FERNANDO RESTOY'S RESPONSE INTRODUCTORY PRESENTATION TOPIC 3: OTC DERIVATIVES CCPs

The OTC derivatives regulatory regime in most jurisdictions is likely to have a degree of extra-territoriality. This is somewhat inevitable because of the global nature of the OTC derivatives market. Mutual recognition of CCPs is one solution to address extraterritorial issues in relation to the mandatory clearing requirement. Another solution is to develop common standards for mandatory clearing requirements and cooperative regulatory oversight and information sharing agreements to facilitate recognition of CCPs. How do you see the different regulatory views around the world would eventually converge on this very important issue? (Mr Fernando Restoy & Mr Howard Wetston).

* Centralized clearing might become more global.

CCPs will increase their clearing activity after the implementation of new regulation developing G20 agreements.

Global CCPs will deal with more clearing members from several jurisdictions and will presumably concentrate products from different markets and currencies. In this kind of business, size yields huge synergies.

* There will be an increasing need to clear in CCPs established in foreign jurisdictions.

New central clearing obligations will apply for all jurisdictions but not all CCPs will offer clearing services for all the range of products subject to mandatory clearing.

* International consistency between mandatory regimes is desirable as it reduces the gaps and the opportunities for regulatory arbitrage and increases efficiency.

A relevant proportion of the OTC transactions are cross border. Proposed new regulations will impact non-domestic participants and will have some extraterritorial components. EU regulation will impose requirements for central clearing to contracts whose parties were not established in Europe. Other jurisdictions could follow similar approaches.

Costs associated with the implementation of new legislation such as those of central clearing obligation, margins for non cleared derivatives, new capital charges and others could tend to increase substantially if each jurisdiction implements regulatory reform in its own way.

The development of a financial environment that might encourage regulatory arbitrage should be avoided.

For those reasons there is a regulatory consensus of a need for coordination to identify overlaps, conflicts and gaps among clearing regimes for reducing inefficiencies.

CPSS-IOSCO Principles for Financial Market Infrastructures (PFMIs) are designed to support global financial markets. Therefore, they constitute a relevant starting point for a good coordination. Their adoption is expected in a relevant set of jurisdictions by the end of 2012.

* Recognition of foreign CCPs could be the best choice for Competent Authorities from many jurisdictions which may need to know in detail how a CCP is performing.

There are two main choices: registration/licensing or recognition.

In the registration/licensing model the foreign CCP registers with a foreign supervisor, which has two consequences: the CCP recognizes the authority of that supervisor (apart from their own, home supervisor) and the CCP commits to comply with the regulation in the foreign jurisdiction --the supervisor's law--, apart or on top from their own regulation (home regulation). This approach would grant satisfaction to the local authorities but could also entail some perverse implications even in critical aspects (e.g. the application of different bankruptcy regimes).

In the recognition model the CCP is recognized by a foreign supervisor, based on two conditions: i) it's regulated and supervised with similar/equivalent terms to the recognizing jurisdiction; and ii) the Competent Authorities have mechanisms in place to share information between them. This does not require subjecting the CCP to the foreign authority or the foreign regulation. The European Union has supported this model.

If the regulations on CCPs in the main jurisdictions are similar on the core elements the issue of recogniti0n versus registration model of a foreign CCP could be solved. However, a CCP which is subject to two different legal regimes may face different challenges:

a. If both pieces of legislation deal with one topic in the same way, the solution is expensive but possible. The CCP should follow the stricter regulation. An example is the capital requirement: one legal system requires keeping capital to cover the risk of the major clearing member whereas the other stricter jurisdiction requires covering the two major participants.
b. If both legislations contain requirements which are mutually exclusive, the CCP was not being able to comply with both. Imagine that one jurisdiction requests that the customer's account shall be segregated into only one account and that it is not possible to have single customer accounts at the CCP whereas the other allows it.

However, although from a legal point of view, these options may differ substantially, in practice, they must not differ that much, specifically if the requirements for CCPs have sufficient reliance on the host supervisor authority. In particular, a registration model based on:

1) the compliance of the supervisor of the CCP with international principles, and
2) that the legislative framework for CCP of this supervisory authority is comparable/equivalent to the legislation of the licensing authority, and
3) that information sharing mechanisms are put in place,

may work as long as the non crucial details are overlooked.

* Adequate cooperative arrangement for CCPs are essential in day-to-day supervision and in crisis management.

In any case, effective supervision or oversight of the CCP is a necessary precondition. One possible choice might require the establishment of cooperation arrangements between competent authorities with the aim of facilitating:

i) How the relevant information should be exchanged and how to assure that the foreign CCP can provide all information requested by the local authorities.
ii) How to assure that the authority where the CCP is established has a prompt notification of any breach of the CCP with the requirements it is obliged to meet.
iii) How to grant that the local authority may be informed of all the new services the foreign CCP may provide in the local jurisdiction.
iv) How to assure a proper coordination of the supervisory activities of both authorities. This might include on site inspection of the CCP and the clearing member if deemed appropriate.

Finally, cooperation should reach crisis management level. However, I have some doubts about whether the FSB Key Attributes defined for GSIFIS should apply directly to CCPs. The CPSS/IOSCO working group and the FSB are working on a resolution methodology for CCPs and important issues should be discussed in the second part of this year.