



The Cross-Border Conundrum: *Reducing Regulatory Impediments to Improve Global Market Efficiency*

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By

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Good morning, everyone.

Thank you for the invitation to speak here today. I am pleased to be in Chicago, one of the nation's most diversified economies and the home of the world's leading and most diverse derivatives marketplace.

This morning I will provide some perspective on the likely approach that will be taken by the global regulatory community, led by multi-national organizations like the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), to tackle the global debt and derivatives markets cross-border agenda.

The financial crisis exposed significant weaknesses in the over-the-counter (OTC) derivatives market. In the immediate aftermath of the crisis, the G20 Leaders agreed to improve the integrity of trading, clearing and reporting of OTC derivative transactions. Individual regulators responded—some more quickly than others—to introduce new rules for dealers and clearinghouses in the derivatives market. The problem is these reforms were introduced without much coordination among the regulators.

The lack of coordination resulted in rule duplication for similar types of transactions and an ever increasing compliance burden, and has led to a fragmentation of liquidity pools in global markets. Markets have balkanized along regional geographic lines, with derivatives traders unable to execute with foreign counterparties, and clear through offshore clearinghouses, without being

subject to multiple regulatory regimes. The global marketplace for OTC derivatives quickly became a regional marketplace.

A case in point: According to the International Swaps and Derivatives Association, in the third quarter of 2013, just before the U.S. swap execution facility regime came into force, 73% of regional European interdealer volume in euro interest rate swaps was traded between European dealers. A year later, 94% was traded between European dealers.

The balkanization of the global market has led to less choice, less liquidity and higher costs for derivatives users.

Two weeks ago, I attended the IOSCO Stakeholders' Meeting in Madrid. The lead-off speaker, Greg Medcraft, Chair of the IOSCO Board, outlined the international organization's successes over the past several years, including its proven effectiveness in identifying the key risks in global financial markets, and the development of global standards for market participants.

Mr. Medcraft also outlined the challenges faced by IOSCO. He noted that IOSCO has found it difficult to encourage individual jurisdictions to make better progress at cross-border harmonization, especially as it relates to clearing and trading activities of OTC derivative transactions. For one, IOSCO does not have the power or regulatory authority to do so. Without a global body to enforce common rules and standards on cross-border activities, participants in global derivatives markets are instead subject to duplicative and inconsistent requirements because individual regulators have been unable to align their rules with other jurisdictions,

or dismantle regulatory impediments to cross-border trade through some form of regulatory recognition.

Nations are gradually moving towards more engagement to address regulatory overlaps, gaps and inconsistencies. IOSCO noted that the increased engagement is mostly bilateral at present, but it is hopeful multilateral engagement will develop further as markets grow and emerge, and will do so with greater use of Memoranda of Understandings—MOUs—between participating jurisdictions.

The *Final Report* of the IOSCO Task Force on Cross-Border Regulation was released on September 17, 2015. A key mandate of the IOSCO Task Force on Cross-Border Regulation was to provide greater cross-border access to domestic or regional OTC derivatives markets through various approaches to relieve or reduce regulatory obstacles. The Task Force identified a broad tool-kit comprised of three approaches to reduce the regulatory barriers to OTC derivatives markets—namely, national treatment, passporting and recognition.

The first approach—national treatment—essentially means treating foreign market participants operating in the domestic jurisdiction in the same manner as domestic market participants in terms of market access and ongoing regulatory requirements. This would be the case regardless of the effectiveness of the foreign regulatory regime or how it may compare to the domestic one. Foreign jurisdictions, however, would be given certain exemptions from domestic rules to operate more efficiently, given their domestic regulatory framework.

The second way to manage regulatory inconsistencies is passporting—an

arrangement that is based on a common set of rules, usually under international treaty or similar legal instrument, to permit market access without requirement for further authorization. The only existing example of passporting under a treaty is the EU, where a central governing body has oversight of all the states participating in the passporting agreement to provide consistent implementation and ensure harmonized supervision practices.

The third way countries could manage regulatory inconsistencies between jurisdiction is through formal recognition (i.e. deference), whether on a unilateral or mutual basis. Following the G20 summit in St. Petersburg in September 2013, Leaders agreed that regulators should be able to defer to other regulatory regimes, if justified by the quality of the overseas regime. This would require an assessment of the rules and supervisory practices of the foreign regulatory regime by the host regulator to ensure it achieves similar outcomes.

In this regard, the U.S. Commodity Futures Trading Commission (CFTC), which took the lead in OTC derivatives rule-making in the U.S., recognized the rules of the Canadian Office of the Superintendent of Financial Institutions (OSFI)—the Canadian bank regulator—in respect of capital, liquidity and leverage, and deemed them equivalent to the U.S. rules in a number of cases.

However, the U.S. CFTC still expects Canadian banks to submit to its oversight, which could include on-site visits, and Canadian institutions will be required to meet U.S. trading and clearing rules to operate in the U.S. OTC derivatives markets.

IOSCO has suggested a number of next steps to potentially enhance engagement with member regulators. It has recommended the establishment of a working group of member regulators to facilitate early discussion of specific cross-border issues among regulators before jurisdictions move to introduce new laws or rules. We all know that in regulatory policy making, early and continuous dialogue is crucial and is a vital ingredient to successful coordination. IOSCO also called for a central hub to facilitate the sharing of information on cross-border impact analyses and regulatory frameworks, and the development of multilateral MOUs on supervisory cooperation.

Finally, it is proposed that IOSCO committees examine the cross-border applications of all ongoing policy work.

The biggest obstacles to implementing an effective cross-border agenda is the deep reluctance among jurisdictions to outsource responsibilities, notably investor protection, to a foreign jurisdiction; to give up sovereignty; and to import bad financial products and bad conduct, made graphic in the last financial crisis.

On the other hand, the failure of individual jurisdictions to cooperate on rule-making process and resolve key differences in rules and regulations reduces the efficiency of global markets, fragments the marketplace and raises the costs of compliance and doing business.

There is a risk that the cross-border objectives of the *Final Report* of the IOSCO Task Force will be subsumed under the general policy work of IOSCO. The IOSCO cross-border agenda would then lose momentum and priority. This would

be most unfortunate. IOSCO is the only international organization capable of tackling and resolving the cross-border problem.

The solution may be to find a way to integrate the political process, namely the G20 Directive and the commitment of the participating governments to harmonize rules and regulations, directly into the rule-making and harmonization exercise managed by IOSCO. Doing so would put pressure on individual regulators to work constructively through bilateral or multilateral negotiations to resolve the cross-border regulatory obstacles stemming from an overlapping rule framework.

IOSCO would play a key role in inspiring the G20 to be more pro-active; identifying the most serious cross-border regulatory impediments; developing more granular criteria for regulatory recognition; establishing a framework for bilateral and multilateral negotiations; and managing the negotiating process among the participating jurisdictions. In turn, the participating jurisdictions would agree on the desired regulatory outcomes and would rely on international regulatory benchmarks (such as the IOSCO *Objectives and Principles of Securities Regulation*) for comparative analysis and to measure progress on removing obstacles to cross-border transactions. It is only through an organized and focused process that headway can be made on improving the efficiencies of global markets.

If the G20 and IOSCO can initiate bilateral or multilateral negotiations on the key cross-border regulatory impediments to capital flows, the successful outcome of these negotiations could trigger a positive response from the other small

jurisdictions, like Asia Pacific countries, that have delayed rule-making and are on the sidelines. The negotiations would provide these jurisdictions with greater clarity on the direction of cross-border harmonization of derivatives regulation.

For its part, the FSB's role is to monitor and report on OTC derivatives reform implementation progress, including the effects of OTC derivatives reforms over time. IOSCO is the better global entity to push the cross-border agenda forward given its regulatory and capital market expertise. Indeed, the IOSCO Task Force, and the consultations it has conducted, has built a solid foundation to negotiate a solution on cross-border derivatives regulation. What is still required is a greater commitment among participating jurisdictions to negotiate a solution.

For our part, the Investment Industry Association of Canada and the International Council of Securities Associations will work with regulators towards achieving greater regulatory cooperation and coordination across jurisdictions.

Thank you for your attention, and enjoy the conference.