SwissBanking

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A.033.1 / SHO

Re: Public Comment on the Task Force on Cross-Border Regulation

Dear Ms Tendulkar,

The Swiss Bankers Association (SBA) welcomes the IOSCO Task Force on Cross-Border Regulation Consultation Report (the Report). We strongly believe that IOSCO can and should play a leadership role in promoting coordinated and consistent cross-border regulatory approaches. The status quo has a number of weaknesses and falls short of the aspirations set out by G20 leaders at the Pittsburgh Summit in 2009.

1. The importance of regulatory coordination: further efforts are required

The propensity of some regulatory authorities to seek to extend the reach of their rules and processes beyond their territorial borders and not consider conflicting laws and other legal consequences is adding layers of further regulatory duplication, fragmentation and incompatibility. The result of this regulatory inconsistency is growing incoherence and conflicting rules surrounding rights of access and the regulation of cross-border business, while at the same time creating scope for and fuelling regulatory arbitrage between jurisdictions.

For the SBA, proper cross-border regulation is vital, as many of our member banks offer services across a number of different jurisdictions and are thus at times confronted with conflicting rules and legal risks that are not easy to overcome or to mitigate. Without appropriate cross-border regulation, there is a risk that institutions will need to meet several sets of overlapping or even conflicting requirements. Furthermore, the ever-increasing granularity of regulation complicates attempts at greater mutual recognition. Finally, the lack of certainty could cause fragmentation in cross-border investment and trade.

At the 2009 Pittsburgh Summit, G20 Leaders recognized the importance of individual authorities implementing *"…global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage"* . In making this commitment, leaders acknowledged that collaborating across jurisdictions reduces the risk of future crisis and enhances the resilience of the international financial system.

We acknowledge that since 2009, much work has been done to achieve further regulatory co-ordination, including leadership in recent years from the Financial Stability Board (FSB) in promoting international coordination and dialogue. We also recognize the similar efforts

made by policy makers and regulators around the world, including through IOSCO, to develop ways to achieve a sound and coherent regulatory framework for financial services.

Unfortunately, there are a number of examples of regulatory divergence which previous reaffirmations of the Pittsburgh commitments have been unable to address. Despite the call for consistency, global approaches continue to be undermined by the unilateral and uncoordinated implementation (and extraterritorial application) of rules by individual jurisdictions, to the detriment of global markets and with a consequential impact on end users.

The issue of promoting coordinated and consistent regulatory approaches is still open and remains urgent: In a letter sent by the FSB Chairman to G20 Finance Ministers and Central Bank Governors on 15 September 2014, Mr. Marc Carney acknowledged that in order to complete the task of reforming the financial system, further steps have to be taken. In particular, he mentioned the need for deploying more widely outcomes-based approaches to resolving cross-border issues: *"G20 Leaders agreed last year that jurisdictions and regulators should be able to defer to each other in the cross-border application of derivatives regulations. They could do so when justified by the quality of their respective regulations and enforcement regimes, assessed in a non-discriminatory way, based on similar outcomes. … The continued support of Ministers and Governors is needed to further this work and to allow the more widespread adoption of flexible outcomes-based approaches to resolving cross-border market regulation issues."*[1]

The enhanced coordination of any regulation affecting other jurisdictions in whatever form (cf. 2) could well create a "win-win" situation for all the various stakeholders in the global market place:

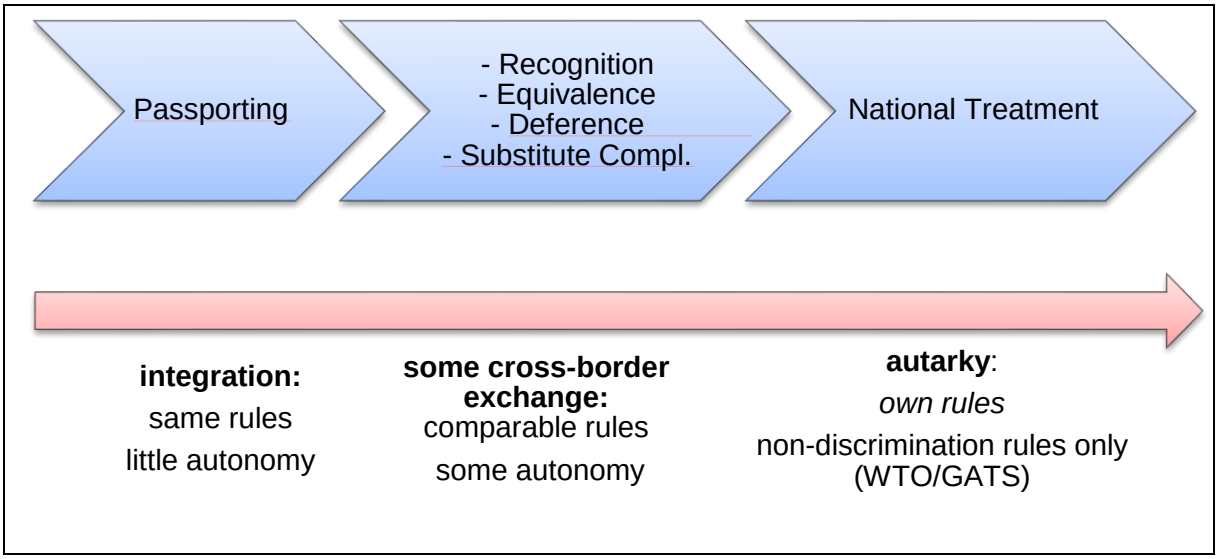
- It would help improve mutual market access based on more efficient and coherent frameworks of regulation.
- Investors, issuers and consumers of financial services would benefit from a greater choice through which to meet their investment, trading, capital raising and risk management needs.
- Financial services providers would benefit from being able to better harmonise their internal procedures across all their operations, reduce the incidence of inadvertent compliance breaches and secure much-needed business and cost efficiencies.
- Market infrastructure providers would be able to offer investment, trading and capital raising facilities more widely and generate deeper pools of liquidity as a result.
- Regulatory authorities would be able to deepen their common understanding, develop more effective working relationships and work towards a common set of regulatory frameworks driven by shared values and regulatory outcomes.

It is important to bear in mind that advocating increased coordination and recognition is not asking for regulation to be any less effective or efficient, but rather recognising that different approaches to implementing rules can lead to similar outcomes.

[1] https://g20.org/wp-content/uploads/2014/12/13 Financial Reforms - Completing the job and looking ahead.pdf

2. Tools of coordination: a comprehensive overview by IOSCO

The Report discusses three tools for regulatory cooperation: passporting, recognition and national treatment.



2.1 On the one hand there is passporting…

Passporting is a useful approach within a highly integrated political and economic union where member states operate through a system of supranational institutions, and decisions are negotiated intergovernmentally by the member states, such as in the European Union (EU).

An institution in an EU member state that is entitled to pursue an activity in another European Economic Area (EEA) state may either establish a physical presence or take advantage of the free provision of services in another EEA state or take advantage of the free provision of services in another EEA state, subject to the fulfilment of the conditions dictated by the relevant directive. In most cases, passporting rights can be exercised following completion of the notification procedures.

A credit institution may then provide the services or conduct the activities for which it has been authorised throughout the Single Market, either by establishing a branch or through the free provision of services.

However, while the SBA is supportive of this tool, it should be recognized that its applicability is limited to already highly-integrated trading blocs.

2.2 …on the other hand, national treatment…

National treatment essentially means treating foreigners and locals equally. National treatment is an integral part of many World Trade Organization (WTO) agreements. Together with the Most-Favoured-Nation principle, national treatment is one of the cornerstones of WTO trade law. It is found in all three key WTO agreements (GATT, GATS and TRIPS).

With regards to those tools highlighted in the Report; while national treatment is important to the conduct of global trade and investment, we are less sure it should be considered a tool for regulatory coordination. National treatment does not govern cross-border issues. It

only stipulates that subsidiaries or branches of foreign banks should not be discriminated against local competitors *within* the respective country. It does not, however, speak to the right and the ability of foreign banks to offer their services *cross-border* on equal, non-discriminating terms with local competitors, which, in our view, is the cornerstone of the issues in question.

We do not view national treatment being jeopardised. Signatories of the WTO agreements are bound by international law to adhere to this principle and perceived violations can be robustly challenged and addressed.

2.3 …and in between there is recognition/deference, equivalence, substitute compliance

Between passporting and national treatment lie a number of principles that can all be summarised in the broader sense by the term “recognition”, be it mutual recognition, equivalence, deference or substitute compliance.

a) recognition / deference (the terms should be regarded as synonymous)

The SBA believes (mutual) regulatory recognition is the most appropriate tool for advancing coordinated global regulatory efforts and thereby avoiding cross-border inconsistencies. Indeed, with the exception of treaty blocs, this approach is the default recommendation for the domestic implementation of G20 agreements.

In the case of jurisdictions that have comparable regulation that achieves similar regulatory outcomes, deference to local authorities is appropriate. It is otherwise detrimental to require market participants to be subject to multiple regimes in these instances, as this increases the risk of imposing duplicative, inconsistent or conflicting rules on market participants.

It is imperative that recognition be provided by means of a clear and transparent process focused on outcomes rather than line-by-line comparisons of different rules or legislative acts. This would prevent the negative consequences arising from duplicative, inconsistent or conflicting requirements, and instead serve to reduce transaction costs, foster competitive markets and facilitate cross-border trading and investment - especially for corporate end users.

As an effective tool for regulatory coordination, mutual recognition offers many advantages. In particular, it is an outcomes-based approach that can effectively eliminate the risk of duplicative rules. It thus helps reducing the compliance costs for the business community, as well as the cost for end users and costs for regulators in providing oversight.

Mutual recognition is an important tool, either through recognition based on the assessment made by each jurisdiction of principles applied by the other jurisdictions, or through adherence to international standards such as IOSCO principles. The fact that IOSCO principles or recommendations are not legally binding does not prevent jurisdictions from applying them as a regulatory benchmark, and we particularly support that principle.

An example of where recognition could have been applied more assiduously is in the recognition of Third Country CCPs under the EMIR framework in Europe. This recognition process is subject to, first, a technical analysis by ESMA and, second, a confirmatory equivalence decision by the European Commission. While ESMA delivered its technical advice for a number of Third Country jurisdictions in September 2013, the bulk of the EDs are still outstanding today, causing major difficulties for a number of Third Country CCPs.

Had the Commission simply followed the advice of ESMA, in other words, accepted deference, these difficulties would have been avoided.

b) EU equivalence

In the case of the European Community, access for third countries is governed by the "equivalence" requirement, or the need for equivalence decisions for third-country regulatory regimes. Before the crisis, the expression was "not more favourable treatment" of third-country service providers, with a tendency towards mutual recognition. Post crisis legislation insists, however, on detailed equivalence examinations in the different areas of legislation, proposed by the ESAs, and subject to Commission implementing acts.

The legal concept of EU equivalence is applied in EU legislations and aims to find a practical way to allow cross-border transactions between EU and non-EU entities without superimposing its rules on all non-EU trading partners of EU financial institutions. It intends to overcome regulatory divergence between EU and non-EU legislations in a fragmented regulatory landscape, and to mitigate the extraterritorial effects of EU legislation while preventing regulatory arbitrage.

Lately, the introduction of principle-based references to international standards (e.g. reference to IOSCO principles in the equivalence requirements of MIFIR, CSDR and drafts for a Benchmark Regulation) suggests a move towards a more practical, principle-based approach for the future.

c) US: substituted compliance

Another tool, and different from an equivalence assessment, is the US concept of substituted compliance. This was developed by the Commodity Futures Trading Commission (CFTC) in the context of implementing its swaps regulations under the US Dodd-Frank legislation (the concept is likely to be similarly applied by the Securities and Exchange Commission (SEC) in connection with the implementation of its own regulations on securities-based swaps).

Unlike the EU concept of equivalence, substituted compliance is a means to soften or reduce the over-reaching extra-jurisdictional effect of US regulations, by allowing foreign non-US institutions to comply with CFTC requirements through compliance with local law, subject to the CFTC reserving its examination and enforcement powers.

In the context of equivalence, the US substituted compliance concept is of interest as regards the method and technique applied by the US authorities for comparing and assessing foreign laws and regulations. In contrast to the European approach and the methods used by the ESAs in establishing their technical advice to the Commission, the CFTC applies, after a line-by-line analysis, a concept of assessing and comparing regulatory objectives underlying the foreign laws and regulations. In cases where the foreign regulation meets the objectives of the CFTC rule in question, the CFTC is usually satisfied if the foreign institution complies with its home-country rule. Convergence by the EU from its complicated assessment processes towards the US method for establishing equivalence would, therefore, be welcomed.

3. A comprehensive overview is not yet a strategy!

The Report gives a comprehensive overview of principles applied worldwide or in particular jurisdictions as well as in whole treaty blocs. However, no overview, no matter how detailed it may be, results in a strategy. What the SBA is missing in the Report is a proper

assessment of the approaches listed using transparent criteria, followed by a conclusion of which principles IOSCO intends to pursue in the future.

IOSCO correctly argues that a "one-size-fits-all" approach to cross-border regulation is neither realistic, nor meaningful or adequate. However, merely listing possible options falls short of establishing a strategy, which is the stated objective of the Report. This is all the more deplorable as the Report provides a solid and broad-based foundation upon which to establish such a strategy. It just avoids going the last and painful mile of assessing the options and weighing the arguments.

4. Cornerstones: similar objectives, competent authorities, comparable outcome

The SBA strongly believes that any workable strategy for cross-border regulation should be principle-based rather than focussing on the discrepancies in the details of the approaches taken by different jurisdictions.

We recommend IOSCO adopt an approach whereby it advocates that national regulators and/or competent authorities examine whether different national approaches are based on equivalent regulatory objectives and lead to comparable outcomes.

We believe such an assessment of regulatory comparability should be based on tests at four different levels, namely:

a) A strong alignment of national regulatory **frameworks**. This should be based on shared public policy objectives and common regulatory values.
b) A high level of similarity in the approach to achieving the **over-arching objectives** while at the same time recognising the inevitability of certain key differences which cannot necessarily be reconciled because of different legal systems, market practices, insolvency laws, etc.
c) **Consistency in regulatory scope and outcomes**, particularly in relation to systemic risk reduction and transparency.
d) **Comparability between national competent authorities** in terms of their capabilities, resources and expertise in the areas of supervision, investigation and enforcement, recognising that effective mutual reliance is dependent on a high degree of trust and confidence between those authorities.

5. High-level principles endorsed by IOSCO to improve legal certainty

High-level principles should be developed along these lines through **early and continuous dialogue** between policy makers and regulatory authorities. This approach would further facilitate the use of recognition, as there would be coordination and agreement on the over-arching principles and standards that local authorities implement.

The agreed high-level principles could then be used to create a **general scheme** recommended by IOSCO. This would further support policy makers and national competent authorities in setting up their own *binding* rules, thus providing for *legal certainty* as well as a coherent and consistent approach to cross-border regulation.

In order to be effective, such principles would have to be sufficiently detailed so as to facilitate common interpretations and cross-border deference.

We encourage IOSCO to act swiftly and decisively given the increasingly fragmented local approaches to regulation and their associated costs. We would urge IOSCO to make a

commitment that includes an **action plan** and a **time frame**. This would increase credibility in the market place and would be welcomed by most market participants.

6. The future role of IOSCO: enhancing international dialogue between policy makers

IOSCO is well-placed to play a greater role and, given the problems in achieving effective coordination in recent years, is warranted in approaching this question with ambition. It is our view that IOSCO should help the G20 promote the coordination of such regulation by focusing on the immediately achievable and fundamental tenets of early dialogue at the policy-making stage, as well as appropriate and better-targeted regulation, and coordinated implementation.

We agree with the Report's suggestion that *"IOSCO could consider enhancing international dialogue between policy makers and regulators among the various jurisdictions."* In particular, as the Report notes, to the extent that this allows for more "early identification" of cross-border ramifications and could represent a valuable improvement over the current patchwork of coordination mechanisms where international dialogue is often conducted too late in the process to be properly taken into account.

Pre-empting issues through *global dialogue* at an early stage is critical. IOSCO could offer a potential forum for consultation and discussion at a much earlier stage than at present. Policy-making jurisdictions could factor this process into their timelines so the cross-border aspects would be accorded proper recognition.

A number of markets now require the release of *impact assessments* for new pieces of legislation in order to understand what impact the proposed legislation will have on markets. Given the international nature of many financial markets, it would be helpful if as a matter of practice, these impact assessments also included a section examining how proposed legislation will impact international consistency. IOSCO should play a role in encouraging such best practices.

Finally, it should be kept in mind that securities markets and banking systems are and will remain interlinked in many ways. Therefore, any adoption of a strategy on cross-border regulation to avoid inconsistencies and potential negative cross-border implications should be coordinated between the competent banking and securities authorities. In particular, we strongly suggest that the Basel Committee on Banking Supervision (BCBS) and IOSCO continue to work closely together and exchange their views and inform of their actions in a timely manner and on a regular basis.

Thank you for your consideration of these views concerning the Report. We look forward to working with IOSCO in this critical area. If you have any questions or wish to discuss, please contact either of the signatories below.

Yours sincerely,

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Swiss Bankers Association

Stefan Hoffmann

Head of European Affairs
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