

11 June 2014

Ashley Alder
Chief Executive Officer
Hong Kong Securities and Futures Commission
Chair, IOSCO Task Force on Cross Border Regulation

David Wright
Secretary General
International Organization of Securities Commissions

RE: The IOSCO Task Force on Cross-Border Regulation

Dear Mr Alder and Mr. Wright:

The World Federation of Exchanges ("WFE") represents more than 60 publicly regulated stock, futures and options exchanges worldwide, and promotes the development of fair and transparent equities and derivatives markets around the world. CCP12's membership represents more than 50 CCPs from North and South America, Europe, Asia, Australia and Africa. CCP12 is active in promoting strong global standards in risk management and works towards the adoption of best practices across its membership.

WFE and CCP12 welcome this opportunity to contribute to IOSCO's Task Force on Cross-Border Regulation ("Task Force"). We believe it is critical that global market participants have cross-border access to well-regulated markets on reasonable and certain terms. The work of the Task Force is very important to exchanges and CCPs maintaining or seeking licenses, recognitions, or exemptions to operate across borders and access customers outside of their domestic markets. WFE and CCP12 fully support this effort to understand the key challenges and costs in cross border recognition and propose workable solutions for IOSCO and its member regulators to consider. We believe the Task Force can play a critical role in developing international standards to rationalize the different jurisdictional approaches to recognition of CCPs and exchanges.

We support mutual recognition between jurisdictions based on the CPSS-IOSCO Principles for Financial Market Infrastructure ("PFMI") and an outcome-based approach to recognizing the regulatory framework in foreign jurisdictions. Such a framework will ensure that market participants have continuous access to exchanges and CCPs without uncertainty or disruptions and will also help maintain a level playing field for market infrastructure without distortions to cross-border access or competition.

There are various recognition and exemption frameworks that regulators currently use to grant access to foreign exchanges and CCPs. Generally, this cross-border access has been granted through substituted compliance which relieves foreign exchanges and CCPs of some host-country compliance requirements based on a finding of comparable home-market regulation. These recognition frameworks typically include ongoing information sharing and cooperation requirements. Recognitions and exemptions have helped connect market participants and thereby increase liquidity and efficiency. They have also established trust and cooperation between regulators, often on the basis of bilateral memoranda-of-understanding (MOUs) and information-sharing agreements.

Current Challenges in cross-border recognition of exchanges and CCPs

Exchanges and CCPs seeking recognition or exemptions to access customers in foreign jurisdictions often face very divergent initial application and recognition processes and ongoing obligations. The implementation of G20 reforms has also created new challenges for CCPs and exchanges seeking to access foreign markets or continuing to offer services to existing clients who now fall under the scope of extraterritorial rules. As a result of the extra-territorial approach to regulation, entities that previously were not regarded as “doing business” in a foreign jurisdiction now fall under that jurisdiction’s regulatory regime and have to comply with their standards in addition to whatever home standards may exist. The negative impacts of this extra-territorial approach have been well-articulated by a number of significant financial market stakeholders.¹ This compliance burden is compounded particularly for emerging markets that now have to be found “equivalent” not just with one global standard but multiple standards.

Cross-border recognitions have been tied to other aspects of regulation such as bank capital rules under Basel III or the regulatory status of products under other market regulations, which have become increasingly important in the wake of the G20 reforms. Delays and complexity around cross-border recognition create uncertainty for markets and all market participants including companies that rely on exchanges to efficiently raise capital and commercial end users that depend on derivatives markets to effectively manage price risk.

Exchange examples

Non-US futures exchanges can apply for direct access under the U.S. CFTC’s Foreign Board of Trade (“FBOT”) rules and comply with ongoing obligations, but the U.S. SEC does not provide an equivalent regime for non-US equities exchanges. In Europe, non-EU exchanges seeking direct access to the EU must apply for recognitions or exemptions in each of the 28 EU Member States to access customers and also seek recognition under EU-level rules to ensure the appropriate regulatory status of their products. However, a list of equivalent jurisdictions, originally due to be published by the European Commission in 2007, is still pending which is creating regulatory arbitrage away from non-EU futures exchanges.

¹ For example, see GFMA, AFME, ASIFMA, SIFMA letter to IOSCO dated 13 March 2014 Re: Recommendations on Foundational Principles for Global Coordination in Cross-Border Regulation.

CCP examples

CCPs from jurisdictions around the world are also facing pressing challenges relating to recognition and equivalence. Under the new Basel III rules, CCPs need to obtain QCCP status in order to remain viable from a bank capital perspective. Since capital treatment as a QCCP under the EU rules is tied to recognition under the European Market Infrastructure Regulation (EMIR), the delays in the EMIR equivalence and recognition process are threatening the entire relationship between European banks and CCPs from around the world. This includes house and client relationships across every asset class. Many CCPs from different jurisdictions have publicly voiced concern that the EU is not taking an outcome-based approach on certain issues and are not adequately accounting for the size or liquidity dynamics of different markets.

A related challenge for CCPs is that collateral segregation rules may be incompatible due to differences in local bankruptcy laws. This incompatibility requires the pragmatic use of targeted exemptions for clearing members to provide different collateral protection options under different regimes. Additionally, although the U.S. CFTC provides clear exemptions for foreign CCPs clearing foreign futures markets for US customers, to date, they have relied on individual No-Action relief rather than creating a comprehensive framework for recognizing foreign CCPs for clearing swaps.

Concerns about the criteria for recognition are not limited to the EU and U.S., as exchanges and CCPs, in some cases, are encountering opaque application and/or recognition criteria in other regions as well, including the Asia-Pacific. It is proving difficult for many exchanges and CCPs, including those from both mature and emerging markets, to comply with multiple sets of standards in order to access foreign markets or retain existing clients. Specifically, certain jurisdictions have adopted principles that require CCPs to establish, in certain cases, local subsidiaries to serve domestic participants. This undermines competition and prevents domestic participants from benefiting from the efficiencies available through membership in global CCPs.

Costs

These challenges are generating costs for market infrastructure and market participants:

- Delays in recognition have created a threat of international market disruption and have already lead to regulatory arbitrage in certain cases.
- A lack of cross-border market access is costly for market participants. Liquidity is constrained and investors and end users may have to alter their investment or risk management activity.
- Although international standards such as the PFMI have set a base-line for regulatory requirements, different jurisdictions have gone further to apply additional standards. If every jurisdiction applies its additional standards beyond the PFMIs as conditions to recognition, it will lead to the implementation of excessively complex and costly regulatory requirements around the world, unnecessarily increasing costs for markets and market participants.

Proposed Solutions

WFE and CCP12 support the development of international standards that rationalize the different jurisdictional approaches to cross-border recognition and focus on several key elements:

1. Measuring equivalence holistically by evaluating other aspects of regulation that have a material impact on the overall outcome or effect of any individual regulation.
2. Creating a transparent process for evaluating equivalence, including public consultations. This will facilitate constructive industry input and mitigate substantive and political delays.
3. The need for targeted relief where compliance is not possible due to conflicting home/host rules.
4. Effective transitional arrangements where gaps in recognition will disrupt the market.

Well-developed standards will promote a level playing field for markets and provide market participants with certainty regarding the status of exchanges and CCPs. This will reduce the fragmentation of liquidity, unnecessary costs to infrastructure or market participants, and risk of regulatory arbitrage.

As the global associations for exchanges and CCPs, WFE and CCP12 appreciate the Task Force's important undertaking to improve and harmonize different jurisdictional approaches to cross-border recognition of market infrastructure. We would be happy to discuss any of these challenges or proposed solutions in greater detail.

Cordially yours,



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