

# **Review of Implementation Progress in Regulation of Derivative Market Intermediaries**



**IOSCO**

**THE BOARD  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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## 1 Executive Summary

This report (“Report”) sets out the findings of the review (“Review”) by the International Organization of Securities Commissions (“IOSCO”) of the progress jurisdictions have made in adopting legislation, regulation and policies in relation to derivatives market intermediaries (“DMIs”) in the following six areas (“Reform Areas”) addressed in IOSCO’s *International Standards for Derivative Market Intermediary Regulation* (“DMI Standards”):<sup>1</sup>

- Scope of regulatory reform — including framework for regulation and definition of DMIs;
- Registration/licensing standards;
- Capital standards or other financial resources requirements for non-prudentially regulated DMIs;
- Business conduct standards;
- Business supervision standards; and
- Recordkeeping standards.

This Report was prepared by a team (“Review Team”) constituted by IOSCO members and co-chaired by the Australian Securities and Investments Commission (“ASIC”) (in their capacity as member of the IOSCO Assessment Committee) and the Ontario Securities Commission (“OSC”) (in their capacity as a member of the IOSCO OTC Derivatives Task Force (“OTCDTF”)). The membership of the Review Team is set out below.

The Review was an Adoption Monitoring Review designed to measure progress in the implementation of the DMI Standards. It will assist the IOSCO Assessment Committee (“AC”) to determine the timing of an Implementation Assessment Review to measure the consistency of a jurisdiction’s legislation, regulation and policies with the DMI Standards.

**The key findings set out in this Report are made solely on the basis of the self-assessments provided by participating jurisdictions and are therefore subject to review (and possible change) by any future assessment. Participating jurisdictions were given an opportunity to confirm the self-assessment provided on the progress of reforms for their jurisdiction and the way it has been reported in this Report.**

In general, jurisdictions have indicated significant progress in adopting legislation, regulation or policy in areas covered by the DMI Standards.

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<sup>1</sup> IOSCO published 15 key policy recommendations relating to the six Reform Areas in 2012. IOSCO, *International Standards for Derivatives Market Intermediary Regulation, Final Report* (June 2012). Available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf>.

Many respondents indicated that their jurisdictions have regulatory frameworks that cover the Reform Areas through a general licensing/registration and regulatory regime that covers, or is being amended to cover, DMIs or derivatives intermediary activities.

Others indicated that they have banking, securities dealer, insurance or asset management licensing and regulatory regimes that either already address the Reform Areas, or which are being amended to do so.

A few jurisdictions are implementing regimes specific to DMIs.

A number of authorities also indicated that the G20-driven OTC derivatives reforms are being implemented in their jurisdictions and key developments are expected during 2015 and 2016 in relation to risk mitigation requirements for non-centrally cleared derivatives (both relating to margin and non-margin risk mitigants). This process will continue for some time and affect the overall derivatives regimes in the respondent jurisdictions.

Based on information collected during the Review on the progress of various changes, including those related to G20 reforms, the Review Team recommends that no Implementation Assessment (or Level 2) Review be undertaken before the end of 2016.

## **1.1 Key Findings**

### *Definitions and Licensing/Registration*

Most jurisdictions indicated they have in place relevant definitions and licensing or registration requirements for entities engaged in derivatives intermediary activities.

However, the responses indicate differences in how jurisdictions approach the licensing or registration of DMIs. The responses also indicate there are exemptions to DMI definitions and to licensing/registration regimes.

Many jurisdictions have general licensing/registration regimes that either cover DMIs and their derivatives activities, or are being amended to do so. This would suggest an entity engaged only in relevant derivatives activities in these jurisdictions would be subject to a licensing requirement. However responses about the degree to which these existing regimes are tailored to address the particular issues arising from OTC derivatives activities were mixed and warrant further consideration in any forthcoming Implementation Assessment Review.

There are some jurisdictions that noted they had banking, securities dealer, asset management or insurance licensing regimes that covered derivatives activities. As with the general licensing regimes, the degree to which these regimes are sufficiently tailored to OTC derivatives warrants consideration. Also, it is worth noting that an entity that is not a bank, securities dealer, insurer or asset manager, and only enters into derivatives intermediary activities, may not be subject to any licensing or other requirements in such jurisdictions.

There are also some jurisdictions that have already established, or are developing, definitions and licensing specific to DMIs and derivatives activities, some of these are in the process of establishing a more tailored regulatory framework with respect to DMIs.

### *Conduct, Capital and Other Requirements*

Jurisdictions generally indicated they had, or were in the process of establishing, capital, business conduct, supervisory and record-keeping requirements that cover OTC derivatives activities.

In some cases the requirements were not expressly tailored to OTC derivatives markets. Some of the requirements, however, take into account the nature and scale of the entity's activities.

As with licensing or registration of DMIs, the degree to which existing or general regimes are tailored sufficiently to address the particular issues arising from OTC derivatives activities warrants further consideration in any forthcoming Implementation Assessment Review.

### *Developments Underway*

Many jurisdictions are in the process of amending their regimes in respect of DMIs and derivatives related activities. By and large the development of regulatory frameworks referred to in the responses should be well progressed or completed by 2016. However, jurisdictions may also continue to implement G20-related OTC derivatives reforms and margin principles for non-centrally cleared derivatives, past that point.

By way of example, recent changes include Hong Kong implementing a new regime to amend the *Securities and Futures Ordinance* to cover OTC derivatives. In Canada, the Canadian Securities Administrators' ("CSA") OTC Derivatives Committee is developing, inter-provincially, a Canadian registration regime for DMIs due for the first half of 2017. Both the US Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("US SEC") are in the process of implementing the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank Act"). The US SEC in particular, has proposed a number of rules relevant to DMIs. On 1 December 2014, changes extending the scope of derivatives related licensing took effect in New Zealand, and in South Africa, changes are also underway, potentially effective in 2015. In Singapore, intermediaries who deal in or advise on OTC securities-based derivatives and OTC margined foreign exchange-based derivatives are subject to licensing, however the Monetary Authority of Singapore ("MAS") is proposing to expand the licensing regime to cover other types of OTC derivatives (e.g., OTC commodity-based derivatives). Other jurisdictions are also considering changes. All of these actions should be taken into account in determining the timing of any Implementation Assessment Review.

### *Challenges in Conducting the Review*

In performing the Review a number of challenges presented themselves. Many jurisdictions are amending their regimes for OTC derivatives activities. Where the development of the regulatory regimes is well progressed in jurisdictions, some responses were made on the basis of the changes which were being made rather than those which had come into force, giving the impression reforms were further advanced. So in reflecting survey responses the Review Team has sought to distinguish between legislation and requirements that are currently in effect, and those draft rules or regulations that have been proposed or are the subject of consultation. Where there are no published proposals, the Review Team has indicated that no action has yet been taken. In some of these instances, there may be changes to DMI

regulation being contemplated by jurisdictions – but as these are not yet fully public, they have not been included in this Report.

The coverage of OTC derivatives activity is approached differently in different jurisdictions and can be subject to a combination of different legislation and different regulators in a single jurisdiction. As mentioned above, in some jurisdictions derivatives market activities are covered by banking or insurance licensing regimes. This may involve other regulators besides securities market authorities. This factor, together with the range of potential amendments underway, made it challenging to develop a high level view of progress and may point to the need to involve other regulators, such as banking regulators, in any further assessment.

The key findings set out in this Report are made solely on the basis of the self-assessments provided by participating jurisdictions. The Review Team has avoided forming views as to whether measures taken by jurisdictions actually are consistent with the DMI Standards. In developing recommendations regarding the timing of any future review, significant weight is also given to whether jurisdictions have indicated whether or not they anticipate changes in order to implement the DMI Standards.

## **1.2 Recommendation on Timing of Further Reviews**

An important matter for consideration by the Review Team has been the timing of any future Implementation Assessment Review of DMI Standards.

If the AC determines such an assessment is warranted, the Review Team recommends that any Implementation Assessment Review of the DMI Standards not take place before the end of 2016 at the earliest. A number of jurisdictions are making substantial changes to their regulatory regimes. From the information provided as part of the Review, this process is likely to be largely completed, or at least significantly progressed, by the end of 2016. In addition, there are significant G20-related OTC derivatives reforms that many jurisdictions are in the process of implementing that may affect the regulatory regime applicable to DMIs.

Before recommendations about the precise timing of an Implementation Assessment Review are made, consideration should be given to conducting a further Adoption Monitoring Review about progress in DMI reform.

## **2 Introduction**

Historically, market participants in the OTC derivatives market have not, in many cases, been subject to the same level of regulation as participants in the traditional securities market. This allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008. In 2009, the Leaders of the G20 committed to reforms in the OTC derivatives market to improve transparency, mitigate systemic risk and protect against market abuse.

In connection with the reforms to the OTC derivatives markets, in June 2012, IOSCO published the DMI Standards to provide high-level international standards for the regulation

of market participants in the business of dealing, making a market or intermediating transactions in OTC derivatives, excluding end-users or market participants<sup>2</sup> entering into OTC derivatives transactions without being engaged in the business of dealing, making a market or intermediating transactions.

IOSCO has now undertaken this Adoption Monitoring Review of the implementation of DMI reforms to assess the progress and timeliness of jurisdictions in adopting legislation, regulation and policies in relation to DMIs.

## **2.1 DMI Standards**

The DMI Standards comprise 15 policy recommendations about the regulation of DMIs.<sup>3</sup> These are set out in Attachment A.

The DMI Standards address regulation in the following Reform Areas:

- Scope of regulatory reform — including framework for regulation and definition of DMIs;
- Registration/licensing standards;
- Capital standards or other financial resources requirements for non-prudentially regulated DMIs;
- Business conduct standards;
- Business supervision standards; and
- Recordkeeping standards.

## **2.2 Reasons for the Review**

A Review of the DMI Standards was proposed for the following reasons:

- To monitor and encourage consistent implementation of standards IOSCO has developed;
- To provide useful information to the AC to determine the appropriate timing for a further Implementation Assessment Review of the DMI Standards;

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<sup>2</sup> Such as funds and asset management companies when they exclusively operate on behalf of a fund.

<sup>3</sup> The DMI Standards focus on DMIs dealing with non-retail clients/counterparties who currently comprise the majority of the clients/counterparties in the OTC derivatives market. The term “non-retail” as used in the DMI Standards and this Report refers to financial, institutional, professional, corporate or certain other market participants that in some jurisdictions are considered sophisticated. For DMI counterparties or clients participating in the OTC derivatives market that would be considered to fall within the retail classification, the DMI Standards state that such intermediaries should be subject to at least the same duties applicable to intermediaries dealing with retail clients/counterparties in the traditional securities markets, to the extent such transactions are permitted by the jurisdiction.



- To provide useful information to the Financial Stability Board and the G20 on the status of regulation of DMIs; and
- By foreshadowing a further review, to raise the profile of the DMI Standards and encourage policy makers and regulators to consider and apply them when developing their regulatory approaches to DMIs.

This Report describes how the Review was conducted and sets out key findings.

### **3 Methodology**

#### **3.1 Nature of the Review and Objectives**

Given the nascent state of implementation of DMI Standards in many jurisdictions, the AC, in consultation with the OTCDTF, decided that an Adoption Monitoring Review of the progress in implementation (or proposed implementation) of a regulatory framework for regulation of DMIs would be most beneficial.

This Review focuses on whether there is a regulatory framework in place for the regulation of DMIs and if not, whether there are regulatory developments to put such a framework in place.

Accordingly, the objectives of this Review were to:

- Identify progress in implementing or formulating proposals to implement the DMI Standards among IOSCO member jurisdictions;
- Where relevant, identify the key elements of DMI regulation; and
- Use information collected as part of this Review to determine the appropriate timing for any Implementation Assessment Review of the DMI Standards.

#### **3.2 Review Team**

The Review was conducted by a Review Team comprising representatives from the OTCDTF,<sup>4</sup> representatives from the AC<sup>5</sup> and the IOSCO Secretariat, with co-chairs from each of the OTCDTF and the AC.

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<sup>4</sup> Ontario Securities Commission (OSC), Quebec Autorité des marchés financiers (Quebec AMF), Italy Commissione Nazionale per le Società e la Borsa (CONSOB) and Dubai Financial Services Authority (FSA).

<sup>5</sup> Australian Securities and Investments Commission (ASIC), Japan Financial Services Agency (FSA) and South Africa Financial Services Board (FSB).

### 3.3 Methodology

IOSCO members provided responses to a questionnaire designed and developed by the Review Team (“Questionnaire”). The Questionnaire was circulated in early 2014.

The Questionnaire focussed on the framework of DMI regulation in the six Reform Areas covered in the DMI Standards. It asked authorities to indicate whether legislation, regulations or other binding rules or non-binding policies addressed each of the following Reform Areas:

- Scope of regulatory reform — including framework for regulation and definition of DMIs (sections 4.1 and 4.2);
- Registration/licensing standards (section 4.3);
- Capital requirements (section 4.4);
- Business conduct standards and segregation (section 4.5);
- Business supervision standards (section 4.6); and
- Record-keeping standards (section 4.7).

After an initial analysis of responses to the Questionnaire, follow-up questions were sent to some respondents. All respondents were given the opportunity to check the accuracy of the response compilation undertaken by the Review Team. Where a jurisdiction had adopted or proposed rules or draft legislation these details were included as part of responses regarding the development of their regime.

There are no specific ratings applied in this Report, but the following nomenclature was used in describing the state of development of the regulatory regimes:

- Measures described as ‘adopted’:
  - Final implementation measures in force;
  - Final implementation measures published; and
- Measures described as ‘proposed’:
  - Draft implementation measures published and being consulted on.

### 3.4 Respondents to the Questionnaire

Twenty-one IOSCO members<sup>6</sup> from 20 different jurisdictions contributed to this Review. This Report reflects their responses to the Questionnaire on the framework of DMI regulation

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<sup>6</sup> Australian Securities and Investments Commission (ASIC), France Autorité des marchés financiers (France AMF), Germany Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Brazil Comissão de

operating in their jurisdiction (as noted in relevant footnotes). Given the cross-sectoral nature of DMI regulation in some jurisdictions, some IOSCO members will have covered areas relevant to other authorities in their jurisdiction, such as banking authorities, in order to provide information on the regime operating in their jurisdiction.

For the purposes of this Report the US is treated as a single jurisdiction with two respondents, the CFTC and the US SEC. Only where the CFTC's and US SEC's responses differed were their responses treated differently – sometimes taking up to 21 the number of total respondents reflected in the responses below. Ontario and Quebec have been treated as two separate jurisdictions. Twelve IOSCO Board members (as at the time the Questionnaire was issued)<sup>7</sup> and eight member jurisdictions of the Financial Stability Board<sup>8</sup> did not participate.

Respondents represented all IOSCO regions and included representation from five members of IOSCO's Growth and Emerging Markets Committee.<sup>9</sup>

The total number of responses to different questions varied, and therefore do not add to 21 responses in all instances. In some cases, questions were not applicable or no response was provided. In a number of instances a jurisdiction may have indicated that its regime covered a particular DMI Standard, in whole or in part, but that there were also published proposals for changes to the regime. Therefore, the aggregate number of responses varies among different questions.

## 4 Summary of Responses

This section summarises the responses received to the Questionnaire in relation to each of the Reform Areas. It also provides examples of the existing requirements in some jurisdictions, and some examples of anticipated developments to amend requirements.

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Valores Mobiliários (CVM), Hong Kong Securities and Futures Commission (SFC), Italy Commissione Nazionale per le Società e la Borsa (CONSOB), Israel Securities Authority (ISA), Japan Financial Services Authority (FSA), Korea Financial Services Commission (FSC)/Financial Supervisory Service (FSS), Netherlands Authority for the Financial Markets (AFM), New Zealand Financial Markets Authority (FMA), Ontario Securities Commission (OSC), Securities and Exchange Commission of Pakistan (SECP), Quebec Autorité des marchés financiers (Quebec AMF), Monetary Authority of Singapore (MAS), South Africa Financial Services Board (FSB), Spain Comisión Nacional del Mercado de Valores (CNMV), Swiss Financial Market Supervisory Authority (FINMA), UK Financial Conduct Authority (FCA), US Commodity Futures Trading Commission (CFTC) and US Securities and Exchange Commission (US SEC).

<sup>7</sup> Argentina Comisión Nacional de Valores, Belgium Financial Services and Markets Authority, China Securities Regulatory Commission, Securities and Exchange Board of India, Securities Commission Malaysia, Mexico Comisión Nacional Bancaria y de Valores, Morocco Conseil Déontologique des Valeurs Mobilières, Nigeria Securities and Exchange Commission, Portugal Comissão do Mercado de Valores Mobiliários, Romania Financial Supervision Authority, Saudi Arabia Capital Market Authority and Trinidad and Tobago Securities and Exchange Commission.

<sup>8</sup> Argentina, China, India, Indonesia, Mexico, Russia, Saudi Arabia and Turkey.

<sup>9</sup> Brazil CVM, Israel ISA, Korea FSC/FSS, Pakistan SECP and South Africa FSB.

## 4.1 Scope of Regulatory Reform

### *Applicable Legislative or Regulatory Framework*

Respondents were asked to describe the legislative or regulatory framework that applied to DMIs in their jurisdictions in order to provide general background. This assisted in providing the Review Team with a framework to understand the responses on specific questions regarding regulation of DMIs.

A total of 21 authorities responded to the question. Fourteen<sup>10</sup> jurisdictions indicated that they have a regulatory framework that applies to DMIs. Most jurisdictions indicated that these regulatory frameworks were being amended in some way. For instance, South Africa is introducing a new regime, the US SEC, as well as the CFTC, are implementing Dodd-Frank Act reforms, and Ontario is introducing an OTC derivatives regime.

Many jurisdictions indicated that they have a single general licensing regime that captures DMIs' derivatives related activities. In a number of other jurisdictions, there are specific regulatory regimes that cover particular types of intermediaries (e.g. banking, securities dealers, insurance or asset management regimes) which also cover OTC derivatives activities, while in other instances such regulatory regimes are being amended to cover OTC derivatives activities. A few jurisdictions are developing more specific DMI licensing and regulatory frameworks. For instance, in the US the CFTC is developing a specific regime for swap dealers, and the US SEC is in the process of developing a regulatory framework for the regulation of security-based swap dealers, consistent with the *Securities Exchange Act of 1934*, as amended by the Dodd-Frank Act.<sup>11</sup>

## 4.2 Definition of DMIs

### *What Entities are DMIs*

Recommendation 1 of the DMI Standards provides that DMIs should generally include those who are in the business of dealing, making a market or intermediating transactions in OTC derivatives. However, DMIs should not include end-users and market participants<sup>12</sup> who enter into OTC derivatives transactions but are not engaged in the business of dealing, making a market or intermediating transactions.

Authorities were asked in the Questionnaire whether they had any statutory, regulatory or working definition of 'derivative market intermediary'.

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<sup>10</sup> Australia ASIC, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Pakistan SECP, Quebec AMF, Spain CNMV, UK FCA and US (CFTC/US SEC).

<sup>11</sup> The US SEC referenced security-based swap dealers for purposes of its responses with respect to DMIs, but also noted that other types of entities (such as broker-dealers), for which there is a pre-existing regulatory structure, may also engage in certain derivative transactions. For example, there is an existing OTC derivatives dealer program for broker-dealers providing a capital regime specifically tailored to derivatives trading.

<sup>12</sup> Such as funds and asset management companies when they exclusively operate on behalf of a fund.

Fourteen jurisdictions<sup>13</sup> indicated they had a statutory, regulatory or working definition of DMI, three<sup>14</sup> indicated they do not, and three<sup>15</sup> have proposed rules defining DMIs.

Of those that have a definition, a variety of definitions have been adopted. Some jurisdictions have, or are developing, *specific* DMI definitions. For instance, in South Africa, the term OTC “derivative provider” will be defined as a person who, as a regular feature of its business and transacting as principal, originates OTC derivatives or makes a market in OTC derivatives. In the US, the CFTC and the US SEC in general define swap dealer and security-based swap dealer as any person who holds themselves out as a dealer in swaps or security-based swaps, respectively, makes a market in swaps or security-based swaps, respectively, regularly enters into swaps or security-based swaps, respectively, as an ordinary course of business for its own account, or engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps or security-based swaps, respectively.

In the other jurisdictions that have definitions there is not a specific definition for a DMI but a general defined term is used. These general defined terms include intermediaries that might deal, make a market or advise on derivatives contracts amongst their other regulated activities. For instance, in Japan, a DMI falls into the category of “Financial Instruments Business Operators engaged in Type I Financial Instruments Business” as a person conducting “over the counter transactions of Derivatives or an intermediary, brokerage or agency service thereof”.

In the EU, the Markets in Financial Instruments Directive (“MiFID”) defines “investment firm” or “investment company”. The term “investment firm” includes any legal person whose regular business is the provision of investment services to third parties and/or the performance of investment activities on a professional basis. Therefore, dealing or providing investments advice in relation to derivatives is captured. MiFID has been transposed by the Member States that responded to the Questionnaire.

Further examples of DMI related definitions include the following:

- **France** has transposed MiFID into French law, so the definition of investment firm includes any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.
- **Germany** has transposed MiFID. Intermediaries which are involved in the business of dealing, making a market or intermediating transactions in OTC derivatives are regulated as investment firms under the German Securities Trading Act and the German Banking Act. The definition of an investment firm, investment service as well as derivative can be found in section 2 of the German Securities Trading Act.
- In **Italy**, MiFID has been transposed. Therefore the provision of investment services in relation to financial instruments, including OTC derivatives, can only be carried out by

<sup>13</sup> Australia ASIC, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Pakistan SECP, Quebec AMF, Spain CNMV, UK FCA and US (CFTC/US SEC).

<sup>14</sup> Brazil CVM, Israel ISA and Switzerland FINMA.

<sup>15</sup> Ontario OSC, Singapore MAS and South Africa FSB.

authorised investment firms and banks according to the Italian Consolidated Law on Finance.

- In **Ontario**, “dealer” will mean, except for the purposes described in legislation, a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in securities or derivatives<sup>16</sup> as principal or agent; “adviser” means a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities or derivatives.<sup>17</sup>
- In the **US**, the CFTC broadly defines a “Swap Dealer” as any person who: (i) holds itself out as a dealer in swaps, (ii) makes a market in swaps, (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account, or (iv) engages in activity causing itself to be commonly known in the trade as a dealer or market maker in swaps.<sup>18</sup> The US SEC uses a similar definition with respect to security-based swaps.

Other jurisdictions do not have particular definitions for different types of intermediaries or for DMIs, but rather focus on the activities being undertaken by a market participant, such as dealing, market making or advising on derivatives. Based on the activities undertaken by the participant certain requirements are imposed - such as licensing, conduct and risk management requirements - on the participant. In this way, although these jurisdictions may not have a particular definition for DMI, they seek to impose relevant obligations on those participants who engage in DMI activities such as market making and dealing in OTC derivatives.

For example:

- In **Australia**, an entity that “deals” in “derivatives” is required to hold an Australian Financial Services Licence under the *Corporations Act 2001* (“Corporations Act”).
  - “Dealing” in a financial product includes issuing, applying for, acquiring, varying or disposing of a financial product (section 766C). In relation to derivatives, both parties

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<sup>16</sup> The term “or derivatives” will be added upon proclamation of the Lieutenant Governor.

<sup>17</sup> These definitions are found in Section 1(1) of the *Ontario Securities Act*. Further guidance on these registration triggers is included in the CSA’s Derivatives Committee *Consultation Paper 91-407 Derivatives: Registration* (the “Registration Paper”) and will be in the registration rules once they are complete.

<sup>18</sup> For the entire definition of Swap Dealer, please refer to Section 1(a)(49) of the *Commodity Exchange Act* (CEA, 7 USC 1(a)(49)); Commission regulation 1.3(ggg) (17 CFR 1.3(ggg)); and Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” and “Eligible Contract Participant,” 77 FR 30596, May 23, 2012 at: <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-10562a.pdf>. See also, *Securities Exchange Act* Section 3(a)(71), 15 U.S.C. 78c(a)(71) and Rule 3a71-1 (17 CFR 240.3a71-1) for the definition of Security-Based Swap Dealer.

to an OTC derivatives transaction are taken to “issue” the product (section 761E).

- “Derivative” is broadly defined in section 761D as an arrangement under which the payment is or may be required at a future time (at least in 3 business days for FX contracts; at least in 1 business day for all other contracts), and the payment may be determined by, derived from, or varied by reference to:
  - an asset;
  - a rate;
  - an index;
  - a commodity.
- In **Hong Kong**, any person engaging in regulated activities, such as dealing in or advising on OTC derivatives products needs to be licensed. This has extended the current regime to cover OTC derivative activities.

### *Exemptions*

Where a jurisdiction had a definition of a DMI, the Questionnaire asked whether there were any exemptions from the definition and the reasoning for these exemptions.

Eight<sup>19</sup> jurisdictions noted exemptions from their definition, each different in scope. The extent of these exemptions and their implications was not analysed.

For instance:

- For **New Zealand**, regulated activities are limited to “futures contracts” only until 1 December 2014. However, “futures contracts” are defined broadly and include OTC options and forwards. From 1 December 2014, issuers of derivatives to retail customers need to be licensed or registered.
- **South Africa** is planning to define DMIs and will exclude end-users and market participants who are not engaged in OTC derivatives as a regular feature of their business. Therefore, only professional OTC derivative providers are captured.
- In **Japan**, dealings with professional investors are excluded from the definition of “Financial Investments Business”.
- In the **US**, specific types of swaps are excluded. The excluded types of swaps include inter-affiliate activities, certain activities of a cooperative, swaps entered into for the purpose of hedging physical positions, swaps entered into by floor traders, swaps entered into for one’s own account, swaps entered into by insured depository institutions that are in connection with originating loans to customers and swaps entered into with non-US persons and foreign branches of US persons.

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<sup>19</sup> Germany BaFin, France AMF, Hong Kong SFC, Japan FSA, New Zealand FMA, Pakistan SECP, Spain CNMV and US (CFTC/US SEC).

- In the EU under MiFID, “investment firm” includes only those who are engaged in derivatives activities on a professional basis. There are exemptions for persons dealing on their own account in certain derivatives products where that is ancillary to their main business.

### 4.3 Registration/Licensing Standards

Recommendation 1 of the DMI Standards provides that DMIs should be subject to registration or licensing and applicable regulation or standards. It recognises that in certain limited circumstances full application of regulation may not be appropriate for certain types of entities.

The Questionnaire asked whether DMIs were subject to any registration or licensing requirements in jurisdictions.

Fifteen<sup>20</sup> jurisdictions indicated that DMIs, or entities that engage in trading in or advising on derivatives, were subject to a licensing regime. Differences were noted in how the regimes apply. Three<sup>21</sup> jurisdictions responded that they did not have a licensing regime that was triggered by DMI activities and no published proposals to introduce such a regime. Five jurisdictions<sup>22</sup> had proposed rules for a new licensing or registration regime for DMIs.

#### *Different Approaches to Registration/Licensing*

Overall, for registration and licensing, jurisdictions tended to follow the approach they had taken in relation to defining DMI’s (described above).

Some jurisdictions have, or are developing, specific licensing and registration regimes for DMIs. For instance, in the US the CFTC registers swap dealers, and the US SEC has proposed rules for registration of security-based swap dealers.

Many jurisdictions have a general licensing regime that captures a range of financial activities and intermediaries, including DMIs or derivatives-related activities. For instance, in Australia an Australian Financial Services Licence is required in order to provide a range of financial services including derivatives related activities and in the EU. MiFiD requires licensing for investment firms which includes any legal person whose regular business is the provision of investment services to third parties and/or the performance of investment

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<sup>20</sup> Australia ASIC, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>21</sup> Brazil CVM, Israel ISA, and Pakistan SECP.

<sup>22</sup> Ontario OSC, Quebec AMF, Singapore MAS, South Africa FSB and US SEC. In Singapore, intermediaries which deal in or advise on OTC securities-based derivatives and OTC margined foreign exchange-based derivatives are subject to licensing, however, Singapore MAS is also proposing to expand the licensing regime to cover other types of OTC derivatives, e.g. OTC commodity-based derivatives.



services on a professional basis, which covers certain derivatives related activities. In Japan, DMIs are regulated as “Financial Instruments Businesses”. Based on the responses provided, it appears that in these jurisdictions any entities engaged in DMI activities would require licensing or registration, subject to any relevant exemptions.

Some jurisdictions indicated that they have separate licensing regimes for banks, securities dealers/broker-dealers, asset managers and insurance institutions. These regimes cover, or are being amended to cover, the derivatives activities of these types of entities – these being the major financial institutions involved in derivatives market activity. In some cases, this appears to mean that derivatives activity itself is not necessarily a trigger for a licensing requirement, but that once otherwise licensed under these alternative licensing regimes, the derivatives activity of these types of entities is subject to requirements imposed by these regimes. The answers provided by these jurisdictions to later assessment questions about the content of their regimes were based on these existing separate licensing regimes, so as to still capture this regulatory coverage of derivatives activity.

#### *Developments Underway*

There is a significant level of reform in progress in relation to the licensing of DMIs. Six<sup>23</sup> jurisdictions indicated that they have not currently fully implemented a licensing or registration requirement for all DMIs or derivatives related activity. Three of these jurisdictions as well as Singapore and Quebec<sup>24</sup> have public proposals to amend their licensing or registration regime. Another jurisdiction<sup>25</sup> also indicated that it is in the process of reviewing its regime so as to cover certain entities that engage in derivatives related activity.

Reforms are being considered or underway in a number of jurisdictions.

Ontario and Quebec’s regimes are currently undergoing changes to provide for DMI specific registration and/or licensing requirements, with implementation due in 2017. In Singapore, Singapore MAS is also proposing to expand the licensing regime to cover other types of OTC derivatives (e.g. OTC commodity-based derivatives). South Africa is in the process of consulting on draft legislation and the broker-dealer regime is being reviewed in Israel. The US SEC is also undertaking significant rulemaking as a result of the implementation of the Dodd-Frank Act.

#### *Implications for the Analysis of Differing Licensing Approaches*

As noted above, some jurisdictions have separate licensing regimes applying to the activities of certain types of institutions, (e.g. banks and securities dealers/broker-dealers). These licensing regimes were not triggered by derivatives intermediary activities, but did set out requirements for the activities of such entities, including their derivatives activities. In order

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<sup>23</sup> Brazil CVM, Israel ISA, Ontario OSC, Pakistan SECP, South Africa FSB and US SEC.

<sup>24</sup> Ontario OSC, South Africa FSB and US SEC. Singapore and Quebec also have published proposals to extend their current licensing regime.

<sup>25</sup> Israel ISA.

to capture coverage of derivatives activity by these key financial institutions, answers to later assessment questions were based on the licensing regimes for these institutions.

For instance, Israel, Ontario, Pakistan, South Africa and Brazil indicated that derivatives regulation is set out in regimes for licensing banks, securities dealers, insurance or asset managers even though in each jurisdiction there is currently no requirement for a licence that is triggered solely by derivatives intermediary activities (with Ontario and South Africa developing DMI specific licensing regimes).

Given that the regimes in some of jurisdictions may in certain cases only cover the derivatives activity of specific types of entities, there is a risk that other entities that may engage in derivatives related activity may not be required to hold a licence or be registered. This may warrant further review.

### *Exemptions*

Authorities were also asked in the Questionnaire whether there were any DMI activities or entities exempt from registration or licensing requirements.

Among the 15 jurisdictions<sup>26</sup> that indicated that they have DMIs registration and/or licensing requirements, eight jurisdictions<sup>27</sup> exempt some of the DMI activities/entities from registration and/or licensing requirements.

There was cross over in responses to this question and the question regarding exemptions to the DMI definition discussed above. Taken together, the responses suggest that most jurisdictions have exemptions to their DMI regulatory framework. The scope and effect of these exemptions will be important to analyse in any Implementation Assessment Review.

For example, exemptions include:

#### **Australia**

- There is an exemption for an entity entering transactions on their own account, for the purposes of managing a financial risk that arises in the ordinary course of a business (i.e., hedging commercial risk) and derivatives transactions are not a significant part of their business. This exemption applies to dealings in derivatives as well as FX transactions.
- It recognizes that some entities (such as corporates) enter these transactions to manage commercial risk.
- ASIC has issued Class Orders that permit entities who are regulated by a recognized overseas regulator to offer financial services to wholesale clients only, to do so without holding an Australian Financial Services Licence (“AFSL”). These class orders are authorized by section 911A of the Corporations Act. The recognized foreign regulators are: US SEC, US CFTC, US Federal Reserve, Office of the Comptroller of the Currency

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<sup>26</sup> Australia ASIC, France AMF, Germany BAFIN, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>27</sup> Australia ASIC, Germany BaFin, Hong Kong SFC, Japan FSA, Netherlands AFM, Ontario OSC, Quebec AMF and Singapore MAS.

(“OCC”); UK FCA; German BaFin; Singapore MAS; and Hong Kong SFC.

### **Germany**

- There is an exemption for enterprises that, without being involved in cross-border activities, conduct banking business solely in the form of principal broking services on derivatives markets (i.e., domestic stock exchanges or domestic multilateral trading systems on or in which derivatives are traded) for other members of these markets or trading systems, provided that clearing members of these markets or trading systems are liable for the fulfilment of these trades.
- There is an exemption for enterprises engaging in execution of orders on behalf of clients, dealing on own account, transmission of client’s orders and investment advice only in relation to derivatives, provided that these services are ancillary to the main activity and are provided only for customers of the main activity in connection with that main activity. It aims to allow companies that are engaged in commodities trading (e.g., energy companies) to offer hedging products to their customers.

### **Japan**

- The definition of “Financial Instruments Business” excludes all OTC Derivative Transactions (excluding Securities-Related OTC Derivative Transactions) with professional investors, such as the persons who are regarded as having expert knowledge of and experience with Derivative Transactions or the stock companies whose amounts of stated capital are not less than JPY 1 billion yen, and activities to provide intermediary, brokerage, or agency for OTC Derivative Transactions on behalf of these professional investors.

### *Requirements Tailored for DMIs*

Recommendation 2 of the DMI Standards provides that registration or licensing requirements applicable to DMIs should be tailored to OTC derivatives activities.

Authorities were asked whether, if DMIs were subject to a registration or licensing regime, that regime was tailored to DMIs<sup>28</sup>.

Among the 15 jurisdictions that indicated they have DMI registration and/or licensing requirements, eight jurisdictions<sup>29</sup> indicated that these requirements are tailored to DMIs.

Of the five<sup>30</sup> jurisdictions that indicated they have public proposals to introduce registration and/or licensing requirements for DMIs, all five had public proposals for tailored regimes.

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<sup>28</sup> Authorities were asked whether the licensing that DMIs were subject to was tailored to DMIs, notwithstanding that the DMI Standards do not require registration or licensing requirements to be tailored to DMIs, but rather to OTC derivatives activities.

<sup>29</sup> Hong Kong SFC, Japan FSA, Korea FSC/FSS, New Zealand FMA, Quebec AMF, Singapore MAS, Spain CNMV and US CFTC.

<sup>30</sup> Ontario OSC, Quebec AMF, Singapore MAS, South Africa FSB and US SEC.

Ten<sup>31</sup> jurisdictions indicated they have no public proposals in place to develop tailored regimes for DMIs<sup>32</sup>.

#### *Information Required for Licensing of DMIs*

Recommendation 3 of the DMI Standards provides that the registration or licensing of DMIs should establish minimum standards and require DMIs to provide regulators with updated information with respect to their OTC derivatives activities in order to assist regulators in determining whether registration or licensing should be granted and/or revoked. In addition, Recommendation 3 provides that all registering or licensing authorities should have the power to grant or reject and suspend or withdraw the registration or licence of DMIs.

Authorities were asked whether DMIs were subject to requirements to provide and update information to regulatory authorities to assist the authority in determining whether registration/licenses should be granted or revoked. Authorities were also asked whether regulatory authorities had the power to grant, reject, suspend or withdraw the registration/license of DMIs registered/licensed by the authority.

Eighteen jurisdictions<sup>33</sup> indicated that DMIs are subject to requirements to provide and update information to the regulatory authority to assist the authority in determining whether registration or a license should be granted or revoked, and two<sup>34</sup> have proposed to introduce related changes to their regimes.

Further, the responses indicated that the regulatory authorities in these 18 jurisdictions all have the powers to grant, reject, suspend or withdraw the registration or license of DMIs registered or licensed by them. Three<sup>35</sup> jurisdictions that are in the process of developing new regimes stated they have proposals introducing similar provisions.

#### *Information on Licensed DMIs be Made Publicly Available*

Recommendation 4 of the DMI Standards provides that relevant material information on licensed or registered DMIs should be made publicly available.

Authorities were asked whether relevant material information about registered or licensed DMIs was made publicly available.

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<sup>31</sup> Australia ASIC, Brazil CVM, France AMF, Italy CONSOB, Israel ISA, Germany BaFin, Netherlands AFM, Pakistan SECP, Switzerland FINMA and UK FCA.

<sup>32</sup> However no public proposals to develop regimes tailored to DMIs does not indicate that these jurisdictions have not implemented, or do not plan to implement, recommendation 2 of the DMI Standards, which does not require registration or licensing to be tailored to DMIs, but to OTC derivatives activities.

<sup>33</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Israel ISA, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>34</sup> Ontario OSC and US SEC.

<sup>35</sup> South Africa FSB, Ontario OSC and US SEC.

Seventeen jurisdictions<sup>36</sup> indicated that relevant material information about registered and/or licensed DMIs is publicly available. Responses provided that information is not made public in Korea or New Zealand, and there are no anticipated regulatory reforms to change this. The US SEC is developing their regulatory regime and stated they have proposed that information collected on registration forms would be made publicly available.

### *Home/Host Regulation*

Recommendation 5 of the DMI Standards takes into account the international nature of OTC derivatives markets. It provides that if a DMI (registered/licensed in its home jurisdiction) is able to conduct derivatives business in another jurisdiction without a licence, the host market authority should ensure that appropriate supervisory arrangements are in place for the OTC business carried on.

The recommendation goes on to provide that these arrangements should take into account how the DMI is supervised in the host jurisdiction and any home/host co-operative arrangements. Further, the DMI Standards provide that market authorities should co-operate to identify overlaps, conflicts and gaps between jurisdictions with respect to cross-border supervision and jurisdictions should co-ordinate approaches via multilateral or bilateral channels to reduce overlaps, conflicts and gaps.

The Questionnaire asked authorities whether they allowed DMIs that were registered/licensed in their home jurisdiction, to carry on DMI activities in that authorities' jurisdiction without being licensed or registered in that jurisdiction. If they did permit this activity they were further asked:

- Whether they had arrangements in place to supervise the DMI activities carried on by such DMIs in their jurisdiction;
- Whether their arrangements took into account how the DMI was supervised in its home jurisdiction, including cooperation arrangements between home and host regulatory authorities; and
- Whether such arrangements included identification of overlaps, conflicts and gaps between jurisdictions with respect to cross-border issues relating to DMI supervision to ensure that the DMI is adequately regulated in the host jurisdiction (including arrangements to coordinate approaches).

Eleven jurisdictions<sup>37</sup> responded that they allow DMIs that are registered or licensed in their home jurisdictions to carry on DMI activities in the host jurisdictions without being licensed

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<sup>36</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Israel ISA, Japan FSA, Netherlands AFM, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, the UK FCA and US CFTC.

<sup>37</sup> Australia ASIC, France AMF, Germany BaFin, Italy CONSOB, Netherlands AFM, Ontario OSC, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA and UK FCA.

or registered. Nine other jurisdictions<sup>38</sup> do not permit DMIs to operate in their jurisdiction without being locally registered or licensed.

Of the 11 host jurisdictions<sup>39</sup> that indicated they allow DMIs to operate based on home registration or licensing, all of them indicated that they have arrangements in place to supervise the activities carried on by such DMIs and arrangements that take into account how the DMI is supervised in its home jurisdiction. This includes cooperation arrangements between regulatory authorities.

Of these 11 jurisdictions, nine jurisdictions<sup>40</sup> indicated that they have arrangements to identify overlaps, conflicts and gaps between jurisdictions and co-ordinate with respect to cross-border issues relating to DMI supervision to ensure that the DMI is adequately regulated in the host jurisdiction. Note that Spain has provisions that partially address this, while the Netherlands does not have any.

#### 4.4 Capital Requirements

The DMI Standards recognise that the maintenance of adequate capital standards by DMIs and the imposition of appropriate margin requirements to OTC derivatives transactions involving DMIs are essential mechanisms to better ensure that OTC derivatives markets operate soundly.

##### *Financial Resources Requirements for DMIs*

Recommendation 6 of the DMI Standards provides that market authorities should consider imposing some form of capital or other financial resources requirements for DMIs that are not prudentially regulated and that reflect the risks that these intermediaries undertake.

Authorities were asked whether their jurisdiction imposed any form of capital or other financial resource requirements on DMIs that are not prudentially regulated in their jurisdiction, and whether these requirements were tailored to DMIs<sup>41</sup>.

Fourteen jurisdictions<sup>42</sup> stated that their jurisdictions impose some form of capital or other financial resources requirements for DMIs that are not prudentially regulated, and six<sup>43</sup> jurisdictions do not.

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<sup>38</sup> Brazil CVM, Hong Kong SFC, Israel ISA, Japan FSA, Korea FSC/FSS, New Zealand FMA, Pakistan SECP, South Africa FSB and US (CFTC/US SEC).

<sup>39</sup> Australia ASIC, France AMF, Germany BaFin, Italy CONSOB, Netherlands AFM, Ontario OSC, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA and UK FCA.

<sup>40</sup> Australia ASIC, France AMF, Germany BaFin, Italy CONSOB, Ontario OSC, Quebec AMF, Singapore MAS, Switzerland FINMA and UK FCA

<sup>41</sup> Authorities were asked this question notwithstanding that the DMI Standards do not require capital or other financial resource requirements to be tailored to DMIs, but rather to reflect the risks that these intermediaries take.

<sup>42</sup> Australia ASIC, France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Quebec AMF, Singapore MAS, Spain CNMV and UK FCA.

Of these 14, 11 jurisdictions<sup>44</sup> stated that these requirements are tailored to DMIs and the other three<sup>45</sup> indicated their requirements were not tailored to DMIs<sup>46</sup>.

Five jurisdictions<sup>47</sup> are proposing modifications to their frameworks to either introduce, or tailor, capital requirements and five<sup>48</sup> have no changes planned.

Jurisdictions proposing changes to capital requirements include:

- **Ontario and Quebec** - On 18 April, 2013 the CSA Committee published the Registration Paper<sup>49</sup> which outlined the proposed Canadian registration regime for DMIs. The consultation paper recommended that capital requirements be imposed on and tailored for DMIs. The CSA Committee is expected to publish a consultation paper on capital and collateral in 2016.
- **South Africa** - The regulations and notices applicable to capital requirements were released these for public comments during the third quarter of 2014. The FSB aim to finalize and implement regulations and notices during 2015.
- **US** – The CFTC has proposed a capital rule for swap dealers and is in the process of developing a framework establishing minimum standards for margin requirements for non-centrally cleared derivatives. The US SEC has also proposed capital rules for security-based swap dealers.

In broad terms, most jurisdictions have a minimum or base capital requirement stipulated. The capital adequacy framework varies across the respondents between a Net Capital Requirement (“NCR”) and a Basel or other equivalent approach.

It is worth noting that various jurisdictions will begin implementing requirements consistent with the BCBS-IOSCO Principles for Margin Requirements (“Principles”) for non-centrally cleared derivatives. Some jurisdictions already impose an exchange of collateral for non-centrally cleared transactions. This exchange of collateral is mostly variation margin, though initial margin exchanges are also required in some situations.

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<sup>43</sup> Brazil CVM, Israel ISA, Pakistan SECP, South Africa FSA, Switzerland FINMA, United States (CFTC/US SEC)

<sup>44</sup> France AMF, Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Singapore MAS, Spain CNMV and UK FCA.

<sup>45</sup> Australia ASIC, Ontario OSC, Quebec AMF.

<sup>46</sup> However no public proposals of this nature does not indicate that these jurisdictions have not implemented, or do not plan to implement, recommendation 6 of the DMI Standards, which does not require capital or other financial resources to be tailored to DMIs, but rather to reflect the risks that these intermediaries take.

<sup>47</sup> Hong Kong SFC, Ontario OSC, Quebec AMF, South Africa FSA and US (CFTC/US SEC).

<sup>48</sup> Australia ASIC, Brazil CVM, Israel ISA, Pakistan SECP and Switzerland FINMA.

<sup>49</sup> Canadian Securities Administrators Consultation Paper 91-407, Derivatives: Registration.

Rule writing and implementation of the margin principles is likely to take some time. The current BCBS-IOSCO staggered implementation timelines for initial margin commences September 2016 and extends to September 2020. The staggered implementation timeline for variation margin is September 2016 to March 2017.

#### **4.5 Business Conduct Standards and Segregation**

The DMI Standards recognise that business conduct standards are important to prevent improper behaviour and should be extended to DMIs.

##### *Business Conduct Standards*

Recommendation 7 of the DMI Standards provides that DMIs should be subject to business conduct standards, which would include prohibitions against fraud, misrepresentation, manipulation and other abusive practices.

Recommendation 8 of the DMI Standards provides that business conduct requirements should be tailored for the OTC derivatives market. Such requirements could be based on the reasonable assessment of the nature of the party dealing with a DMI or on the complexity of the specific product.

Authorities were asked whether their jurisdictions imposed business conduct standards on DMIs and if they were, whether those requirements were tailored to DMIs and for the OTC derivatives market<sup>50</sup>.

Where there were standards, authorities were asked whether they included prohibitions on fraud, misrepresentation, manipulation and other abusive practices.

Nineteen<sup>51</sup> jurisdictions responded that they impose business conduct standards on DMIs and that such requirements include prohibitions on a) fraud; b) misrepresentation and c) manipulation or other abusive practices. Although not specifically covered in the Questionnaire, certain jurisdictions responding to the Questionnaire may have requirements related to fraud and misconduct prohibitions that already apply broadly to all persons as part of the regulatory framework, without the need for specific provisions relating to DMIs.

Out of the 19 jurisdictions which reported business conduct standards, nine jurisdictions<sup>52</sup> indicated the requirements are tailored to DMIs and the OTC derivatives markets<sup>53</sup>.

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<sup>50</sup> Authorities were also asked whether business conduct requirements were tailored to DMIs and the OTC derivatives market, notwithstanding that the DMI Standards do not require conduct requirements to be tailored to DMIs, but just to the OTC derivatives market.

<sup>51</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>52</sup> Germany BaFin, Hong Kong SFC, Italy CONSOB, Japan FSA, Korea FSC/FSS, Singapore MAS, Spain CNMV, the UK FCA and US CFTC.



Seven jurisdictions<sup>54</sup> are proposing changes to this area of business conduct rules as they amend their regimes.

For example:

#### **Australia**

- In Australia, licensees must comply with the general licensing obligations (including the obligations to provide financial services honestly, efficiently and fairly, comply with financial services laws, including prohibitions on misleading and deceptive conduct and dishonesty, and have adequate risk management systems). Although certain requirements, such as for risk management systems, are not tailored they must be adapted to the scale, nature and complexity of their financial services business and therefore such requirements are applied to each licensee in a way that reflects the type of financial services business operated.

#### **Hong Kong**

- A similar approach is taken in Hong Kong whereby only the Core Operational and Financial Risk Management Controls for OTC Derivatives Activities of Persons Licensed by or Registered with the SFC are tailored to DMIs and for the OTC derivatives market. Other business conduct requirements are not specific to DMIs, they are principle-based and apply to licensed corporations in a manner commensurate with their size, nature of business, complexity of operations and risk profile.

### *Segregation and Portability*

Recommendation 9 of the DMI Standards provides that for centrally cleared OTC derivatives transactions, DMIs should segregate collateral belonging to clients from their own proprietary assets and employ an account structure that enable the efficient identification and segregation of positions and collateral belonging to DMI clients. Recommendation 9 further provides that, where possible, DMIs should have in place procedures to facilitate the rapid transfer of porting of cleared client positions and collateral.

Authorities were asked in the Questionnaire whether their jurisdiction imposed requirements for DMIs to identify positions and segregate client collateral from their own proprietary assets. In addition, the Questionnaire asked whether there were requirements for DMIs to implement procedures to facilitate rapid transfer or porting of cleared client positions and collateral.

The same 19 jurisdictions that impose business conduct standards on DMIs also impose requirements for DMIs to identify positions and segregate client collateral from their own

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<sup>53</sup> This does not indicate that these jurisdictions have not implemented, or do not plan to implement, recommendation 8 of the DMI Standards, which do not require business conduct standards to be tailored to DMIs, but rather to the OTC derivatives market.

<sup>54</sup> Australia ASIC, Hong Kong SFC, Ontario OSC, Quebec AMF, South Africa FSB, Switzerland FINMA and US SEC.

proprietary assets and 13 jurisdictions<sup>55</sup> provide for rapid porting or transfer of client assets. Again, the US SEC and South Africa indicated that regulations have been proposed. While Ontario and Quebec already have requirements in place in respect of segregation, they are also proposing regulatory amendments regarding both segregation and portability.

#### **4.6 Business Supervision Standards**

The DMI Standards recognise that to effectively manage risks, DMIs should have adequate internal supervisory structures to monitor risk across all business activities, including appropriate governance, compliance, supervisory, competency and risk management systems.

For most questions, the majority of jurisdictions indicated they had relevant supervisory and corporate governance requirements in place, as outlined below. . Notwithstanding the largely positive response, five jurisdictions<sup>56</sup> indicated that they had public proposals to develop their frameworks. For instance, South Africa and the US SEC indicated that they have proposals for their regimes that are relevant to supervision.

##### *Corporate Governance*

Recommendation 10 of the DMI Standards provides that DMIs should be required to have effective corporate governance frameworks designed to ensure appropriate management of OTC derivatives activities within the DMI.

Respondents were asked whether there were requirements for DMIs to have effective corporate governance frameworks, and if so, were those requirements (i) tailored to DMIs and (ii) were they designed to ensure appropriate management of OTC derivatives activities within the DMI.

Nineteen jurisdictions<sup>57</sup> indicated that they impose requirements for DMIs to have effective corporate governance frameworks designed to ensure appropriate management of OTC derivatives activities within the DMI.

##### *Supervision*

Recommendation 11 of the DMI Standards provides that DMIs should be required to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their representatives.

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<sup>55</sup> Brazil CNMV, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AMF, Singapore MAS, Spain CVNM, UK FCA and US CFTC.

<sup>56</sup> Hong Kong SFC, Ontario OSC, Quebec AMF, South Africa FSB and US SEC.

<sup>57</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

Authorities were asked whether their jurisdiction imposed requirements for DMIs to design supervisory policies and procedures to manage the OTC derivatives operations and activities of their representatives.

The 19 jurisdictions<sup>58</sup> that indicated that they impose requirements for DMIs to have effective corporate governance frameworks also indicated that they impose requirements for DMIs to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their representatives.

### *Risk Management*

Recommendation 12 of the DMI Standards focuses on risk management systems. It provides that DMIs should be required to maintain risk management systems to properly identify and manage their OTC derivatives related business risks.

Respondents were asked whether their jurisdiction imposed requirements for DMIs to maintain risk management systems to properly identify and manage OTC derivative related business risks.

Nineteen jurisdictions<sup>59</sup> indicated that they impose requirements for DMIs to maintain risk management systems to properly identify and manage OTC derivative related business risk. Again, the US SEC and South Africa indicated that regulations have been proposed.

### *Compliance and Competency*

Recommendation 13 of the DMI Standards provides that DMIs should have policies, procedures and systems of control sufficient to provide reasonable assurance that the DMI is competent and complies with applicable regulatory standards and the DMI's internal policies and procedures. Jurisdictions were therefore asked whether they imposed requirements for DMIs to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable assurance that DMIs were competent and complied with applicable regulatory standards and the DMIs internal policies and procedures, and also to ensure that each person acting on the DMIs behalf was competent and complied with applicable regulatory standards and internal policies and procedures.

All 19 jurisdictions<sup>60</sup> indicated that they had requirements in place for such policies and procedures. As with other questions, Ontario indicated that once its planned legislation becomes effective there would be additional and/or new requirements for DMIs.

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<sup>58</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>59</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>60</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC,

## *Business Continuity*

As part of managing key business risks, Recommendation 14 provide that DMIs should be required to develop and maintain an effective business continuity plan which is tailored to the DMI's size, risks and the nature of its operations, to allow them to mitigate, respond to and recover from business disruption or disasters.

Authorities were asked whether their jurisdiction imposed requirements on DMIs to develop and maintain effective business continuity plans were tailored to the DMI's size, risk and nature of its operations.

Fourteen jurisdictions<sup>61</sup> indicated that they imposed requirements for DMIs to develop and maintain these tailored business continuity plans ("BCPs") and seven<sup>62</sup> indicated they did not, or there was no response.

## *Developments Underway*

The Questionnaire asked if jurisdictions which do not yet have this type of requirement had any plans to implement requirements regarding governance, risk management, compliance and/or business continuity. Five<sup>63</sup> jurisdictions indicated that they had related proposals.

For example:

### **Ontario and Quebec**

- The CSA's Registration Paper sets out proposals affecting both Ontario and Quebec. The CSA proposes additional requirements for OTC derivatives, including in relation to requiring registrants to establish, maintain and apply systems, policies and procedures that establish robust compliance and risk management systems, appropriate for their derivatives business, and require the registrant to appoint and register an ultimate designated person who will be the individual responsible for conduct and supervision of the derivative trading or advising operations of the entity.

### **Hong Kong**

- In Hong Kong, the plans for additional risk management and risk mitigation requirements specific to DMIs are contained in the code of conduct as well as in revisions of the Derivative Control Mechanisms which will be incorporated into the new requirements.

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Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>61</sup> France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Netherlands AFM, Ontario OSC, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>62</sup> Australia ASIC, Brazil CVM, Korea FSC/FSS, New Zealand FMA, Pakistan SECP, South Africa and US SEC.

<sup>63</sup> Hong Kong SFC, Ontario OSC, Quebec AMF, South Africa FSB and US SEC.

## 4.7 Record-keeping Standards

The DMI Standards address the need for appropriate record-keeping to allow market authorities to gain an accurate view of the DMI activities and for efficient and organised interactions with market participants.

Recommendation 15 of the DMI Standards provides that DMIs should be required to retain OTC derivatives transaction records and be able to provide them in a timely, organised and readable manner. Recommendation 15 further provides that the record retention period for OTC derivatives transactions should apply for a specified period after termination/maturity or adjustment of the trade.

Authorities were asked whether their jurisdiction imposed requirements for DMIs to retain OTC derivative transaction records in a timely, organised and readable manner, and whether there was a requirement for DMIs to provide these transaction records to the relevant authority.

Nineteen jurisdictions<sup>64</sup> answered that they impose requirements for DMIs to retain OTC derivatives transaction records in a timely, organised and readable manner.

The Questionnaire also asked whether there were requirements for DMIs to provide OTC derivative transaction records to the relevant authorities. Of the respondents that impose some form of requirements for DMIs to retain OTC derivatives transaction records, 17 jurisdictions<sup>65</sup> indicated that they impose requirements for DMIs to provide OTC derivatives transaction records to the relevant authorities.

The remaining two respondents<sup>66</sup> indicated that they do not impose such requirements.

### *Developments Underway*

Six<sup>67</sup> respondents indicated that they have proposed requirements to retain OTC derivative transaction records.

Ontario and Quebec have recently imposed requirements for DMIs to retain OTC derivatives transaction records that are tailored to DMIs. Ontario also indicated that it will impose requirements for DMIs to provide these OTC derivatives transaction records to the relevant authority.

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<sup>64</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, New Zealand FMA, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, Switzerland FINMA, UK FCA and US CFTC.

<sup>65</sup> Australia ASIC, Brazil CVM, France AMF, Germany BaFin, Hong Kong SFC, Israel ISA, Italy CONSOB, Japan FSA, Korea FSC/FSS, Netherlands AFM, Ontario OSC, Pakistan SECP, Quebec AMF, Singapore MAS, Spain CNMV, UK FCA and US CFTC.

<sup>66</sup> New Zealand FMA and Switzerland FINMA.

<sup>67</sup> Hong Kong SFC, Ontario OSC, Quebec AMF, South Africa FSB, Switzerland FINMA and US SEC.

## **Attachment A**

### **International Standards for Derivatives Market Intermediary Regulation**

#### Recommendation 1:

DMIs should generally include those who are in the business of dealing, making a market or intermediating transactions in OTC derivatives. However, DMIs should not include end-users and market participants<sup>68</sup> who enter into OTC derivatives transactions but are not engaged in the business of dealing, making a market or intermediating transactions. DMIs should be subject to registration or licensing and applicable substantive regulations and/or requirements and standards once registered or licensed in some form by the relevant market authority or authorities, recognizing that in certain limited circumstances full application of substantive regulations and/or requirements and standards may not be appropriate for certain types of entities.

#### Recommendation 2:

Registration or licensing requirements applicable to DMIs should be tailored to OTC derivatives activities.

#### Recommendation 3:

The registration or licensing of DMIs should establish minimum standards and require DMIs to provide and update information with regard to their OTC derivatives activities to regulators to assist them in determining whether registration or license should be granted and/or revoked. All registering or licensing authorities should have the power to grant or reject and suspend or withdraw the registration or license of DMIs registered or licensed by such authority.

#### Recommendation 4:

Relevant material information on licensed or registered DMIs should be made publically available.

#### Recommendation 5:

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<sup>68</sup> Such as funds and asset management companies when they exclusively operate on behalf of a fund.

If a DMI registered or licensed in its home jurisdiction is carrying on OTC derivatives business in another jurisdiction in which the DMI is not registered or licensed, the market authority of the host jurisdiction in which the DMI is carrying on business should ensure that there are appropriate supervisory arrangements in place for the OTC derivatives business carried on by that DMI. These arrangements should take into account how the DMI is supervised in the host jurisdiction and any cooperative arrangements in place between the market authorities of the home and host jurisdictions. Market authorities should closely cooperate to identify overlaps, conflicts and gaps between jurisdictions with respect to cross-border issues relating to DMI supervision and to ensure that the DMI's activities in the host jurisdiction are adequately supervised. It is further recommended that jurisdictions coordinate their approaches via multilateral or bilateral channels to reduce overlaps and conflicts, to the extent possible.

Recommendation 6:

Market authorities should consider imposing some form of capital or other financial resources requirements for DMIs that are not prudentially regulated that reflect the risks that these intermediaries undertake.

Recommendation 7:

DMIs should be subject to business conduct standards. These standards would include, among other things, prohibitions against fraud, misrepresentation, manipulation and other abusive practices.

Recommendation 8:

Business conduct requirements should be tailored, as appropriate, for the OTC derivatives market. This could be based on the reasonable assessment of the nature of the party dealing with a DMI or on the complexity of and the risk associated with the specific OTC derivatives market product or service.

Recommendation 9:

For cleared OTC derivatives transactions, DMIs should segregate collateral belonging to clients from their own proprietary assets and employ an account structure that enables the efficient identification and segregation of positions and collateral belonging to DMI clients. Where applicable and possible, DMIs should have in place procedures to facilitate the rapid transfer or porting of cleared client positions and collateral.

Recommendation 10:

DMIs should be required to have effective corporate governance frameworks designed to ensure appropriate management of OTC derivatives activities within the DMI.

Recommendation 11:

DMIs should be required to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their representatives.



Recommendation 12:

DMIs should be required to maintain risk management systems and organization to properly identify and manage their OTC derivatives related business risks.

Recommendation 13:

DMI's management should be required to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and procedures.

Recommendation 14:

DMIs should be required to develop and maintain an effective business continuity plan, based on their size, risks, and the nature of their operations, to allow them to mitigate, respond to and recover from business disruptions or disasters.

Recommendation 15:

DMIs should be required to retain OTC derivatives transaction records and be able to provide them in a timely, organized and readable manner. The record retention period for OTC derivatives transactions should apply for a specified period after its termination, maturity or assignment.