Associação Brasileira das Entidades
dos Mercados Financeiro e de Capitais

ANBIMA

To: consultation-2014-09@iosco.org
Subject: Re: Task Force on Cross-Border Regulation

Dear Ms. Rohini Tendulkar,

The Brazilian Financial and Capital Markets Association (ANBIMA) appreciates the opportunity to provide comments on the Consultation Report of the IOSCO Task Force on Cross-Border Regulation (TFCR) and to share the Brazilian experience with respect to cross-border issues from the viewpoint of Brazilian securities markets participants.

You will find attached our response to the consultation, in which we detail the Brazilian experience with cross-border issues focusing on three main areas: the OTC derivatives market reform, financial market infrastructures and the impact of the Volcker Rule in relation to hedge/private equity funds. These three experiences imply different lessons and messages from the perspective of cross-border regulation and point to different possibilities and roles for IOSCO.

The Brazilian financial and capital markets are supportive of the work of the Task Force and believe that the role of IOSCO on cross-border regulatory and supervisory harmonization should be furthered and strengthened.

We are at the disposal of the IOSCO Task Force to discuss these issues in greater depth.

Yours Sincerely,

José Carlos Doherty
ANBIMA Chief Executive Officer

São Paulo, Brazil
February 23, 2015

Ms. Rohini Tendulkar
International Organization of Securities Commissions (IOSCO)
General Secretariat

Re: Task Force on Cross-Border Regulation

Dear Mr. Ashley Ian Alder,
Chair of the IOSCO Task Force on Cross-Border Regulation,

Dear Prof. Anne Héritier Lachat,
Vice-Chair of the IOSCO Task Force on Cross-Border Regulation,

Introduction

The Brazilian Financial and Capital Markets Association (ANBIMA) appreciates this opportunity to provide comments on the Consultation Report of the IOSCO Task Force on Cross-Border Regulation (TFCR) and to share the Brazilian experience with respect to cross-border issues from the viewpoint of Brazilian securities markets participants.

ANBIMA represents close to 90% of the Brazilian financial and capital markets participants, accounting for more than 300 members including banks, asset managers, brokers, securities dealers and investment advisers. We work for the representation and coordination of our members' interests, locally and internationally, and are dedicated to the development of stronger capital markets in Brazil. We serve the needs of our members and other stakeholders through a range of activities including self-regulation, representation, financial education and the provision of financial market data.

Since the onset of the global financial reform, ANBIMA has engaged with its members to discuss the changes in the international regulatory framework and in global standards, and to assess the impacts of regulatory changes for Brazilian markets and institutions. A dedicated working group was set in 2012, the Working Group on International Regulation (GTRI), with a focus on the over-the-counter (OTC) derivatives market reform, the Volcker Rule and other 'structural' banking reforms[1].

[1] The GTRI includes both Brazilian and foreign financial institutions, representing entities of different sizes, business models, market segments and customer bases, and the main Brazilian financial markets infrastructures, BM&FBovespa and CETIP.

The Brazilian situation is not different from other jurisdictions (especially from Asia and Latin America): the impact of differences in regulatory approaches to cross-border financial activity is a reality for market participants and their customers, as well as the duplication/inconsistency of regulatory requirements. Especially, in the OTC derivatives market, cross-border business had been affected and market participants have faced a fragmentation of their activities with foreign counterparties in response of regulatory uncertainty and duplication.

We would like to stress the importance of this Consultation Report and commend the Task Force and IOSCO for their efforts to achieve a greater harmony of cross-border regulation. This work is fundamental to call the attention of national/regional regulators about the effects of their local rules on global securities markets and the interaction of national/regional rules with international standards. However, we recognize that the TFCR's role in addressing the issues already identified, especially in the global OTC derivatives market, is limited, as pointed out in the Report.

The regulatory toolkit presented in the Consultation is comprehensive: basically there is no other option to national/regional regulators when defining new rules which is not well described by national treatment, recognition or passporting. Nevertheless there is room for improving international cooperation among authorities, given the current situation, and for improving coordination when transposing global standards to national/regional frameworks – in other words, for promoting regulatory harmonization.

Brazil is a good case study in this context. Despite the stringency of our regulators with respect to several areas of the global regulatory reform, and despite the alignment of our rules with international standards, as recognized, for instance, by the Committee on Payments and Market Infrastructures (CPMI) and the Basel Committee on Banking Supervision (BCBS), authorities from others jurisdictions are not yet recognizing the Brazilian regulatory framework for the purpose of harmonization – whilst they have the proper 'tool' available.

It is relevant to notice that this situation is not a consequence of inaction from the part of Brazilian authorities. On the contrary, we recognize the efforts of the Brazilian Comissão de Valores Mobiliários (CVM) and of the Central Bank of Brazil (BCB), as well as of BM&FBovespa and CETIP, regarding all the necessary measures and initiatives to ensure the adequate engagement of Brazil in the international regulatory harmonization discussions.

In our response we will detail the Brazilian experience with cross-border issues focusing on three main areas: the OTC derivatives market reform, financial market infrastructures and the impact of the Volcker Rule in relation to hedge/private equity funds. The remaining of our comment letter is divided as follows: the executive summary highlights some of the main recent cross-border issues from the Brazilian perspective; Section 1 explores the work carried out by ANBIMA´s Working Group on International Regulation (GTRI) with respect to OTC derivatives reform; Section 2 details the cross-border issues related to financial market infrastructures; Section 3 discusses the issues related to the impacts of the Volcker Rule on Brazilian investment funds; the conclusion summarizes the main messages from the Brazilian markets participants to IOSCO's consultation.

Executive Summary

The Brazilian situation is not different from other jurisdictions: the impact of differences in regulatory approaches to cross-border financial activity is a reality for market participants and their customers, as it is the duplication/inconsistency of regulatory requirements.

As anticipated, in the present document we have opted to present three situations that highlight different aspects of cross-border regulatory conflicts. Firstly, the OTC derivatives markets reform serves as an example of a situation in which the proper tool is in place, *recognition*, but its application is still not effective. Secondly, the reform of financial markets infrastructures deals with coordination between national/regional jurisdictions and multilateral forums, in this case, CPMI and IOSCO. Finally, we analyze the implications of the Volcker Rule banning of proprietary participation or sponsorship of hedge and private equity funds, an illustration of unintended consequences of national regulations on third countries´ institutions and clients.

All these three situations imply different lessons and messages from the perspective of cross-border regulation. They also imply different possibilities for roles to be played by IOSCO. We summarize below the main lessons from the Brazilian experience which can help the IOSCO Task Force on Cross-Border Regulation and IOSCO in general contributing to a more harmonized regulatory and supervisory framework for global capital markets.

OTC derivatives market reform:

- In addition to developing a regulatory Toolkit, IOSCO should develop a set of Principles for the treatment of cross-border conflicts in regulation;
- IOSCO should also establish guidelines for the assessment of foreign regulatory regimes;
- IOSCO should continue working to enhance international dialogue between regulators among the various jurisdictions and as a forum to build trust and confidence among them.

Financial markets infrastructure:

- CPMI and IOSCO could serve as a central hub of information;
- The grades given by CPMI and IOSCO when assessing the implementation of international standards could be used as reference to national/regional regulators;

- CPMI and IOSCO should play a role in coordinating the timing among jurisdictions' application of cross-border regulatory tools.

Volcker Rule´s covered funds:

- The application of the covered funds´ provisions of the Volcker Rule to Brazilian investment funds is a clear example of an *unintended cross-border consequence* of the adoption of a regulation in one country without the consideration of their effects on third countries;
- IOSCO could create a permanent Committee or organism in which cross-border issues could be discussed between regulators;
- These discussions should involve the financial industry on a regular basis.

The Brazilian financial and capital markets, represented here by the participants of the ANBIMA's Working Group on International Regulation (GTRI), are supportive of the IOSCO Task Force on Cross-Border Regulation's work and believe that the role of IOSCO in cross-border regulatory and supervisory harmonization should be furthered and strengthened.

Section 1: Over-the-counter derivatives market reform

One of the most prominent regulatory reforms implemented since the onset of the 2008-9 financial crisis is the over-the-counter (OTC) derivatives markets reform. The G20, in the 2009 Pittsburgh Summit, sets forth a comprehensive reform agenda for these markets, with the aims of improving market transparency, mitigating systemic risk, and protecting participants against market abuse.

Five main lines of change were defined:

- (i) all contracts should be reported to trade repositories (TRs);
- (ii) all standardized contracts should be cleared through central counterparties (CCPs);
- (iii) all standardized contracts should be traded on exchanges or electronic trading platforms;
- (iv) non-centrally cleared contracts should be subject to higher capital requirements; and
- (v) non-centrally cleared contracts should be subject to margining requirements[2].

In the United States, the OTC derivatives market reform was ruled by the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA), released in 2010, which reforms the U.S. financial system in several aspects. DFA provisions were complemented by several rules promulgated by U.S. regulatory agencies, namely the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC), which established more granular requirements[3].

DFA also extended the regulatory perimeter of U.S. agencies, as it was established that the swaps provisions of the Act also apply to cross-border activities when certain conditions are met, namely, when such activities have a ‘direct and significant connection with activities in, or effect on, commerce of the United States’ or when they contravene CFTC or SEC rules or regulations. This new section opens room to extend the regulatory authority of the CFTC and the SEC over cross-border operations, provided they have connections with the U.S. markets. Therefore, new requirements applicable to U.S. institutions (and *swap dealers*) and to swaps operations carried out in the U.S. are also applicable to activities and institutions located abroad.

To clarify the cross-border application of swaps requirements, the CFTC released in July 2012 a proposal on the cross-border application of the swaps provisions. The difficulty to achieve full harmonization among jurisdictions is recognized in the proposal, and the CFTC cross-border rule – and subsequently the SEC cross-border rule – introduces a mechanism of recognition (i.e. the second tool outlined in IOSCO’s Report), under the name of *substituted compliance*.

In the proposal, the applicability of this recognition tool depends on the following elements: (a) the location where the counterparty is domiciled; (b) the formal relationship between non-U.S. person

[2] This provision was included at the Cannes Summit in 2011.

[3] In addition, the rules regarding additional capital requirements were incorporated in the U.S. banking regulatory framework by the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (FED) and the Federal Deposit Insurance Corporation (FDIC).

counterparties and U.S. persons (whether it is a branch, affiliate, etc.); (c) the place where the swaps are entered into; (d) the "origin" of the guarantees (whether a non-U.S. person is guaranteed by one U.S. person or not). Moreover, it establishes that the feasibility of a *substituted compliance* arrangement depends on a detailed analysis about *each* rule in force in a foreign jurisdiction in comparison to *each* specific objective to be pursued by *each* CFTC requirement.

Following the proposal, swaps markets´ participants and foreign regulators expressed numerous concerns and doubts, in particular with respect to the duplication of regulatory requirements, the violation of customer information secrecy rules, and even legal uncertainty which may harm deals between non-U.S. persons and U.S. persons. After one year of discussions, the CFTC released in July 2013 the final version of the cross-border rule but without settling all concerns related to regulatory harmonization and maintaining the approach described above[4].

The European parent of the OTC derivatives reform was implemented through the European Market Infrastructure Regulation (EMIR) and the Capital Requirements Regulation (CRR). The European Securities Markets Authority (ESMA) is responsible for establishing technical standards regarding the reporting of derivatives transactions to TRs, the clearing obligation for certain classes of OTC derivatives, the risk-mitigation techniques for OTC derivatives not cleared by a CCP, and the general and prudential requirements for CCPs with respect to all derivatives classes.

Similarly to U.S. rules, the European OTC derivatives markets requirements apply to both European and foreign market participants. EMIR regulations apply to contracts with a "direct, substantial and foreseeable effect" within Europe, namely the contracts in which one third country party benefits from a guarantee provided by an EU financial counterparty and the derivatives entered into by European branches of third country financial counterparties.

EMIR also establishes a cross-border regulatory tool, recognition, under the name of 'equivalence', with respect to a third country regulatory framework. If the regulatory objectives incorporated in the foreign rules are considered to be compatible with the objectives of EMIR, the rules of the foreign jurisdiction are considered sufficient to comply with the European rules, allowing foreign entities and counterparties to comply only with local regulations.

Changes in the US and EU OTC derivatives regulatory frameworks were the focus of attention when ANBIMA started to engage with its members to discuss the global regulatory reform. Brazilian institutions regularly deal with U.S. and European counterparties in their derivatives trades and the

[4] To illustrate this statement one can mention the discussions on electronic trading and the registration of trading systems of foreign jurisdictions as swap execution facilities (SEFs) that occupied the agenda of regulators since the beginning of 2014 and was a matter of Commissioner J. Chistopher Giancarlo's White Paper on swaps trading rules, released in January 29, 2015.

establishment of the Working Group on International Regulation (GTRI) in September 2012 reflected the need for a better understanding and discussion of the ongoing regulatory changes abroad.

In the beginning, the focus was the U.S. reform, given the deadlines which were getting closer. Its noteworthy that the final CFTC cross-border rule was not yet released, so the participants of GTRI faced a huge uncertainty about the impacts of U.S. modifications on the Brazilian industry: there was no certainty about the counterparties covered by the concept of U.S. person, the swaps covered by the cross-border rule, the need to register – or not – as a *swap dealer*, the report requirements that the Brazilian institutions will need to follow, and the phase-in period, the schedule and the deadlines for adopting the swap provisions. The group also discussed the adoption of the ISDA August Protocol, the impact of the several No-Action Letters released by CFTC, and how the clearing requirements will apply to Brazilian counterparties[5].

The uncertainty about possible impacts was even greater due to the characteristics of the regulatory requirements set by Brazilian authorities, according to which all derivatives contracts need to be 'reported to a TR', i.e., registered in a proper system, and capital requirements were already higher with respect to non-centrally cleared contracts (since 2007). Conduct standards and recordkeeping requirements were in force[6] and the institutions which are allowed to trade OTC derivatives and credit derivatives were subject to minimum capital and net worth limits and capital requirements[7]. Last but not least, suitability requirements and selling practices were defined according to self-regulatory practices which set a high bar on the conduct of institutions when selling a derivative contract, OTC or not, to non-financial counterparties.

Another point is that the Brazilian market practice was also quite different from the United States (and European Union). In the matter of report/registration, the financial markets infrastructures (FMIs) are not merely trade repositories, but entities which are responsible for checking information consistency about contracts' parameters, calculating and monitoring prices, implementing and checking mark-to-market valuation, etc. Regarding the market configuration in terms of central clearing, the major part of Brazilian derivatives contracts are centrally cleared or traded/executed electronically: respectively 85% and 80% of all derivatives contracts, according to the Central Bank of Brazil (BCB), in December 2013.

In this context the first reaction of the Brazilian market participants in face of the possibly applicable foreign requirements was to highlight that they already complied with similar or even stricter

[5] The group also briefly discussed the European framework for treating OTC derivatives contracts with "direct, substantial and foreseeable effect" within EU, as well as the provisions of EMIR, but it was found that the European rule is clearer about its scope, and, in that occasion, market participants considered that its impacts on Brazilian institutions is limited in comparison with U.S. rules. So GTRI focused its discussions on the U.S. framework, trying to clarify the application of the rules and to solve the uncertainties which were faced.

[6] The CVM Instruction no. 505/11.

[7] Respectively, the National Monetary Council (CMN) Resolutions no. 3505/07, 2933/02, 2099/94 and 3490/07.

requirements domestically, to comply with existing Brazilian authorities' requirements. Accordingly, if regulatory uncertainty was the first concern of Brazilian institutions, the second main concern was the duplication of requirements implied by foreign rules. Doubts as 'if I trade and confirm a contract with a U.S. counterparty, will I need to register this contract here in Brazilian FMIs and report it to a TR in the U.S.?' illustrate perfectly these two main concerns.

Discussions held in GTRI however revealed that impacts were unavoidable. They are not only theoretical, 'regulatory uncertainty' and 'regulatory duplication', but practical, operational: institutions started to change their client registration practices and their internal policies and systems in order to identify which clients and counterparties could be deemed as U.S. persons; some institutions defined specific rules to govern the contracts entered into with U.S. persons and imposed limits to avoid the *swap dealer* threshold; and systems were changed to allow the monitoring of positions with U.S. counterparties and controlling the threshold.

These changes on internal policies and systems were irreversible. But the discussions revealed that further impacts could be avoided. The possibility of using the recognition tool presented in the U.S. framework, *substituted compliance*, to alleviate regulatory duplication was considered in details. All the situations outlined by the CFTC 'interim' cross-border rule were discussed and each institution tried to identify its own situation in light of the CFTC provisions, especially the items (b) and (d) mentioned above, i.e., whether the institution is a branch, affiliate or has no formal relationship with a U.S. parent, and whether their contracts are guaranteed by an U.S. person or not. Several cases were identified but it was clear to everyone that the recognition of the Brazilian regulatory framework by the U.S. agencies was the main exit to avoid regulatory duplication and uncertainty and market fragmentation, while keeping untouched (or at least avoiding further major changes in) the Brazilian market practices, already in a baseline more stringent than the ones desired by the G20.

To help in the discussion with foreign regulators, members of the working group prepared a comparison table and a tentative comparability analysis between the Brazilian framework and the U.S. CFTC framework, and a position paper about the relevance of regulatory harmonization on OTC derivatives markets. Currently, the group is finalizing an impact assessment paper.

However, whereas the implementation of the reforms is at an advanced stage in Brazil – and one may say several steps ahead –, the same does not applies to *recognition*. The Brazilian market participants are aware that this situation is not a consequence of inaction from the Brazilian authorities neither a result from the lack of a proper cross-border regulatory tool: the U.S. and the EU have the proper frameworks to *recognize* the Brazilian regulatory framework.

This situation is challenging from the viewpoint of the work carried out by the IOSCO Task Force on Cross-Border Regulation (TFCR) and of the Consultation Report released last year. The reasons are twofold. Firstly, when wondering for guidance the report suggests that a lot of discretion should be given to national/regional regulators when implementing and applying the Tools. The type of cross-border securities market activity and associated risks, robustness and effectiveness of the foreign regulatory regime, and costs and benefits to regulators and securities markets are, in fact, questions which should be considered but with a common line of guidance in mind. An excessively open approach, as the one reflected in the report suggests, opens room for cooperation issues that reinforces the problems outlined in the above paragraphs.

Secondly, the cross-border issues related to the global OTC derivatives market reform are to some extent out of the scope of the Task Force. The mandate of TFCR is clearly set in the report: (i) to develop a cross-border Regulatory Toolkit; (ii) to lay a foundation for the development of guidance on the coordinated use of the Toolkit (p. 2).

The report is indeed comprehensive with respect to the regulatory toolkit outlined. It has the merit in identifying the main distinct ways of treating cross-border regulatory situations, namely, through national treatment, recognition or passporting, and in putting forth a *common terminology* for the tools available to national/regional regulators when defining or adopting new rules – or changing a rule already in force. In that way, the TFCR was successful in developing the Toolkit and in detailing the characteristics and possibilities of each tool (mandate (i)).

However, as already mentioned, both the U.S. and the EU have in place the proper frameworks to recognize, or to defer to, a third jurisdiction regulatory framework. Despite the different terms they use to designate the recognition tool (*substituted compliance* or *equivalence*), and some differences in the two approaches to recognition, the main issue is not the terminology used by authorities but the effective application of the tool and the coordination of this application on a global level.

In this area, we support the industry's perspective reflected in the report: we agree that "a lack of coordination among regulators in setting implementation dates for rules impacting global markets and promulgating duplicative, inconsistent and conflicting requirements" has led to substantial compliance burdens and created barriers to cross-border business and activities. But we believe the reasons for the rise of current cross-border challenges go further than the focus on domestic markets: the first-mover advantages in defining the lines of the global reform and the competition among different financial centers, as well as political aspects, also help explaining the emergence of cross-border regulatory conflicts.

We believe that the mandate which was given to the Task Force by IOSCO is quite limited to cope with these aspects and thus is not sufficient to further contribute to the settling of the current issues on the OTC derivatives markets.

Moreover if it is recognized that "there are few **universal principles** that guide the way regulators coordinate on cross-border regulation and resolve disputes arising from potential or apparent conflicts of interest and laws among jurisdictions" (p. 40), we believe IOSCO should advance on these principles in addition to gathering tools and developing toolkits in a descriptive manner, as mandate (i) sets forth.

We also support the idea that IOSCO could play a role in developing guidelines for assessing foreign regulatory regimes. These principles or common guidelines should be flexible but they need to be effective in promoting convergence when regulators are developing frameworks both for cross-border activities and for supervisory regulation.

IOSCO also needs to further enhance international dialogue between policy makers and regulators among the various jurisdictions. Firstly, to help in settling the current cross-border issues in the OTC derivatives markets (and other areas). Secondly, to allow the early identification of cross-border consequences and of possible conflicting areas before the adoption of final regulations that has cross-border impacts.

OTC derivatives market reform:

- In addition to developing a regulatory Toolkit, IOSCO should develop a set of Principles for the treatment of cross-border conflicts in regulation;
- IOSCO should also establish guidelines for the assessment of foreign regulatory regimes;
- IOSCO should continue working to enhance international dialogue between regulators among the various jurisdictions.

Section 2: Financial Market Infrastructures

The ‘introduction’ of trade repositories (TRs) and the greater concentration of trades and risks in exchanges and central counterparties (CCPs) create a new landscape for the operation of financial market infrastructures (FMIs). Due to the new systemic importance of these entities, especially in light of the OTC derivatives markets reform, it was necessary to strengthen and improve the risk management standards applicable to them. In the case of TRs, there was a need to set the basis to their constitution and operation.

In this context the Committee on Payments and Financial Markets Infrastructures (CMPI) and IOSCO started a review of some guiding principles in the regulation of these entities, a work that was eventually finished with the release in 2012 of a new set of principles for FMIs (PFMIs). In addition, Basel III standards set stricter requirements for the capitalization of exposures to FMIs and their default funds, adding specific risk-weights according to the classification of CCPs with respect to PFMIs.

In the European Union (EU), the reform of FMI regulation was adopted through the European Market Infrastructure Regulation (EMIR). The Regulation establishes organizational conduct of business and prudential standards for both TRs and CCPs within the Union and contains provisions for the qualification of third country FMIs.

Article 25 of EMIR sets that third country CCPs should be assessed and recognized by ESMA in order to provide clearing services to EU clearing members or trading venues. In the case of a third country CCP providing clearing services to European financial counterparties, which includes foreign branches of EU financial counterparties, EMIR requires its 'qualification' by the European Securities and Markets Authority (ESMA), requesting the submission of an application.

The recognition of a third country CCP by ESMA also requires the adoption of an *equivalence* determination with respect to this third country by the European Commission, which is based on the soundness of legal and regulatory frameworks ruling the operation of this CCP. So cooperation arrangements between ESMA and equivalent-third country regulators need to be effectively built for the purpose of recognition. In this context, in the case of a European financial counterparty operating through a branch, the membership in a third country CCP that is not able or willing to apply for recognition should be winded up. This CCP will then be deemed as a non-qualifying CCP.

The European Basel III rules set in the Capital Requirements Regulation link the concept of qualifying CCPs (QCCPs) and EMIR recognition to capital requirements. Mirroring Basel III standards, CRR rules provide a favorable 2% risk weighing factor for exposures to QCCPs. In the case of non-qualifying CCPs, this risk weighing factor varies, resembling specific exposures. Moreover the exposures to default funds of QCCPs receive favorable risk-weights while exposures to default funds of non-QCCPs are subject to a greater capital burden.

This means that any exposure of a third country branch of a European financial counterparty to non-qualifying CCPs, when accounted on a consolidated basis, will be extremely capital consuming, putting the operations of this institution in that country at risk. This consequence could create market fragmentation, with the relocation to local markets of transactions of a European financial counterparty with counterparties in a third country and of foreign counterparties within the EU, i.e., the so-called balkanization.

In Brazil the implementation of PFMIs was divided in two fronts. The first one is the regulatory front. Brazilian authorities concluded that Brazilian FMIs were already compliant with the new PFMIs, but not all obligations were formally covered by or included in domestic laws and regulations, and part of them are covered by self-regulatory rules of FMIs.

The regulation of payment systems and securities settlement systems were generally compliant with PFMIs and required no material changes in Laws and regulations in force, namely Law no. 10215/01, CMN Resolution no. 2882/02, and BCB Circular no. 3057/01. The regulation of central securities depositories (CSDs) however passed by various changes recently, in line with PFMIs. The Law no 12810/13 established a sound legal basis for centralized deposit, regulating explicitly the fiduciary ownership of assets and securities, and setting the obligations and duties of CSDs. In addition, the CVM Instruction no. 541/13 and the BCB Circular no. 3743/15 specified the rules for centralized deposit and requirements for authorization and operation of CSDs in their regulatory perimeters, respectively, securities and financial assets. These regulations will be fully in force in 2016.

In the case of central counterparties, BM&FBovespa incorporates all CCPs authorized in Brazil to date. No legal/regulatory changes were made but several adjustments in BM&FBovespa's rules and procedures to be followed by its CCPs were made to deal with regulatory gaps with respect to PFMIs. These changes aligned the new rules and procedures, as endorsed by the Central Bank of Brazil (BCB), with PFMIs and EMIR (and US)'s specific requirements[8].

Finally, in Brazil, as detailed above, the entities which are authorized to perform the functions of TRs were not considered merely repositories of information about trades/assets, but entities which have the responsibility of checking information consistency about trade's parameters, calculating and monitoring prices, implementing and checking mark-to-market valuation, among others. Some regulatory changes were also implemented. The BCB Circular no. 3709/14 established more stringent rules for the registration of financial assets, requiring more details in the registration form and reducing from BRL 50,000 to BRL 5,000 (USD 1,800) the minimum threshold for registration. The BCB Circular no. 3743/15 in its turn set new rules governing the entities responsible for the registration of financial assets.

All these changes were complemented by the implementation of PFMIs in the supervisory front. The Central Bank of Brazil released several Policy Statements to make explicit the utilization of PFMIs for the ends of supervision. The BCB Policy Statement no. 25097/14 formalized the utilization of PFMIs to guide the BCB's oversight of Brazilian FMIs, while the Policy Statement no. 25164/14 listed the various Brazilian´s payment systems (PS), securities settlement systems (SSS), central securities depositories (CSD), central counterparties (CCP) and trade repositories (TR). Finally the Policy Statement no. 27115/15 detailed the principles which will be used to monitor and assess each FMI:

[8] Among the changes which are in force since March 2014 the following are noteworthy: (a) BM&FBovespa will contribute to default funds and its contributions will at least equal the overall amount provided by clearing members; BM&FBOVESPA contributions will be used after the exhaustion of defaulting members' contributions and before the use of non-defaulting members' contributions; (b) Rules were set limiting the total amount of contribution of clearing members to default funds during a particular period of time for the purpose of reconstituting their contributions; (c) The entity established new rules and requirements related with setoff rights, contractual netting and collateralization agreements in the case of resolution of BM&F Bovespa; and (d) The minimum degree of confidence used in margin calculation models was increased from 95% to 99% for the equity CCP.

Entity	PS	CDS	SSS	CCP	TR
Reserves Transfer System (STR)	●				
Special System for Settlement and Custody (Selic)		●	●		
Foreign Exchange Clearinghouse, operated by BM&FBovespa	●			●	
Equities Clearinghouse, operated by BM&F Bovespa		●	●	●	●
Securities and Organized Over-the-Counter Market Systems, operated by BM&F Bovespa					●
Securities Clearinghouse, operated by BM&F Bovespa			●	●	
BM&F Bovespa Clearinghouse			●	●	●
Organized Over-the-Counter Market for Securities and Derivatives, operated by Cetip S.A. – Mercados Organizados		●	●		●
Central Credit Assignments (C3) operated by the Interbank Payment Clearing House (CIP)			●		●
Centralizer Clearance for Checks (Compe), operated by Banco do Brasil S.A.	●				
Multicard Clearing System, operated by Cielo	●				
Domestic Clearing System, operated by Rede	●				
Deferred Settlement System for Interbank Credit Orders (Siloc), operated by CIP	●				
Funds Transfer System (Sitraf), operated by CIP	●				

The implementation of these various changes gave to Brazil the rating 4 of the CPMI-IOSCO Implementation Monitoring (Level 1) report of principles and responsibilities set forth in the PFMIs, according to the document released in May 2014. Rating 4 means that Brazil has final implementation measures in force: "this status corresponds to cases where, in addition to the required implementation measures having been finalized and approved/adopted, FMIs are expected to observe the Principles or authorities to observe the Responsibilities".

However the recognition of CPMI-IOSCO does not mean that the Brazilian FMIs regulatory framework is deemed as equivalent to EMIR and other EU regulations. Neither the BM&F Bovespa is classified as a QCCP by ESMA. In this case, the impact on the activities of European financial counterparties in Brazil could be significantly punitive and may even result in firms having to withdraw from certain market segments and closing entire lines of business, reducing dramatically the presence of European institutions in Brazilian markets and vice-versa.

If the *equivalence* determination with respect to a third country by the European Commission depends on ESMA´s evaluation of the soundness of legal and regulatory frameworks ruling the operation of the CCPs, the recognition of multilateral organisms like CPMI and IOSCO should be sufficient to provide grounds in which international authorities can rely upon. The granularity demanded by European authorities in this case only contributes to cross-border issues. The determinations of *equivalence* released by the European Commission to date encompass countries that achieved a rating 4 in all of the PFMIs according to CPMI-IOSCO; Brazil which has a CCP that applied for recognition as QCCP and has a rating 4 assigned in CCPs is laying behind Canada, Korea and Switzerland that have lower grades in ESMA's and European Commission's lists.

In light of the TFCR's consultation report, CPMI and IOSCO could have an enhanced role to play in two areas. First, as some survey respondents indicated but with a different focus, they could provide a central hub of information**.** National/regional regulators can benefit from the data collected by CPMI and IOSCO for their assessments and from the evaluations and grades gave by these entities. The establishment of a 'clearinghouse' for information could facilitate better understanding among authorities, save time and resources and enhance coordination. Secondly, and as a consequence of the central hub role, CPMI and IOSCO can play a role in the coordination of the timing for the jurisdictions' application of cross-border regulatory tools, mitigation of cross-border conflicts and prioritization issues.

Financial markets infrastructure:

- CPMI and IOSCO could serve as a central hub of information;
- The grades given by CPMI and IOSCO when assessing the implementation of international standards could be used as reference to national/regional regulators;
- CPMI and IOSCO should play a role in coordinating the timing among jurisdictions' application of cross-border regulatory tools.

Section 3: Volcker Rule

The Volcker Rule encompasses the prohibition of proprietary trading and the restriction of ownership of hedge or private equity funds by commercial banks and their affiliates. The provisions of the Rule are established in the Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) and the Agencies[9] released, in December 2013, joint final rules that complement and detail the provisions for the implementation of the Volcker Rule.

In the case of investment funds, the rules prohibit banking entities from *owning*, *sponsoring*, or *having certain relationships* with hedge funds or private equity funds, referred to as 'covered funds'. The main motivation behind these provisions is to avoid regulatory arbitrage: "the 'covered funds' provisions of the Volcker Rule are intended to prohibit a banking entity from doing indirectly, or even inadvertently, what the proprietary trading provision prohibits it from doing directly: trading as principal in financial instruments"[10].

Some characteristics of U.S. 'covered funds' are also relevant to explain the provisions: hedge and private equity funds are not subject to all of the securities regulation protections applicable with

[9] The Federal Reserve System, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Securities and Exchange Commission.

[10] PwC, "The Volcker Rule Proposal and asset management firms". Available at: http://www.pwc.com/gx/en/asset-management/asset-management-insights/volcker-rule-proposal.jhtml. Accessed in February 13, 2015.

respect to funds that are registered with the Securities and Exchange Commission (SEC) as investment companies, and those entities may be more likely to engage in 'risky investment strategies' that may put principal from the bank in risky – and so customer resources.

Some exemptions were included in order to permit the ownership or sponsorship in investment funds that does not imply any of the 'risks' highlighted above, i.e., regulatory arbitrage, regulatory gap or principal in risk. Some characteristics need be observed to qualify the fund for the exemption:

- The fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, or investment advisory services and only to persons that are customers of such services of the banking entity;
- The banking entity does not acquire or retain an equity interest, partnership interest, or other ownership interest in the funds;
- The banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund;
- Any losses in such covered fund are borne solely by investors in the fund and not by the banking entity;
- The banking entity does not share with the covered fund the same name or a variation of the same name for corporate, marketing, promotional, or other purposes; among others.

The Volcker Rule provisions apply not only to banks established in the United States but also to *foreign banking entities*, a concept including any foreign bank with a 'U.S. branch, U.S. agency, U.S. commercial lending company or Edge Act subsidiary' or any parent company of such foreign bank. So, as foreign institutions could be impacted, there is potential cross-border issues derived from the application of the rule. And the Brazilian case is illustrative.

The Brazilian regulation has no similar provisions with respect to the prohibition of proprietary trading or covered funds sponsorship but some institutions have identified that they can be deemed as *foreign banking entities* and will be subject to proprietary trading and covered funds restrictions – i.e., they have agencies or branches in the U.S. or are parent companies from U.S. banks. Due to this situation, institutions started to analyze their activities in order to assess whether the Volcker Rule provisions may apply.

At a first glance, an analysis revealed there is no expected material impact of Volcker restrictions on Brazilian investment funds, due to their legal nature and to the specific characteristics of Brazilian regulation. Institutions are expecting to be able to qualify Brazilian mutual funds according to one of the exemptions, especially 'foreign excluded funds' or 'foreign public funds'. However, a more detailed analysis revealed that some Brazilian investment funds could fall within the scope of covered funds, because they do not qualify for the 'foreign public fund' exemption.

This is the case of mutual funds distributed solely to 'qualified investors' and exclusive funds. As the concept of 'qualified investor' encompasses not only institutional investors but also high worth individuals and companies, the distribution of these funds can be deemed as restricted, as their availability to investors is based on minimum net worth or net investment assets and they are not broadly distributed to retail investors. So these funds could fall outside the concept of 'foreign public fund'.

Many consequences follow. No director, employee or family member from the banking entity would be allowed to have interests on these funds. The Super 23A and 23B rules would apply to transactions between these funds and banking entity's affiliates. The banking entity would not be allowed to share the same name or a variation of the same name with the fund and additional information will need to be inserted in the disclosure documents. Other provisions would apply too, but these are the main changes that would be felt by Brazilian institutions.

The point however is that despite the fact that these mutual funds distributed to qualified investors may not be deemed as foreign public funds, these funds do not constitute any attempt of regulatory arbitrage, do not fall within any regulatory gap, or do not put principal of the banking entity at risk.

In Brazil, investment funds are legally characterized as *condominiums*. This is a unique legal structure that does not comprehend principles of limited liability for investors. The mutual fund does not have a Board of Directors but an annual shareholders meeting, in which any changes in funds by-laws, fees or other subjects that adversely affects investors must be approved by a majority vote. The implications of this legal basis in light of the Volcker provisions are threefold: any losses in the Brazilian mutual funds are borne solely by investors; the banking entity does not acquire or retain interests in the funds; the banking entity does not guarantee the obligations or performance of the covered fund. So there is no principal in risk.

From the viewpoint of regulatory gaps, hedge funds and private equity funds regulation have a completely different regulatory nature in Brazil in comparison to the U.S. All investment funds are regulated by the Brazilian Comissão de Valores Mobiliários (CVM) and hedge funds and private equity funds are subject to the securities regulation protections applicable to mutual funds in general[11]. Moreover hedge funds do not have any special characterization in Brazilian regulation: they are treated as regular mutual funds, but classified as a balanced/mixed investment fund ('Fundo Multimercado') due to their investment strategy. Private equity funds, in its turn, are subject to general regulations and to specific provisions established in the CVM Instruction no. 391/03.

The main difference between qualified investors' mutual funds and retail mutual funds relates to the foreign investment restrictions and concentration limits that these funds need to observe: those are flexible in the case of qualified investors´ mutual funds whilst retail funds need to comply with defined boundaries. In addition, the calculation of performance fees can vary in the case of qualified investors' funds and redemptions generally can be done only in money in retail funds.

[11] The CVM Instructions no. 409/04 and 555/14.

In spite of these clarifications the Brazilian market participants are still facing uncertainties about the qualification of Brazilian mutual funds distributed to qualified investors in the exemptions. They cannot be used as a regulatory arbitrage tool, there is no regulatory gap, and they do not put the principal of the banking entity in risk. However Brazilian institutions may need to change the names of these funds, change disclosure documents demanded by Brazilian authorities, and change the way they operate with affiliates in the management of these funds. This is a clear example of an unintended cross-border consequence of the adoption of a regulation in one country without the consideration of their effects on third countries.

We already mentioned that IOSCO could play a role in enhancing international dialogue within its structure. We believe that dialogue among regulators is fundamental to avoid these unintended consequences. As the Consultation Report sets forth some survey respondents believe that IOSCO committees can provide a forum for members to discuss the potential advantages and disadvantages of various cross-border regulatory tools. However IOSCO Committees and organisms can go further: IOSCO could create a permanent Committee or organism in which cross-border issues such as the ones described above can be discussed between regulators.

Stakeholders from the financial industry also can contribute to these discussions, as they are the main agents affected by regulatory changes, and thus should be involved on a regular basis in these conversations. The experience provided by the IOSCO Stakeholders Meetings and by the work carried out by the IOSCO Task Force on Cross-Border Regulation is illustrative of the benefits this open conversation can deliver. We believe that these exchanges need to be furthered.

Volcker Rule´s covered funds:

- The application of the covered funds´ provisions of the Volcker Rule to Brazilian investment funds is a clear example of an *unintended cross-border consequence* of the adoption of a regulation in one country without the consideration of their effects on third countries;
- Dialogue among regulators is fundamental to avoid these unintended consequences;
- IOSCO could create a permanent Committee or organism in which cross-border issues could be discussed between regulators;
- These discussions should involve the financial industry on a regular basis.

Conclusion

In the present document we have opted to present three different situations that highlight different aspects of cross-border regulatory conflicts. Firstly, the OTC derivatives markets reform serves as an example of a situation in which the regulators from the U.S. and European Union have the proper Tool in place, *recognition*, but its application still lacks effective results. Secondly, the reform of financial markets infrastructures would benefit from more coordination between national/regional jurisdictions and multilateral forums, in this case, CMPI and IOSCO. Finally, we analyze the implications of the Volcker Rule´s banning of proprietary participation or sponsorship of hedge and private equity funds, an illustration of unintended consequences of national regulations to third jurisdictions´ institutions and clients.

All these three situations imply different lessons and messages from the perspective of cross-border regulation. They also imply different possibilities and roles for IOSCO. We believe that IOSCO could:

- Develop a set of Principles regarding the treatment of cross-border conflicts in regulation in addition to developing a regulatory Toolkit;
- Establish guidelines for assessing foreign regulatory regimes;
- Enhance international dialogue between regulators among the various jurisdictions;
- Serve as a central hub of information;
- Further its role on implementation monitoring and coordination;
- Create a permanent Committee or organism in which cross-border issues can be discussed between regulators;
- Involve the financial industry in these discussions on a regular basis.

The Brazilian financial and capital markets, represented here by the participants of the ANBIMA's Working Group on International Regulation (GTRI), are supportive of the IOSCO Task Force on Cross-Border Regulation's work and believe that the role of IOSCO on cross-border regulatory and supervisory harmonization should be furthered and strengthened.