to include, at its inception, a feedback loop that should include market participants to help assure that it remains on course with any goals and vision set for it.

Question 7: What roles do (i) IOSCO and (ii) the industry have in relation to the development and implementation of cross-border regulatory approaches?

3.3.3 In response to this question, the CBRF has taken into account our understanding of the matters raised by IOSCO's member authorities in response to the survey conducted by the Task Force (which are summarised in section 2.2.1 above).

3.3.4 In response to (i) and with some consideration of ranking, the CBRF believes that IOSCO can play a key role in:

a. Developing more granular regulatory standards and principles, with supporting implementation guidance, which should help to respond to the need for improved harmonised implementation of those standards and principles. (The rules on market infrastructures and the differentiated jurisdictional approaches to what is a 'qualifying' CCP, CSD, SEF, TR (in line with the PFMI) are good examples of where harmonisation would help to support a more consistent approach to the regulation and recognition of global markets).

b. Providing a central mechanism or hub for information clearing through which national regulators could share their analysis of the extraterritorial impacts of proposed rules. Such a mechanism could also facilitate early dialogue on proposed changes on regulatory policy, rules and processes; help to ascertain whether there is enough consensus to justify their adoption within international standards; and ensure that any such changes do not undermine, where applicable, regulatory recognition between authorities as may have been agreed.

c. Working with its regulatory authorities to develop, where achievable, standardised regulatory disclosure requirements (e.g. risk disclosure requirements, client money memoranda) and, in particular, a standardised risk warning for investors when engaging in financial services activities beyond the supervisory reach of their domestic regulatory authority, which should allow the domestic regulatory authority to be able to recognise/accommodate differences in rules which are designed to have the same outcomes.

d. Working with its member authorities to harmonise key definitions (e.g. hedging) and regulatory scope (e.g. regulated instruments, activities and, where appropriate, exemptions).

e. Working with its member authorities to establish a common set of principles, priorities, objectives and regulatory good practices (otherwise principles of good regulation) which would facilitate regulatory recognition (similar to the kind of regulatory standards and objectives set out in the overarching legislation of some jurisdictions or which are reflected in principles for businesses and licensed persons).

f. Establishing a common definition for 'equivalence' or, as it is sometimes described 'comparability' and developing standards of measurement capable of being adopted by all IOSCO's member authorities for determining whether or not regulatory recognition can be achieved (see para 2.1.1(b)).

g. Monitoring the implementation of its regulatory standards and principles, including observance of any supporting guidance (but current resource constraints may mean that this is best achieved, at least in the first instance, through a process of self-assessment and self-certification by IOSCO's member authorities).

h. Developing the existing MMOU beyond enforcement to cover information sharing and supervisory coordination.

3.3.5 In response to (ii), the CBRF believes that the industry can play a key role in:

a. Encouraging and providing input into the process of rule convergence to better facilitate regulatory recognition.

b. Identifying areas where rule differences do not appear to be sufficiently justified or, in cases where they are properly justified, the areas in which the differences are not so great as to undermine eligibility for regulatory recognition.

c. Identifying areas where regulatory authorities may have failed to fully implement agreed IOSCO standards and principles or are applying their rules extraterritorially without adequate public policy justification or engaging in duplicate or conflicting regulatory processes and procedures.

d. Identifying beneficial commercial (as well as regulatory) outcomes which would reflect the need for proportionality and would enhance overall market competitiveness, deliver greater choice for customers and avoid undue compliance complexity.

e. Providing feedback statements and contributing to cost-benefit analysis.

3.3.6 The CBRF would welcome the IOSCO Task Force's feedback on the value of the CBRF undertaking further work to develop these ideas with a view to proposing processes and mechanisms that would involve industry participants and be global in nature.

4 CONCLUSION

4.1.1 As stated in its earlier paper '*Regulatory recognition: processes and criteria for measuring and determining inter-jurisdictional compatibility*' (March 2014), the CBRF recognises that there are national and regional sensibilities surrounding the loss of regulatory 'sovereignty', but that IOSCO needs a sufficient degree of international authority/influence to establish the mechanisms and implement the findings of the Task Force. For this reason, the CBRF would urge the G20, at its next leaders' summit, to consider the following propositions:

a. Reaffirm its commitment to open markets.

b. Reviewing, redefining and expressly support the roles of the Financial Stability Board and IOSCO.

c. Mandating the creation of mechanisms for more coordinated rule-making.

d. Establishing a mechanism under the auspices of IOSCO for assessing the effectiveness of measures in different jurisdictions in cases where one regulator is inclined to believe the standards of another are 'inadequate'.

In this context, the CBRF would refer again to the letter sent by Mark Carney, Chairman of the Financial Stability Board, dated 17 February 2014, to G20 finance ministers and central bank governors in which he referred to the G20 agreement in St Petersburg which stated

that *'jurisdictions and regulators should be able to defer to each other when justified by the quality of their respective regulations and enforcement regimes in a non-discriminatory way, based on similar outcomes. This does not necessarily mean that different jurisdictions need to have identical market regulations, as long as the outcomes are similar.'*

4.1.2 In summary, the CBRF would commend the proposals in this submission to the Task Force and are open and ready to provide more information on the issues or the case studies set out in this submission.

ANNEX I: CBRF CASE STUDIES ON CROSS-BORDER REGULATORY ISSUES

Foreword

The following seven case studies were developed by members of the CBRF. Each case study provides a specific example that highlights a specific issue. We hope the issues raised in each case study and suggested solutions will be considered by the IOSCO Task Force and will help inform the consultation paper IOSCO is expected to publish over the summer of 2014.

The CBRF – and, in particular, the members who prepared the case studies – are available to discuss them in greater detail if required.

Cross-Border Regulatory Issues

SEFs

SEFs

Background

- Over the past 30 years derivative markets have developed into truly global markets
- This led to competition and liquidity that have driven spreads to very low levels on liquid products and increased access to a range of counterparties

Mandated Exchange Trading

- The G20 committed to mandate exchange trading for liquid derivatives, where appropriate
- The CFTC was the first regulator to mandate trading of derivatives on regulated platforms
- The CFTC Swap Execution Facility (SEF) rules required trading platforms to register as SEFs from October 2013 and mandated trading on exchange progressively from February 2014
- The CFTC's mandatory trading rules apply to any trade with a 'US person' and to trades between non-US swap dealers and guaranteed affiliates

Impact

- There was considerable confusion in the market in October 2013, particularly outside the US where platforms with US participants were required to register as SEFs
- There has been a fragmentation in liquidity. US persons have been cut-off from certain non-US liquidity pools, while non-US persons are avoiding SEFs
- For example, volumes of cleared EUR IRS between European and US dealers have dropped 77% between October and December 2013 (source: ISDA)

(continued)

SEFs

Impact (cont'd)

- In February 2014 there was a decline in SEF trading activity as mandatory trading came into effect. Volumes have not recovered. For example, in the week following the implementation of mandatory trading on SEF, swap volumes traded on SEFs fell by 50% (source: FIA)
- A number of market participants have restructured activity in response to these rules

Cross-Border Application

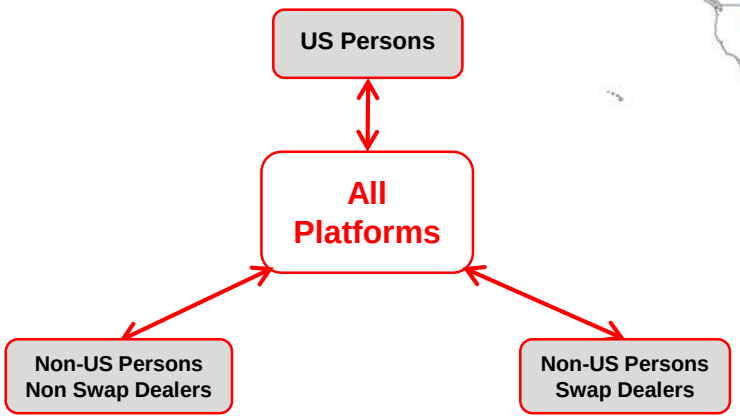
- There was general confusion outside the US around the SEF implementation dates. The rules were not well-communicated outside the US, especially to the trading platforms impacted
- The CFTC implementation of mandatory exchange trading was not coordinated with similar rules in other jurisdictions
- Although the CFTC issued a no action letter in February to allow mandatory trading to take place on EU multilateral trading platforms (MTFs), this relief was too late and, in substance, required the MTFs to comply with the SEF rules, thereby negating any 'relief'

Possible Solutions

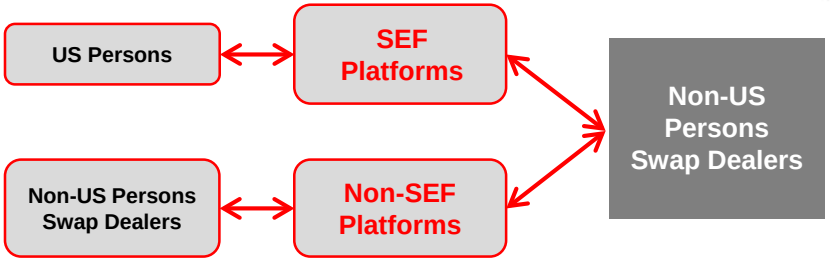
- Explicit communication of the extraterritorial impact of rules through IOSCO at the consultation and implementation stages
- Recognition of third-country regimes based on 'outcomes' and consistency with international standards, rather than line-by-line comparison of rules
- Coordination of implementation dates for rules impacting global markets, or workable relief mechanisms during transition periods

SEFs: Risks of fragmentation

Pre-SEF



Post-SEF



Case Study No.2 – Volcker

Cross-Border Regulatory Issues

The Volcker Rule

Volcker

Background

- In most advanced economies, universal banks have developed. These entities may both take retail deposits and engage in trading activity
- Post-crisis, a political view emerged in many countries that retail deposits should not be put at risk through a licensed deposit-taking entity also undertaking proprietary trading

The Volcker Rule

- Title VI of the Dodd-Frank Act introduced the Volcker Rule
- The Volcker Rule bans FDIC-insured depository institutions (as well as foreign banks that control a US bank subsidiary, branch, agency or commercial lending company) and their affiliates from undertaking proprietary trading, subject to certain exemptions
- It also generally prevents such institutions from investing in or sponsoring private equity or hedge funds ('covered funds'), subject to certain limited exemptions and then, only within prescribed de minimis levels
- The Volcker Rule contains an exemption for 'foreign banking entities' but this exemption is not well-correlated to the risk the Rule seeks to address

Impact

- Banks are in the process of restructuring their businesses to comply with the Volcker Rule
- Non-US funds are themselves directly subject to the Volcker Rule's prohibitions on trading and fund investment activities, if controlled by banks subject to the Volcker Rule (see below) – this is likely to significantly restrict activity

(continued)

Volcker

Impact – cont'd

- Although the Rule is final and metrics reporting begins this summer, substantive compliance with the Volcker Rule is not required until July 2015. Therefore, the impact on market liquidity is unclear

Cross-Border Application

- Although the Rule's prohibition on trading contains an exemption for foreign banking entities, this is narrowly drafted. Therefore, trades that do not present any systemic risk to the US are captured
- For example, two UK-incorporated and regulated entities enter into a trade. However, the trading decision is made in the US – e.g. (i) because that is where the relevant credit or risk acceptance team is located, (ii) to provide services outside of London working hours, or (iii) because the team that manages the risks of the product traded is located in the US
- This transaction won't benefit from the exemption for foreign banking entities, and will be prohibited, unless it can benefit from another exemption (in which case, quantitative trading metrics will have to be calculated and reported and qualitative requirements will apply). This is so, despite having been transacted, as principal, between non-US entities, and posing no systemic risk to the safety and soundness of the US financial system
- The Volcker Rule excludes certain non-US funds from being treated as 'covered funds' (thereby making it permissible for a foreign bank to sponsor or invest in such funds), but, where such funds are controlled by a bank subject to the Rule, this subjects the funds themselves to the Rule's prohibitions on trading and fund investment activities. 'Covered funds' themselves benefit from separate relief, and these prohibitions counter-intuitively do not apply to them in the same circumstances
- The Volcker Rule does not contemplate recognition of other regimes designed to achieve the same outcome (e.g. ICB in the UK or European rules on bank structure)

Volcker

Possible Solutions

- Explicit communication of the extraterritorial impact of rules through IOSCO at the consultation and implementation stages
- Recognition of third-country regimes based on ‘outcomes’ and consistency with international standards, rather than line-by-line comparison of rules
- Cost-benefit analysis on the extraterritorial impact of rules to ensure the cost on foreign jurisdictions is justified

Case Study No.3 – Private Fund/AIF reporting

Cross-Border Regulatory Issues

Private Fund/AIF reporting

Private Fund/AIF reporting

Background

- Regulators and policymakers have identified lack of data as a key barrier to understanding systemic risk
- G20 identified alternative funds such as hedge funds, private equity funds, real estate, institutional funds as a blind spot
- Although alternative funds did not cause the 2007/8 financial crisis there are genuine policy concerns as to whether alternative funds could lead to or amplify future crises
- Regulators also need data flow for enhanced cross-border supervision and cooperation

Alternative/Private fund regulation

- IOSCO produced a high-level reporting template in response to the G20
- Key data fields include leverage, liquidity, investor concentration, counterparty exposure and asset concentration
- The template has been considerably expanded upon by regional regulation (e.g. Forms PF/PQR under Dodd-Frank Act and ESMA reporting annexe under AIFMD)
- The information reported is designed to drive local systemic risk analysis e.g. by SEC/ESMA/ESRB
- Individual national regulators are primarily responsible for supervisory action. ESMA MOUs under AIFMD allow for some information sharing for supervisory action but are unclear as to pooling of data for systemic risk analysis
- Limited feedback loops to the industry on global trends and potential risks

Private Fund/AIF reporting

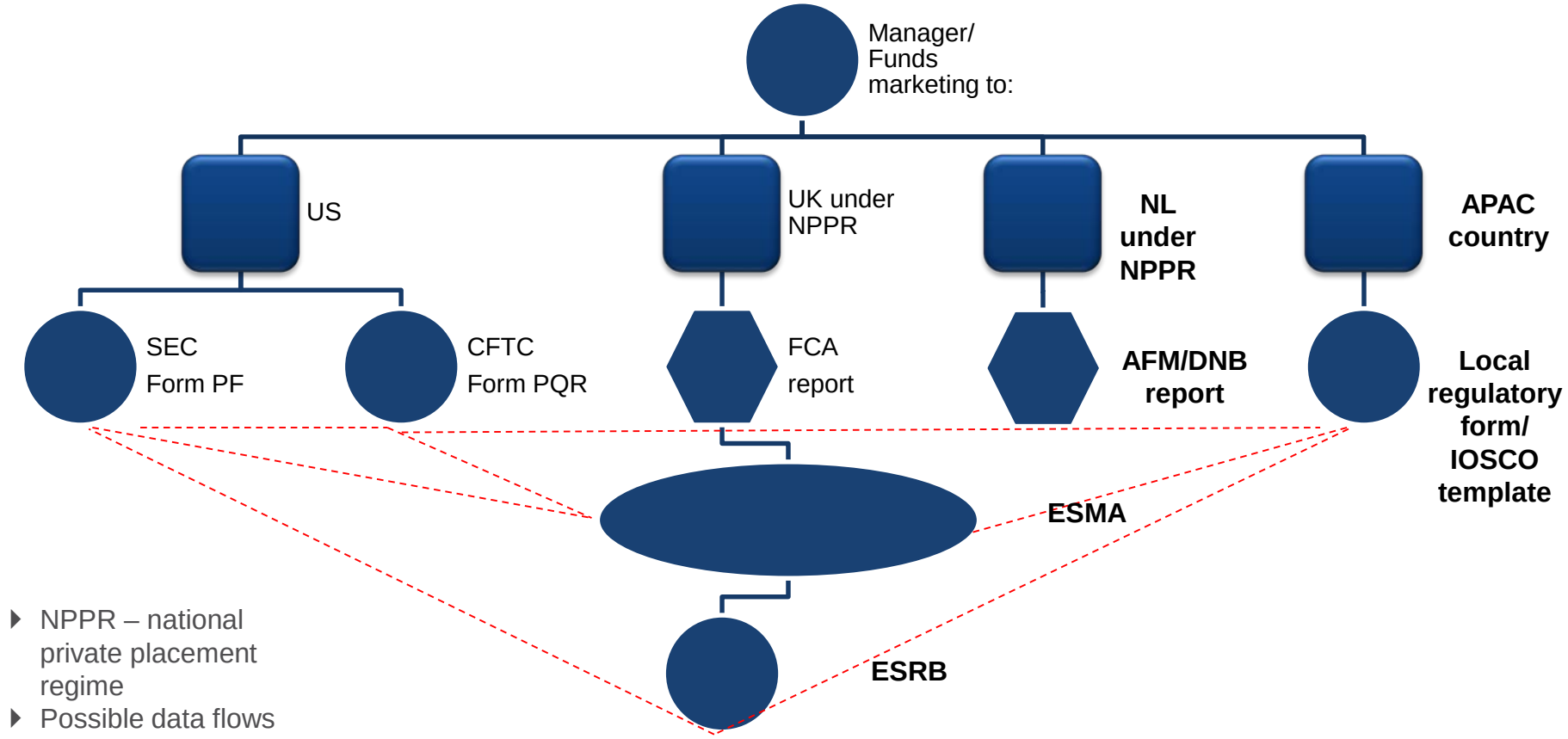
Impact

- Proliferation of templates, formats and definitions reduces the ability of regulators to share data on a cross-border basis and cooperate effectively with each other
- Current process leads to duplication and inconsistency in reporting by firms and operational complexity with up to 500 separate data points required per fund per filing, many requiring manual intervention
- Reporting requirements do not match. Between US and EU the data requested in each jurisdiction is similar in nature (i.e. position sizes, counterparties, etc.) but is asked for differently on each form. Under AIFMD and Form PF there is around a 30% direct overlap, a further 40% which is a close fit and 30% where data requirements differ

Cross-Border Application

- Investors wish to access portfolio management solutions suited to their investment needs from around the world. Managers respond by offering portfolio management in a single fund wrapper marketed to investors in multiple jurisdictions. Frequently this is the most efficient way to offer best in class portfolio management solutions
- Private placement rules mean filing separate forms in each EU jurisdiction in which private placement occurs. In principle, this is the same form but it has to be filed via different national platforms
- APAC, MEA and LatAm rules in many cases are still to be defined

Cross-border marketing and reporting for alternative funds



- NPPR – national private placement regime
- Possible data flows

Private Fund/AIF reporting

Possible Solutions

- Take the opportunity of forthcoming reviews of AIFMD to allow ESMA/SEC and other key regulators to agree a common format by updating the existing IOSCO template. This could take into account developments in global data standardisation such as the FSB work on LEIs and pave the way for reporting in other jurisdictions
- Move from a close fit to a direct match of data fields between jurisdictions so the collecting and reporting of data is exactly the same for the vast majority of data collected
- Close cooperation between key regulators internationally and mutual recognition of each other's forms would significantly reduce processing time and allow for timelier and more consistent regulatory dialogue
- A precondition is the need for (i) standard identifiers (e.g. FSB work on LEIs) (ii) definitions and FAQs
- Need to define a balance between sharing data for systemic risk analysis e.g. on an aggregated anonymised basis, and individual firm and fund data for supervisory purposes which needs to respect data privacy and commercial confidentiality
- Consider the long term development of a centralised data reporting hub (or hubs in the nearer term)
- As the primary role of this data collection is for monitoring systemic risk we believe it is essential to have a feedback mechanism to industry as to what the data collected is saying to regulators. A far closer dialogue between regulators and industry is needed
- Standardising data reporting will lead to more effective evidence-based regulation and increase trust between regulators

Case Study No.4 – Derivative reporting and confidentiality

Cross-Border Regulatory Issues

Conflict between derivative reporting requirements and local statutes limiting financial disclosure

Derivative reporting requirements versus confidentiality

Background

- After the onset of the financial crisis, a coordinated private- and public-sector effort saw the establishment of OTC derivative trade repositories in different derivative asset classes
- These trade repositories should facilitate timely provision of data to regulators, helping them to identify build-up of risk in parts of the financial sector

Mandatory reporting

- In September 2009, the G20 committed to mandatory reporting of OTC derivatives to trade repositories
- In 2012, US reporting to ‘swap data repositories’ began to take effect, following CFTC rulemaking
- In February 2014, EU reporting requirements (under EMIR and associated technical standards) took effect (relating to both exchange-traded and OTC derivatives)
- In both EU and US rules, counterparties subject to reporting requirements are required to report counterparty information, which often conflicts with rules restricting reporting of such information in other jurisdictions
- Industry bodies had highlighted the existence of such restrictions and their potential incompatibility with new derivatives reporting requirements to regulators at global level (ODSG) prior to drafting and enaction of EU and US reporting rules
- ESMA officials have stated that failure to give up counterparty information in mandatory reports – even for reason of conflicting rules in non-EU jurisdictions – represents non-compliance with EMIR

Derivative reporting requirements versus confidentiality

Mandatory reporting – cont'd

- Similar considerations apply under US rules, with CFTC having granted time-limited relief from reporting (until 30 June 2014) to counterparties, subject to provision of certain information regarding applicable local restrictions to the CFTC
- EU counterparties dealing with counterparties from many non-EU jurisdictions would be required to break the rules of one of the jurisdictions involved in order to trade. This discourages cross-border business
- US 'no action' relief for named jurisdictions expires on 30 June 2014, and there is no guarantee this relief will be extended. Similarly this discourages cross-border business

Possible Solutions

- Post-fact: The FSB's OTC Derivatives Working Group is monitoring progress in removing such barriers, following agreement in the ODRG that jurisdictions should remove such barriers
- Preventative: Regulators should consult and cooperate with each other – leveraging multilateral groups like the ODRG or IOSCO – before implementing derivatives regulations

Derivative reporting requirements versus confidentiality – risks of fragmentation

Pre-DF/EMIR

- Counterparties in different jurisdictions free to transact with one another in absence of mandatory derivative reporting requirements requiring reporting of counterparty information.

Post-DF/EMIR

- Conflicts between local confidentiality statutes and major jurisdictions' derivatives reporting requirements discourage cross-border business in view of legal risks.

Case Study No.5 – Securitisation

Cross-Border Regulatory Issues

Securitisation

Securitisation

Background

- Prior to the financial crisis the securitisation market was on track to become a truly global market
- The financial crisis reversed that process, and political and regulatory reactions impeded market recovery and led to investor and issuer aversion to securitisation
- Yet many sectors of both the US and European securitisation markets have performed well, through and since the financial crisis

Mandated Changes

- The G20 committed to addressing the reasons for the crisis in the securitisation market – misalignment of interest, over-reliance on ratings, insufficient transparency and excessive complexity in some sectors, as well as inappropriate use of the originate-to-distribute model
- Multiple guidelines and proposals were launched at international level (BIS, IOSCO) and national/regional level:
  - US: Dodd-Frank (including Volcker Rule) and Reg AB
  - Europe: CRD rules on retention, due diligence and disclosure including the European DataWarehouse, Solvency II regulatory capital requirements for insurers, CRA regulation and bank structural reform
  - Globally: the BIS proposals for RWA for bank investors and other related workstreams including trading book treatment, cost of credit protection, Net Stable Funding Ratio (NSFR)

(continued)

Securitisation

Mandated Changes – cont'd

- There are significant differences between US and European proposals as regards retention, disclosure regulatory capital model usage, regulatory capital for insurance companies, due diligence, bank structural reform, etc.
- Many of the changes were introduced as a knee-jerk reaction to the crisis without an adequate study of the alleged problems and without considering the consequences of proposed solutions. There has been no comprehensive impact study of the multiple changes in the regulatory framework for securitisation

Impact

- The US securitisation market has followed a trajectory of recovery since the collapse during the financial crisis, while the European market has seen contraction
- Various initiatives will require market participants seeking to place transactions on a cross-border basis to navigate through different regulatory regimes applicable in different jurisdictions (including complying with multiple sets of requirements), which is highly likely to create fragmentation and reduce liquidity, efficiency and viability of transactions and markets
- Current regulations create incentives for European issuers and investors to redirect their investments towards the covered bond and wholesale loan markets due to beneficial regulatory capital, liquidity and reputational treatment, creating an unlevel playing field

Securitisation

Cross-Border Application

- There is general confusion among US and European investors as to what they can invest in cross-border securitisations. European investors are concerned by new retention and disclosure requirements and how to treat legacy investments in transactions which have become non-compliant, as well as how to carry out and prove due diligence. Note the penalty for non-retention in Europe falls on investors, but on issuers in the US
- The counterparty requirements for OTC swaps, and the lack of sufficiently highly rated counterparties, are reducing the volume of cross-border issuance

Possible Solutions

- Full assessment of the cumulative effect of the regulatory capital, liquidity, repo eligibility, disclosure, and operational requirements for securitisation and other comparable instruments – covered bonds, whole loan portfolios, senior portion of whole loan portfolios, direct property – needed to realign treatment in all its different aspects across comparable instruments to create a level playing field globally
- Address the retention regime on a global basis in terms of forms of and exemptions from retention or through mutual recognition of different regimes
- Ensure regulatory capital requirements for securitisation are calibrated better to reflect historic loss incidence in most asset classes, as well as comparable capital requirements for other methods of finance and the underlying asset pools
- Admit a broader range of securitisations (not just only limited forms of RMBS) to the Liquidity Coverage Ratio
- Agree mutual recognition of local asset class specific templates to align degree of transparency and cost for securitisation and other comparable investment instruments

Case Study No.6 – Futures Exchanges

Cross-Border Regulatory Issues

Recognition of futures exchanges

Cross-border recognition of futures exchanges

Background

- Regulators in jurisdictions across the Americas, EMEA, and the Asia-Pacific administer a framework for recognition of foreign futures exchanges and exempt them from many host-country obligations
- These recognition or exemption arrangements have been beneficial for market operators and market participants. They allow direct access for foreign participants and increase liquidity and efficiency
- However, inconsistency and complexity related to initial and ongoing recognition or exemption requirements can create significant challenges for market operators and market participants

G20 reforms

- Historically, futures exchanges needed foreign recognitions or exemptions primarily to offer direct market access to foreign participants and/or membership with the exchange
- Post-G20 reforms, recognitions and exemptions have become critical for ensuring the appropriate regulatory status of products, ensuring the consistent application of G20 policy objectives across jurisdictions, and avoiding regulatory arbitrage

Cross-border application and impact

- Inconsistencies and delays across jurisdictions' recognition or exemption frameworks are creating an uneven playing field for exchanges, and having a significant impact on market participants and the real economy. For instance, non-financial counterparties in the EU using US futures exchanges' products are more likely to breach the EMIR clearing threshold, because of the present OTC regulatory status of products traded on non-EU exchanges. Until resolved, this situation puts EU NFCs at a disadvantage compared to commercial market participants in the US or Asia

(continued)

Cross-border recognition of futures exchanges

Cross-border application and impact (cont'd)

- The CFTC's Foreign Board of Trade (FBOT) regime offers a regulatory framework for non-US futures exchanges and their products which (i) gives them direct access to US participants and (ii) provides for substituted compliance for many regulatory requirements required of US futures exchanges, which must register as a Designated Contract Market (DCM). Registration as an FBOT is subject to a range of CFTC requirements, an assessment of the comparability of the FBOT's regulatory regime, requirements relating to contracts which reference the settlement prices of DCMs, and increased scrutiny of the FBOT by the CFTC
- In contrast, the EU's system is more complicated, and not yet finalised. Non-EU futures exchanges seeking access to EU customers face multiple layers of recognition
  - First, there are differing national licences or exemptions required for direct market access or membership in each of the 28 EU member states. There is no single EU point-of-entry or 'passport' regime available. Delays or gaps in recognition create uncertainty for exchanges and market participants and there is significant complexity in complying with multiple recognition regimes with multiple authorities
  - Second, there is also an EU-level regime under MiFID I whereby non-EU futures exchanges need an 'equivalence' determination and recognition from the EC in order for their products to be designated 'exchange traded derivatives' (ETD), rather than OTC derivatives under EMIR. A list of equivalent markets, originally mandated under MiFID for publication in 2007, has never been produced. Since the regulatory status of products (ETD v OTC) has become critical for certain market participants, this is placing non-EU exchanges at a disadvantage and creating regulatory arbitrage
  - Third, there are 'equivalence' provisions in the MiFIDII/MIFIR text that will be in place by 2017, which will require additional recognitions for other activities; for example, equivalence will be needed to satisfy the EU trading obligation for certain products

Cross-border recognition of futures exchanges

Solutions

- IOSCO should develop principles for recognition of foreign futures exchanges and guidelines for equivalence assessments, based on equivalent outcomes. IOSCO can draw from existing standards for the oversight of securities markets and venues. This will make the process more transparent, opening it to input from stakeholders, and minimizing political interference and delays
- IOSCO can also facilitate information sharing between foreign exchanges and home jurisdiction regulators by standardising the scope, frequency, and other aspects of regulatory reporting required to maintain recognitions or exemptions. This will level expectations around the types of information to be shared and frequency of data delivery, which will simplify compliance for exchanges and negotiations around recognition

Case Study No.7 – Scope/definitional conflicts – FX example

Cross-Border Regulatory Issues

Scope/definitional conflicts – FX example

Scope/definitional conflicts – FX example

Background

- The inclusion in aspects of European regulation (including MiFIR, EMIR, FTT) is driven by the definition of a MiFID Financial Instrument. For FX, it is specifically stated in MiFID Annex1, Section C.4 that:
  - Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash
  - Note FX forwards are not mentioned
- MiFID is a directive, thus the above definition is open to national interpretation in each individual EU member state; different countries have interpreted the above definition in different ways, specifically:
  - Varying inclusions of FX forwards as MiFID Financial Instruments
  - Varying definitions of the tenor split between FX spot and FX forwards
- Historically, this definition has presented little challenge for the FX markets due to the nature of MiFID 1:
  - It is now creating challenges with the implementation of EMIR, specifically trade reporting (live February 2014)
  - It is expected to do so with the implementation of other derivatives regulations in Europe
- In February 2014 ESMA wrote to the European Commission (EC) asking for clarification on the definition of FX spot versus FX forward and for regulatory changes to be made to bring Europe-wide consistency in what FX products are defined as MiFID Financial Instruments

Scope/definitional conflicts – FX example

Mandated Changes

- EMIR requires market participants in Europe to report MiFID Financial Instruments to a trade repository:
  - Dual-sided reporting, so both parties have to report their side of the trade
  - Trade reports are required to match in the trade repository, or across trade repositories if appropriate
  - Matching requires the same data to be reported by both parties

Cross-Border Impact

- Trades between parties with differing jurisdictional interpretations/obligations:
  - Result in mismatches at the trade repository and incomplete reporting for ESMA and the local National Competent Authority (NCA)
- Ability for ESMA to oversee the European Market as a whole will be impacted as they will not have transparency for all required transactions
- Market participants will have increasing numbers of trade repository breaks that they will not be able to clear; the artificially increased volume could 'mask' real breaks:
  - Their counterparty will never submit a trade to clear the break
- An additional impact resulting from inconsistencies in the regulatory treatment of FX products between the US and Europe is that under Dodd-Frank, FX forwards and swaps are explicitly exempted from any clearing and execution regime, but remain open to this in Europe under EMIR as potential MiFID instruments. This gives rise to concerns that this may result in future fragmentation in the market.

Scope/definitional conflicts – FX example

Solution

- The EC and ESMA recognised these interpretation differences and the EC subsequently issued a consultation paper (CP) on FX Financial Instruments on 11 April 2014, with the response due on 9 May 2014.
- GFMA Global FX Division (GFXD) responded that:
  - FX spot is T+2, except for scheduled or unscheduled holidays (i.e. two good business days from trade date)
  - FX Security Conversions are also FX spot. An FX Security Conversion is an FX trade entered into to fund the +/- of a foreign security, with the FX trade settling at the same time as the security (this could be up to T+7 for the settlement of South African securities)
- EC is expected to hold further discussion with member states in June to substantiate the feedback from the CP
- EC is then expected to publish a draft Implementing Act in July 2014 for consultation with national experts
- Implementing Act could be adopted around August 2014, entering into force November 2014

ANNEX II: LIST OF MEMBERS OF THE CROSS-BORDER REGULATION FORUM

Associations and other bodies:
AFB: Association of Foreign Banks
AFMA: Australian Financial Markets Association
AFME: Association for Financial Markets in Europe
AMIB: Mexican Securities industry Association
ASIFMA: Asia Securities Industry and Financial Markets Association
Bombay Stock Exchange Broker's Forum
CCP12 - The Global Association of Central Counterparties
EACH: European Association of CCP Clearing Houses
ECSDA: European Central Securities Depositories Association
FESE: Federation of European Securities Exchanges
FIA Global: (replacing its 3 EU US and Asia affiliates)
ICMA: International Capital Market Association
ICSA: International Council of Securities Associations
IIAC: Investment Industry Association of Canada
IIF: Institute of International Finance
IMA: Investment Management Association
ISDA: International Swaps and Derivatives Association
SBA: Swiss Bankers Association
SIFMA: Securities Industry and Financial Markets Association
WFE: World Federation of Exchanges
WMBA: Wholesale Markets Brokers' Association
Firms:
Bank of America Merrill Lynch
Barclays
Blackrock
Deutsche Bank
Goldman Sachs
HSBC
ICAP
Marex Spectron
Morgan Stanley
Nomura
RWE Supply & Trading
Shell International Trading and Shipping Co Limited
(STASCO) Societe Generale
Standard Chartered
UBS

Market Infrastructures:
CME Group
Eurex Group
ICE: Intercontinental Exchange
LME: London Metal Exchange

Observers:
BBA: British Bankers' Association
JSDA: Japan Securities Dealers Association
KOFIA: Korea Financial Investment Association

ANNEX III: CBRF SUBMISSION DATED 25 MARCH 2014

CROSS-BORDER REGULATION FORUM

REGULATORY RECOGNITION: PROCESSES AND CRITERIA FOR MEASURING AND DETERMINING INTERJURISDICTIONAL COMPATIBILITY

MARCH 2014

CROSS-BORDER REGULATION FORUM (CBRF)

REGULATORY RECOGNITION: PROPOSED PROCESSES AND CRITERIA FOR MEASURING AND DETERMINING INTERJURISDICTIONAL COMPATIBILITY

SUPPORTING THE G20 AGENDA AND REINFORCING IOSCO'S ROLE

1 Introduction

1.1 In March 2014, a group of international and regional financial service trade associations, investment banks, brokerage houses, market infrastructure operators and institutional and corporate consumers of financial services established the Cross-Border Regulation Forum (CBRF) to:

(a) provide a broad based industry interface with the newly established IOSCO Task Force which has been set up to develop a "tool box" of measures for regulating cross-border business and, as appropriate, shared principles and standards of measurement for assessing regulatory comparability; and

(b) energise the dialogue on interjurisdictional regulatory recognition, substituted compliance, exemptive relief, supervisory cooperation and the conditions for accommodating cross-border access.

1.2 A list of the (current) members of the CBRF is attached at Appendix 1.

1.3 The CBRF welcomes and supports the momentum by the international standard-setting organisations to set a threshold of regulatory standards and principles that can be held in common by regulatory authorities and commissions; broad coordination on delivery of the G20 commitments; and the efforts by regulatory authorities in different jurisdictions to achieve a consensual regulatory approach to regulating cross-border business, including the recent "Path Forward on Derivatives" communiqué (July 2013) between the European Commission and the US Commodity Futures Trading Commission to better accommodate the need for cross-border regulatory cooperation.

On the other hand, the CBRF is concerned that, despite these initiatives, there is a failure to develop and implement global standards consistently, or coordinate effectively, on the evolution of rules at the development stage, resulting in growing incoherence and conflict surrounding rights of access and the regulation of cross-border business, or to give adequate weight to the trading, hedging and investment needs of customers. This, in turn, is generating a significant and needless increase in legal risk and customer confusion, market fragmentation, compliance complexity and duplicative processes, as well as undermining regulatory and market efficiency, impairing customer access to markets and products, enhancing the risk of inadvertent regulatory breaches and driving up costs for end-users of financial products.

More specifically:

- Corporate and institutional consumers of financial services and users of markets are not able to access – in a global marketplace – a sufficiently broad spectrum of international products and services for trading, investment, risk-management and capital-raising purposes on a coherently regulated and cost efficient basis, particularly relevant for exporters and companies that raise capital cross-border. Moreover, the complexity of cross-border regulation is impairing the ability of corporate and institutional consumers of financial services to properly comprehend the levels of protection that are applicable to their activities as well as limiting choice and increasing the cost for customers

- Regulatory complexity and undue access restrictions carry the risk of Balkanising markets, fragmenting liquidity and working against broader regulatory goals, such as in

the areas of increased transparency and risk-mitigation, and delivering market efficiencies for endusers

- Regulatory inconsistency can only increase the potential for regulatory arbitrage between jurisdictions

- Insufficient consideration has been given to the interplay of regulatory changes designed to fulfil the G20 objectives and the manner in which conduct, prudential, resolution and market infrastructure issues are interconnected

- While the CBRF recognises the need for additional supporting rules to supplement international regulatory standards and principles, the regulatory authorities in different jurisdictions have tended not to adopt a consensual approach towards those supplementary rules, but rather to have implemented the relevant standards and principles with varying degrees of sometimes significant differentiation

- The propensity of regulatory authorities to seek to extend the reach of their rules and processes beyond their territorial borders and not to consider the conflict of laws and other legal consequences is adding tiers of further regulatory duplication, fragmentation, regulatory risk, and conflict - at a time when regulatory authorities are struggling to fulfil their public policy agendas within their own jurisdictions and for their own domestic consumers

- Regulatory authorities, which are deemed broadly comparable for regulatory recognition purposes, have not given adequate *practical effect* to that comparability or provided transitional relief during the period when comparability is being measured, particularly relevant in the case of substituted compliance

- Measuring compatibility must allow adequately for the need to accommodate fundamental differences in jurisdictions to ensure that comparability is realistic and takes into full account those differences

- Better account must be taken of the accepted contribution that liberalised and accessible financial markets can make to the post-crisis policy objective of accelerating business recovery and delivering higher growth and more jobs as well as reducing the cost of capital and enhancing choice for consumers of financial and market services

- The lack of comprehensive common standards for exchange of information and data supervision and enforcement between regulatory authorities and commissions is hindering the development of an effective national supervisory framework

- Duplicative measures generate an inefficient allocation of regulatory resources at a time when regulators are facing considerable cost pressures in meeting their new and significantly more extensive post-crisis responsibilities.

1.4 The CBRF refers to the ISDA report "Cross Border Fragmentation of Global OTC Derivatives: An Empirical Analysis" which reviewed the US SEF registration regime and how its failure to adequately take into account local regulatory regimes resulted in market fragmentation impact. (see *http://www2.isda.org/functional-areas/research/research-notes/ 2 studies – Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis(1/21/2014); Footnote 88 and Market Fragmentation: An ISDA Survey (12/18/2014)).*

1.5 Against this background, the CBRF looks forward to the IOSCO Task Force's much anticipated consultation paper which, together with the results of its survey of members of the Task Force and the Emerging Markets Committee, should help all stakeholders identify a way forward for establishing a common and more harmonised approach to cross-border regulation (and supervision) that is effective and pragmatic as well as flexible.

1.6 The CBRF also believes that developing an effective supervisory architecture to generate greater trust and confidence between regulatory authorities and commissions is essential and it will enhance regulatory capability for effective action in times of crisis. Inevitably, the concerns expressed in this paper affect global markets and their regulatory authorities and is more than addressing the need to resolve the much publicised, albeit extremely important, issue of post-crisis transatlantic coordination.

2 The case for energising the dialogue on regulatory recognition

2.1 Prior to the financial crisis, there was a clear and consensual recognition of the importance of globally connected and coherent regulation governing the cross-border financial activity. This was evidenced by the EU Commission and US Securities and Exchange Commissioner (SEC) which stated, in their February 2008 Joint Statement on Mutual Recognition in Securities Markets, that *"a concept of mutual recognition offers significant promise as a means of better protecting investors, fostering capital formation and maintaining fair, orderly and efficient transatlantic securities markets";*

2.2 Since that time, policy makers and regulators have concentrated on the overarching priority of redesigning, reforming and strengthening regulation to bolster financial stability. The CBRF understands this focus, but notes that this was also the point where mutual trust and confidence between the various regulatory authorities started to break down.

2.3 Post-crisis, the G20 emphasised the continued importance of regulatory recognition by stating in its November 2008 Washington Summit that "*we underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty"* and that has been a recurring theme for G20 in subsequent communiques. For its part, the EU Commission stated in its Communication "Driving Economic Recovery" (March 2009) that "*protectionism and a retreat towards national markets could lead to stagnation, a deeper and longer recession and lost prosperity"*. In March 2012, Michel Barnier, Director General of Internal Markets and Services at the EU Commission stated, in his speech in Copenhagen, that we need "*an integrated market not only within the EU, but worldwide*" and, in doing so, pointed out that it was good for economic efficiency, the allocation of capital and investor choice.

2.4 More recently the CFTC and the EU Commission issued a joint statement confirming that further work was being undertaken to improve harmonisation of the regulatory framework covering US Swap Execution Facilities (SEF) and EU Multilateral Trading Facilities (MTFs) pursuant to their earlier Path Forward statement issued in July 2013. In commenting on the agreement, Michel Barnier emphasised that "*regulators can and should work together to ensure that their respective rules interact with each other in the most effective and efficient fashion. This needs to be done without creating regulatory overlaps or loopholes thus creating a global level playing field for operators".* CFTC Acting Chair Mark Wetjen also noted that, "*[a]s the CFTC moves forward with the swap trading mandate in the United States, it must and will continue to work with its counterparts in Europe and elsewhere to meet the G20 commitments and ensure that standardized trading on regulated platforms protects global liquidity formation and provides much-needed pre-trade transparency to market participants*."

2.5 These views were further supported by Mark Carney in a letter dated 17 February 2014 to G20 finance ministers and central bank governors written in his capacity of Chairman of the Financial Stability Board in which he stated that "*G20 leaders agreed in St Petersburg that jurisdictions and regulators should be able to defer to each other when justified by the quality of their respective regulations and enforcement regimes, in a non-discriminatory way, based on similar outcomes. This does not necessarily mean that different jurisdictions need to have identical market regulations, as long as the outcomes are similar*".

2.6 Despite all these unequivocal expressions of policy intent and the flow of communiques, particularly between the various regulatory authorities in the US and the EU, the reality has been, despite the issuance of shared high-level regulatory standards, an increased momentum towards regulatory protectionism and extraterritoriality. Clearly, global business access can be a vehicle for the importation of extraterritorially sourced risks which can have real adverse consequences for domestic markets, financial service providers and consumers. However, the

CBRF believes that vulnerability to global contagion is better mitigated through the adoption of harmonised regulatory standards, better and deeper real time cooperation and supervision and comprehensive information-sharing between regulatory and supervisory authorities. This, in turn, will require a restoration of trust and confidence between regulatory authorities in different jurisdictions.

3 Factors and criteria relevant to measuring interjurisdictional regulatory compatibility

3.1 The basis for measuring regulatory recognition has been the subject of very different language ranging from "strict equivalence" to "equivalence" to "comparability" and, in some cases, "adequacy" and "sufficiency". The CBRF believes that it should be based on "comparability" in all cases and that this does not require identical rules, reflecting the fact that regulatory systems, overarching legal frameworks and market practices will vary significantly from jurisdiction to jurisdiction.

3.2 The CBRF emphasises that, in pressing for a more realistic approach to regulatory recognition, it is not asking for regulation to be any less rigorous or effective. However, if the goal of the dialogue is to address the problems and deliver the benefits outlined in para 1.3 and implementing the policy statements expressed in Section 2 above, a more open and pragmatic approach needs to be adopted to assessing comparability, e.g. where there are comparable regulatory outcomes, a greater willingness to "give and take" on the detail of the rules and to de-prioritise rules' "ownership" will be necessary, subject to maintaining acceptable standards of investor protection, market integrity and systemic risk mitigation.

3.3 The CBRF believes that the test of regulatory comparability applies at three different levels, namely:

(a) comparability between national regulatory frameworks, which should be based on shared public policy objectives and common regulatory values, scope and outcomes, particularly in relation to systemic risk reduction and transparency;

(b) comparability between rules' sets for the purpose of applying substituted compliance, but recognising the inevitability of certain key differences that cannot necessarily be reconciled because of differentiated legal systems, market practices, insolvency laws, etc. – and if and where key rules are deemed to be so divergent as not to accommodate substituted compliance, they should be the subject of a dialogue to assess the prospect of amendment and convergence; and

(c) comparability between national competent authorities in terms of their capability, resources and expertise sufficient to ensure effectiveness in the area of supervision, investigation and enforcement (recognising that effective mutual reliance in this area is dependent on a high degree of trust and confidence between those authorities).

It is important to bear in mind that the scope, scale, timetable and culture standing behind supervisory practice could vary significantly insofar as firms in different jurisdictions are subject to different laws and may exercise their supervisory responsibilities in different ways, which, in turn, means that a lack of close comparability in supervisory approaches should not necessarily be assumed as a deficiency in supervisory standards. This is particularly relevant in the case of host-state rules which, even though they will be comparable, are formulated and implemented on different timelines to a home state regime.

3.4 The CBRF urges the IOSCO Task Force to consider the following related issues, namely:

(a) the need for a system to monitor on an ongoing basis continuing regulatory compatibility for recognition purposes (see also (b) below) as well as continuing compliance with IOSCO Principles, particularly since they would serve as a basic foundation for regulatory recognition;

(b) the importance of establishing a mechanism for prior collaboration (and mandating its use other than *in extremis* situations) between relevant competent authorities when considering significant changes in their rules to encourage early consideration of convergence and avoid any undue divergence that would undermine the scope for substituted compliance;

(c) the need for IOSCO standards to establish, for example:

(i) the right of clients to access foreign financial institutions and infrastructures and the preconditions necessary to be able to exercise that right;

(ii) a presumption that a "qualifying" third country institution is deemed eligible for recognition;

(iii) a consensual process for determining regulatory recognition;

(iv) the laws, standards, principles and criteria that should be taken into account when determining the existence or otherwise of regulatory comparability.

(d) the need to provide data and examples in support of the findings in the Task Force's eventual report, e.g.

- identified access problems attributable to unjustifiable regulatory barriers;

- significant cost differentials generated by unjustifiable differentiation between rule sets that could exacerbate market fragmentation and/or regulatory arbitrage; and

- in relation to the implementation of rules across jurisdictions, examples of how different approaches to oversight and supervision are evidential of inadequate compliance with international standards.

(e) the commissioning of a cost-benefit analysis to demonstrate the economic importance of regulatory recognition in terms of enhancing market access, economic growth and consumer choice;

(f) considering the extent to which greater granularity in IOSCO's standards – in the form of supporting guidance on implementation – could help to reduce differences in national and regional implementation, diminish the opportunities for regulatory arbitrage and deliver greater consistency in the setting of risk parameters across jurisdictions;

(g) the linkages between functional regulation aimed at the financial markets, on the one hand, and prudential rules aimed at banks and other market intermediaries, on the other, and, in particular, where differentiated national rules are undermining the objectives set out by the G20 in Pittsburgh;

(h) enlarging IOSCO's MMOU beyond information-sharing to cover other areas of inter-regulator co-operation such as supervision and enforcement;

(i) how to incentivise regulators to make better use of existing statutory capacity to recognise foreign firms and, in many cases, maintain and amplify existing recognitions; and

(j) the extent to which risk disclosure statements regarding dealings by domestic investors/customers in non-domestic foreign regulated markets and/or with financial service providers could play a part in lessening the need for exacting standards of rules' equivalence when measuring regulatory comparability.

4 Conclusion

4.1 The increasing globalisation of financial products and services and cross border risk importation calls for a more globally interlinked approach to regulation, information-sharing and supervision.

4.2 The emergence of internationally-agreed regulatory standards has enhanced the capability of deeper regulatory inter-dependence, but, for the reasons set out in this paper, in practice, the scaling back of regulatory conflict, inconsistency, duplication and cost continues to be a major undertaking.

4.3 Furthermore, as also pointed out in this paper, a more efficient and coherent framework of regulation is a "win-win" for all the various stakeholders in the global market place, namely:

(a) investors, issuers and consumers of financial services will have the benefit of lower costs and greater choice for meeting their investment, trading, capital-raising and risk management needs;

(b) financial service providers will benefit from being able to better harmonise their internal and customer-facing procedures across all their operations and reduce the incidence of inadvertent compliance breaches;

(c) market infrastructure providers will be able to offer investment, trading and capital raising facilities more widely and so generate deeper pools of liquidity; and

(d) regulatory authorities will be able to deepen their common understandings, develop more effective working relationships and work to a common set of regulatory frameworks driven by shared values and regulatory outcomes and this, in turn, should lead to a better allocation of regulatory resources, improved regulatory efficiency, cure the pre-crisis knowledge deficit and facilitate quicker identification of emerging risks to market integrity and the financial system.

4.4 The CBRF believes, for the reasons set out by a number of trade associations and exchanges in a letter sent to the Financial Times on 19 March 2013 that IOSCO and its member commissions are best placed to review the "tools" for interjurisdictional regulatory recognition and to set standards of measurement for determining comparability across the three levels identified in para 3.3 above. In effect, it is the only organisation which is able to access what is the largest pool of cross-border regulatory expertise in all the relevant jurisdictions.

4.5 The CBRF is keenly aware of national and regional sensitivities surrounding the loss of regulatory "sovereignty" and the reluctance to introduce the necessary legislative changes that would allow recognition of an enhanced role for IOSCO. Nevertheless, the CBRF is supportive of the role of IOSCO being strengthened in terms of its ability to be influential and persuasive in the adoption and implementation of regulatory principles and standards aimed at enhancing cross border regulatory cooperation or comparability.

To this end, CBRF believes that IOSCO should be provided with a sufficient degree of international authority with regard to its role as the international grouping of regulators, particularly in the areas of market and business conduct regulation, equivalent to that enjoyed by the Basel Committee on Banking Supervision in relation to the issuance of prudential regulatory standards.

The CBRF believes that this can be achieved by the G20, at its next leaders' summit, by:

(a) re-affirming its commitment to open markets;

(b) reviewing, redefining and expressly supporting the roles of the FSB and IOSCO in this regard;

(c) mandating the creation of mechanisms for coordinating rule-making and regulatory interdependence; and

(d) establishing a mechanism for assessing the effectiveness of measures in different jurisdictions in the case where one regulator is inclined to believe that the standards of another are “inadequate”.

4.6 The CBRF recognises that IOSCO and its member regulatory authorities must be able to engage in confidential regulator-to-regulator dialogues, but the CBRF also believes strongly in the importance of a separate dialogue being maintained on a regular basis with industry participants (i.e. the providers and consumers of market and financial services) in order to ensure that commercial and business benefits are given due consideration alongside the regulatory benefits.

LIST OF MEMBERS OF THE CROSS-BORDER REGULATION FORUM (CBRF)

Associations and other organisations:
CCP12 - The Global Association of Central Counterparties
AFB: Association of Foreign Banks
AFMA: Australian Financial Markets Association
AFME: Association for Financial Markets in Europe
ASIFMA: Asia Securities Industry and Financial Markets Association
Bombay Stock Exchange Broker's Forum
EACH: European Association of CCP Clearing Houses
ECSDA: European Central Securities Depositories Association
FESE: Federation of European Securities Exchanges
FIA Global: (representing its 3 EU US and Asia affiliates)
ICMA: International Capital Market Association
ICSA: International Council of Securities Associations
IIAC**:** Investment Industry Association of Canada
IIF: Institute of International Finance
ISDA: International Swaps and Derivatives Association
SBA: Swiss Bankers Association
SIFMA: Securities Industry and Financial Markets Association
WFE: World Federation of Exchanges
WMBA: Wholesale Markets Brokers' Association

Firms:
Bank of America Merrill Lynch
Barclays
Blackrock
Deutsche Bank
Eurex Group
Goldman Sachs
HSBC
ICAP
Marex Spectron
Morgan Stanley
Nomura
RWE Supply & Trading
Shell
Societe Generale
Standard Chartered
UBS

Market Infrastructures:
CME: Chicago Mercantile Exchange
Eurex Group
ICE: Intercontinential Exchange
LME: London Metal Exchange

Observers:
IMA: Investment Management Association
JSDA: Japan Securities Dealers Association
KOFIA: Korea Financial Investment Association

NB Please note this list is still growing

ANNEX IV: LIST OF ABBREVIATIONS

CBRF	Cross-Border Regulation Forum
CFTC	Commodity Futures Trading Commission
DCM	Designated Contract Market
EMIR	European Market Infrastructure Regulation
FBOT	Foreign Board of Trade
FSB	Financial Stability Board
IOSCO	International Organisation of Securities Commissions
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MTF	Multilateral Trading Facilities
ODRG	OTC Derivatives Group
OTC	Over the Counter
RTS	Regulatory technical standards
SEF	Swap Executive Facilities
UCITS	Undertakings for Collective Investment in Transferable Securities