FINANCIAL MARKETS LAW COMMITTEE
DISCUSSION PAPER

COORDINATION IN THE REFORM OF INTERNATIONAL FINANCIAL REGULATION

Addressing the Causes of Legal Uncertainty

February 2015

FINANCIAL MARKETS LAW COMMITTEE

This discussion paper has been prepared by the FMLC Secretariat.[1]

In preparing this paper, the Secretariat drew on meetings and discussions with stakeholders and national authorities in the UK, US, EU, Japan, Hong Kong, Switzerland and Australia.[2]

Given the involvement of the UK authorities in the reform programme, Sean Martin, Graham Nicholson and Stephen Parker took no part in the preparation or discussion of this paper and it should not be taken to represent the views of the Bank of England, the Financial Conduct Authority, HM Treasury or the Prudential Regulation Authority.

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PREFACE

The role of the Financial Markets Law Committee (the "FMLC") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.[3]

In October 2012, the FMLC initiated a series of seven panel discussions and seminars to examine the inter-jurisdictional aspects of countries' implementation of certain G20 commitments in the field of financial services regulation and the possibility that divergent implementation may give rise to uncertainty in the legal framework of the global financial markets. The series was introduced by a discussion, led by then Commodity Futures Trading Commission (the "CFTC") Chairman Gary Gensler and European Director General of Internal Markets Jonathan Faull, of mutual recognition as a key—if occasionally controversial—element in the regulatory world order. More recently, the FMLC was pleased to host a seminar on the subject of International Regulation and Cooperation in the Post-Crisis Environment given, *inter alios*, by Financial Stability Board (the "FSB") Deputy Secretary General, Rupert Thorne. This series provided a forum within which market participants, professionals and regulators alike were able to discuss whether anything more might be done to facilitate the effective and efficient implementation in national law of G20 commitments. It is against this background that several stakeholders raised with the FMLC the suggestion that a discussion paper could usefully be produced to foster debate and a wider consideration of the issues. This paper has been developed by the FMLC in response to those suggestions.

3 Information regarding the FMLC, and examples of its work, are available on its website at www.fmlc.org.

1 EXECUTIVE SUMMARY

1.1 Overview

In Pittsburgh in 2009, the G20 adopted core recommendations for strengthening global financial stability—among them, recommendations on regulatory reform in the areas of capital requirements, OTC derivatives, compensation, accounting standards and bank resolution. Five years later on, the G20 and the FSB are justifiably proud of all that has been accomplished in building a more resilient financial system populated by more robust institutions and served by more transparent and orderly markets.

There can be no doubt, however, that the FSB, other international standard-setters and national regulators have encountered challenges in implementing the Pittsburgh commitments.[4] Overlaps, inconsistencies and conflicts have emerged between respective national rules contributing at times to the impression that the regulatory and legal framework which supports the financial markets is beset by legal uncertainty. Examples of these inconsistencies—and the legal uncertainties to which they give rise—are set out in detail in the annex to this discussion paper (the "Annex").

In the sections of the discussion paper which precede the Annex, the FMLC explores options to strengthen the structural and procedural mechanisms that implement the G20's political commitments with a view to addressing legal uncertainty in the global wholesale financial markets. The sections below examine (i) the challenges facing consistent implementation of G20 commitments; (ii) the factors which contribute to these challenges; and (iii) proposals for possible solutions.

1.2 Progress and challenges

Commitments made at a subsequent G20 Summit, held in London in 2009 (the "London Summit"), resulted in, amongst other things, the establishment of the FSB to facilitate international efforts to build consistency. Considerable progress has been made by the FSB, other international standard-setters, national regulators and supervisors towards the ideal of regulatory consistency and systematic cooperation, but challenges remain. For example, deadlines and timetables have proved difficult to meet and/or subject to a failure of coordination. Countries have legislated unilaterally in advance of international principles or

4 Rather than refer separately to supranational regulators (e.g. in the case of the EU), the term "national" is used in this paper for simplicity.

standards. Approaches to important issues such as "equivalence" or "substituted compliance" differ across countries. Gaps and overlaps have emerged between jurisdictional requirements.

In his letter of November 2014 to G20 Leaders, the Chair of the FSB, Mark Carney, accepted the need for further work by the FSB on aligning the national implementation of G20 commitments, announcing that, from next year, the FSB will begin "an annual reporting process on implementation".[5]

1.3 Contributing factors

The FMLC and its stakeholders have identified the following as some of the key factors contributing to the challenges facing policymakers and regulators:

- discontinuity in the G20 handover process;
- reticence of governments to follow through on specific G20 commitments or international principles;
- constraints imposed by domestic legislative processes;
- the effects of any tendency towards super-equivalence or "gold-plating";
- a lack of consensus regarding consistency and comparability assessments;
- limits on the powers of international bodies;
- concerns regarding regulatory cooperation, supervision and enforcement; and
- a lack of a formal grievance procedure.

These are discussed further in Section 3 below.

1.4 Proposals

The ways in which legal uncertainties and inconsistencies in the implementation of international financial regulatory reforms could be ameliorated are considered in Section 4 of this discussion

[5] The FSB Chair's Letter to G20 Leaders for the Brisbane Summit, Financial Stability Board, 7 November 2014, available at: http://www.financialstabilityboard.org/wp-content/uploads/FSB-Chair's-Letter-to-G20-Leaders-on-Financial-Reforms-Completing-the-Job-and-Looking-Ahead.pdf, p. 5.

paper. Among them are the following proposals, which have surfaced in discussions with stakeholders:

- formalising early multilateral discussion and consultation among regulators and standard-setters;
- early and ongoing engagement with national legislatures;
- further development of the G20 commitments and phased timetable set between the G20 and the FSB;
- common principles regarding consistency and assessments of comparability to set benchmarks for the determination of regulatory recognition;
- a permanent G20 secretariat;
- multilateral understandings regarding supervision and enforcement; and
- a formal dispute resolution procedure.

These suggested proposals seek to address factors contributing to a lack of harmonisation in the implementation of financial commitments and resulting legal uncertainties and inconsistencies. Key examples of such legal uncertainties and inconsistencies in the implementation of core issues in the G20 reforms are set out in the Annex.

2 PROGRESS AND CHALLENGES

The London Summit saw the G20 nations agreeing to

> establish the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires.[6]

In the same year, the FSB inherited the role of the Financial Stability Forum (the "FSF"), with an extended mandate to promote international financial stability by coordinating national financial authorities and international standard-setting bodies in developing regulatory, supervisory and other financial sector policies. The objective of the FSB is to encourage

[6] The European Commission, *G20 London Summit: Official Communique* (2 April 2009), EC09-068EN, available at: http://www.eu-un.europa.eu/articles/en/article_8622_en.htm, para. 14.

"coherent implementation of these policies across sectors and jurisdictions".[7] Broadly speaking, the FSB's role is to promote the reform of international financial regulation according to an agenda set by the G20.[8] One might say that it is, to that extent, the agency through which the G20 achieves the implementation of its commitments.

2.1 Assessing progress on key G20 commitments

Assessing progress on G20 commitments is itself a difficult task, in view not only of their breadth but also of the scale and geographical scope of the financial markets. Undoubtedly a great deal has been achieved. As recently as 7 November 2014, the Chair of the FSB wrote to G20 Leaders to state that "progress has been made across all policy areas… so that the job is now substantially complete".[9] One notable example of recent success is the progress made by the Basel Committee on Banking Supervision (the "BCBS") and other authorities in developing and adopting capital/liquidity frameworks for financial institutions, where the BCBS reports that it has "largely completed its post-crisis reform agenda".[10] Another area where considerable progress has been made is regulation on capital requirements for non-centrally cleared derivatives and trade reporting requirements, where international regulatory standards have been at least partly implemented in more than three-quarters of FSB member jurisdictions.[11]

However, as progress reports published by the FSB since 2009 demonstrate, implementation of the other G20 commitments remains piecemeal and the level of consistency across countries depends on the extent to which national legislatures are willing to align their own priorities with the commitments:

- Resolution and recovery of Globally Systemically Important Financial Institutions ("GSIFIs"). Many jurisdictions continue to face difficulties in meeting objectives or timetables for developing measures for the resolution of GSIFIs—e.g. the adoption of "bail-in" powers, powers for cross-border cooperation and the recognition of resolution actions in other jurisdictions. The FSB has recently presented proposals on the cross-

7 The FSB, "About the FSB", available at: http://www.financialstabilityboard.org/about/.

8 The FSB "Charter of the Financial Stability Board" (adopted 25 September 2009, amended and restated on 19 June 2012), available at: http://www.financialstabilityboard.org/publications/r_120809.pdf, Articles 1 and 2.

9 The FSB Chair's Letter to G20 Leaders for the Brisbane Summit, see footnote 5, p. 5.

10 The BCBS, *Implementation of Basel Standards* (November 2014), available at: https://g20.org/wp-content/uploads/2014/12/implementation_basel_standards.pdf, p. 11.

11 The FSB, *OTC Derivatives Market Reforms Eighth Progress Report on Implementation* (7 November 2014), available at: http://www.financialstabilityboard.org/2014/11/eighth-progress-report-on-implementation-of-otc-derivatives-market-reforms/.

border recognition of resolution actions and on the new standards for "total loss-absorbing capacity";

- "Shadow banking". International bodies and national authorities are facing challenges in collecting and sharing data to assess risks with regard to non-bank financial entities in many jurisdictions. The FSB has noted some improvement, however, in the level of interconnectedness between the banking sector and the non-bank financial system in a recent global monitoring report, which concluded that, overall, the level of exposures across jurisdictions by banks to non-banks and *vice versa* declined in 2013;[12]

- OTC derivatives reforms. The FSB has reported that several practical implementation issues have emerged that, if unresolved, have the potential to impede the effectiveness of reforms in meeting the G20 objectives with regards to cross-border OTC derivatives markets, particularly those reforms intended to achieve: (i) improved transparency; (ii) mitigation of systemic risk; and (iii) protection from market abuse. A primary concern for many authorities and market participants has been to ensure that regulatory requirements are implemented in a consistent and coordinated fashion across jurisdictions, given the highly complex, cross-border nature of OTC derivatives markets. National authorities continue to work through these issues, complemented by a number of multilateral workstreams. Other implementation issues have been noted, for example, regarding the usability of data reported to trade repositories and the concentration of intermediaries providing clearing services and access to central clearing;

- Reliance on Credit Rating Agency ("CRA") ratings. The FSB and international bodies are facing challenges in developing approaches to reduce reliance on ratings published by credit rating agencies and progress in this regard has been described as "patchy".[13] For example, there is an implicit discontinuity between the Basel standards, which refer to ratings when assessing the credit-worthiness of instruments, and the Dodd-Frank Act which moves away from reference or reliance on ratings;

- Accounting. In 2013, the FSB called on the International Accounting Standards Board (the "IASB") and Financial Accounting Standards Board (the "FASB") to reconcile major convergence issues, especially the development of a common model for loan impairment provisioning. The FSB also required both boards to report by mid-2013 on

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12 The FSB, *Global Shadow Banking Monitoring Report 2014* (31 October 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_141030.pdf, pp. 24-27.

13 The FSB Secretariat, *Progress in implementing the G20 Recommendations on Financial Regulatory Reform* (5 September 2013), available at: http://www.financialstabilityboard.org/publications/r_130905b.pdf, p. 8.

all outstanding convergence projects and gave a specified time for their completion. Despite strong statements by G20 Leaders, historically, accounting convergence has proved difficult to achieve despite the efforts of standard setters such as the IASB and the FASB. In the latest G20 Sydney Summit 2014 (the "Sydney Summit"), there were no longer calls for accounting convergence. The International Federation of Accountants has issued a letter to the G20 outlining eight recommendations for the G20 to consider at the G20 Leaders' Summit; and

- Obstacles regarding data exchange. Several of the FSB's on-going efforts, including the Data Gaps Initiative (which works to develop a common data template for Global Systemically Important Banks ("GSIBs") to address key information gaps)[14] and the resolution and recovery planning mandated by the FSB, are hampered by legal and practical obstacle considerations regarding confidentiality and data transfer.

Many of the issues identified by the FSB could be dealt with by increased consistency and cooperation across jurisdictions. In his letter to G20 Leaders meeting at the G20 Brisbane Summit 2014 (the "Brisbane Summit") in November 2014, the Chair of the FSB accepted the need for further work by the FSB on aligning the national implementation of G20 commitments, announcing that, from next year, the FSB will begin "an annual reporting process on implementation".[15]

2.2 Improving consistency in implementation

Standing Committees

Since the establishment of the FSB, various standing committees have been established within the FSB to promote international cooperation and consistency in implementation, including committees on Standards Implementation ("SCSI") and Supervisory and Regulatory Cooperation ("SCSRC"). These committees do valuable work to improve consistency in implementation. A number of other bodies are working towards the same, or similar, objectives.

International standard-setting bodies

Specific initiatives to improve consistency in regulatory approaches have been led by the international standard-setting bodies. For example, the International Organisation of Securities

14 See *FSB Data Gaps Initiative – A Common Data Template for Global Systemically Important Banks* (25 July 2013), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_130725.pdf?page_moved=1.

15 The FSB Chair's Letter to G20 Leaders for the Brisbane Summit, see footnote 5, p. 5.

Commissions (the "IOSCO"), the BCBS and the Committee on Payments and Market Infrastructures (the "CPMI", previously the Committee on Payment and Settlement Services (the "CPSS")) have worked—both individually and collaboratively—to develop principles and guidance to promote international regulatory consensus (e.g. the CPSS-IOSCO *Principles for Financial Market Infrastructure*).[16]

In March 2013, IOSCO launched a task force on cross-border regulation. The task force was established to focus on the regulation of cross-border activity and to develop principles for regulatory cooperation and, in particular, methodologies for assessing the comparability of rules in other jurisdictions (i.e., methodologies for determining "equivalence" or "substituted compliance"). In November 2014, IOSCO published the consultation report of the IOSCO Task Force on Cross-Border Regulation, which identifies and describes cross-border regulatory tools and challenges.[17] It was intended that the discussion in the consultation report could facilitate the development of a cross-border regulatory toolkit and provide a common terminology for IOSCO members to consult when considering options for cross-border regulation.

Other noted international standard-setting bodies include the International Association of Insurance Supervisors (the "IAIS"), which developed The Common Framework ("ComFrame") for the Supervision of Internationally Active Insurance Groups, a set of international supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups. The IAIS is scheduled to formally adopt ComFrame in 2018, with its Members to begin implementation of ComFrame thereafter.

<u>Bilateral and multilateral regulatory initiatives</u>

In addition to the work of the FSB and other international standard-setters, regulators are working to improve consistency and cross-border cooperation through both bilateral and multilateral discussions.

2.3 Common challenges to consistent implementation

Despite the involvement of a considerable number of international committees and initiatives designed to foster consistency in international regulation, policymakers and regulators have encountered significant challenges in their efforts to achieve consistent implementation of G20 commitments:

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16 Available at: http://www.bis.org/cpmi/publ/d101a.pdf (April 2012).

17 IOSCO Task Force on Cross-Border Regulation, *Consultation Report* (24 November 2014), available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD466.pdf.

- G20 deadlines for implementation have proven difficult to meet in many cases and timetables have not always been sufficiently coordinated across countries. On occasion, countries have taken unilateral action, resulting in disordered timetables;

- following the financial crisis, some jurisdictions have manifested a tendency towards super-equivalence or "gold-plating" internationally agreed standards. While countries are subject to peer review in respect of under-implementation, there are no measures in place to control "gold-plating" as the standards are widely understood merely to establish minimum requirements;

- jurisdictions differ in their approach to recognising the comparability of regulation and supervision in other jurisdictions (i.e., mutual recognition standards or determinations of "equivalence" or "substituted compliance");

- memoranda of understandings between national regulators and supervisors remain non-binding and supervisory colleges are not empowered to make binding decisions. The core tenets of such memoranda, such as timely sharing of information, come under considerable stress at times of crisis and do not always prevail. Regional data protection or bank secrecy requirements have also presented obstacles to the collection and sharing of information between regulators.

As a result, inconsistencies, gaps, overlaps, duplicative requirements and legal uncertainties have emerged between jurisdictional requirements—particularly in a cross-border context.

3 CONTRIBUTING FACTORS

The challenges facing the pursuit of the international financial regulatory agenda are formidable. The global financial system is characterised by extreme interconnectedness and complexity, which makes collecting and processing the data necessary to inform policy decisions extremely costly and difficult. Once international regulatory policy has been set, the options for implementation at a national level are often severely constrained by pressing constitutional, administrative, political, financial and practical considerations. These lead to divergent national approaches and differences which present a serious challenge to effective cross-border regulation. In all, regulation itself is becoming vastly more complex and, in consequence, the challenges of supervision have also increased substantially. The following factors have been identified as presenting particularly acute challenges to the consistent implementation of G20 commitments.

3.1 Discontinuity in the G20 handover process

Despite the helpful structures such as a specialist track for financial discussions of commitments in the field of financial regulation among G20 members and the institution of a troika to smooth the handover from one presidency to the next, it has been difficult to guarantee continuity in priorities and objectives between successive presidencies. The process of handover, differences in priorities between successive presidencies and the addition of new commitments may result in work or analysis on existing agenda items being truncated. Some commentators have suggested that successive presidencies tend to introduce a "proliferation of new topics" and that there is a lack of "continuity on technical topics".[18]

3.2 Governments may not be equally committed to international principles agreed by the G20

Governments may have different perceptions of risk and priorities. Achieving international consistency and increased cooperation requires significant political will among executives of the G20 countries, which may not always be sustained where the reform initiative is of a low domestic priority. Even where G20 commitments have been agreed, changes in government or political priorities may result in political support for long-term reforms becoming reduced over time. On the other hand, unilateral and accelerated national action is increasingly prominent in areas where the reform agenda is high in priority and where the government is unwilling to cede autonomy, resulting in super-equivalent implementation and/or accelerated implementation timelines.

3.3 International commitments may be constrained by domestic legislative processes

Even where the political will to implement G20 commitments in a timely and coordinated manner does exist at the executive level, national legislatures may choose to reject, amend or go beyond those commitments when passing laws.

There is a perceived risk that legislators may become disengaged from commitments arising from a G20 process in which they do not participate. In such cases, national legislative processes may impose practical limits on the ability of the G20, the FSB and international bodies to achieve consistent regulatory outcomes.

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18 Jörg Asmussen (Member of the Executive Board of the European Central Bank), "The G20 and the future of global economic governance" (Institute of International Finance Annual Membership Meeting, 12 October 2013), available at: https://www.ecb.europa.eu/press/key/date/2013/html/sp131012.en.html.

3.4 Insufficiently coordinated timetables

In some cases, G20 commitments have set firm deadlines for implementation (e.g. the end-2012 deadline for OTC derivatives reforms) without further defining the necessary stages of implementation or taking other steps to establish a clear timetable in detail. Such deadlines have never been revisited—even where it has become clear that they may not be practically feasible or realistic.

As a result, countries have been encouraged to act swiftly to introduce legislation, often "front-running" the implementation timetable adopted in other countries. For example, in the US, the Dodd-Frank Act was enacted in July 2010, to enable the US to meet the end-2012 deadline and to meet political demand for reforms that are high in the national legislative priority. Relevant international standards were only finalised by mid- to late-2011, by which stage a "number of potential overlaps, gaps or conflicts [had] been identified",[19] whilst many jurisdictions were awaiting the finalisation of rules in the EU and US. Nevertheless, the existence of a firm deadline led to recommendations that "jurisdictions should aggressively push forward to meet the end-2012 deadline".[20] The deadline was not reviewed at the G20 level and, in the event, was not met by any jurisdiction.

3.5 No consensus regarding deference measures

The implementation of G20 commitments has highlighted a lack of commonality among policymakers and regulators on key issues—in particular, the level of consistency required and the related question of how to assess and recognise the comparability of regimes in other jurisdictions (i.e., "substituted compliance" or "equivalence").[21] These questions are referred to below as questions of "deference".

These concepts, which "are chiefly distinguishable by scale or degree of granularity", have become increasingly prominent in view of the challenges faced in achieving consistency in legislative approaches *ex ante*.[22] Despite recent efforts in this regard, the lack of consensus has

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19 The FSB, *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability,* available at: http://www.financialstabilityboard.org/wp-content/uploads/r_111104.pdf?page_moved=1, p.18.

20 The FSB, *OTC Derivatives Market Reforms: Progress report on Implementation* (11 October 2011), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_111011b.pdf, p. 3.

21 Elisse Walter (then the Chairman of the US Securities and Exchange Commission), "Regulation of Cross-Border OTC Derivatives Activities: Finding the Middle Ground" (6 April 2013), American Bar Association Spring Meeting, available at: http://www.sec.gov/News/Speech/Detail/Speech/1365171515202.

22 The ISDA, "Methodology for Regulatory Comparisons" (August 2013), available at: http://www2.isda.org/attachment/NTgwOQ==/Methodology%20for%20Regulatory%20Comparisons%2020130820.pdf, p. 1.

resulted in actual or potential overlap, duplication, conflicts or gaps in regulatory requirements and considerable uncertainty for participants in cross-border markets. For example, the US approach on substituted compliance in the case of swaps clearing regulated by the CFTC applies to non-US swap dealers located in third country jurisdictions that are assessed to satisfy the entity level requirements but substituted compliance for transaction level requirements is more limited. In particular, substituted compliance is not available in the case where a non-US person transacts with a US person. This restriction on the deference shown to other regimes could result in overlap and conflict with other legal systems, particularly in view of the wide definition accorded to "US person" by the CFTC.[23] In contrast, the EU's own well-established concept of deference—"equivalence"—has been applied on an all or nothing basis. Some EU regulators have recognised recently that, given the diversity of global financial markets, there is a need to introduce flexibility to recognise regimes which are "partially equivalent".[24] Even where there are some broad similarities in different jurisdictions' approaches to the application of deference (e.g. OTC derivatives reform),[25] there may nevertheless be differences in the scope of the deference, the standards or criteria used and the process and timetable for granting deference.

In particular, there are variations in the circumstances under which deference is applied, and the manner in which it is applied. Such differences may be a result of the variation in the authority (or types of authority), standards and processes for making determinations across jurisdictions and, in some instances, within a single jurisdiction, depending on the entity requesting deference or the scope of deference being granted. The scope of deference a supervisor or regulator can exercise and the standard used for deference may also vary across jurisdictions and often even within a jurisdiction, depending on the policy area, the supervisor or regulator exercising deference (and the scope of the statutory authority granted to the supervisor or regulator) and/or the type of entity to which deference is being granted.

Jurisdictions may maintain their supervisory authority by requiring entities to register, be licenced or apply for an exemption, even if deference can be granted for a wide range of oversight responsibilities and requirements. As a condition for granting deference, many jurisdictions require the relevant foreign authorities to enter into, at a minimum, information

23 Coffee, J. "Extraterritorial Financial Regulation: Why E.T. Can't Come Home" [2013] CLR 1259, available at: http://cornelllawreview.org/files/2014/09/Coffee99CLR1259.pdf, pg. 1277.

24 Steven Maijoor (then Chair of the European Securities and Markets Authority), "International Coordination of the Regulation and Supervision of OTC Derivatives Markets" (17 October 2013), American Bar Association Fall Conference, available at: http://www.esma.europa.eu/system/files/2013-1486_international_coordination_of_the_regulation_and_supervision_of_otc_markets_-_steven_maijoor_esma_chair_at_aba_london_17_otober_2013_final.pdf, p. 7.

25 With regard to OTC derivatives reforms, the FSB published a report entitled *Jurisdictions' Ability to Defer to Each Other's OTC Derivatives Market Regulatory Regimes* (18 September 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140918.pdf. It identified some common issues regarding deference.

sharing or cooperation arrangements (e.g. a Memorandum of Understanding ("MoU")) and may also look closely at the home/host country's actual oversight and enforcement regimes as well as the home/host country's use of non-public or confidential information. The assessment process can take at least several months to complete and many jurisdictions are not able to provide specific timelines for reaching a final decision on deference as this may depend on when their own rules are in effect and when the rules in other jurisdictions are finalised. Further, priority in granting deference might be given to some jurisdictions over others in the overall process. All these factors contribute to legal uncertainty.

3.6 FSB and international bodies have limited powers

The remit of the FSB is, *inter alia,* to assess vulnerabilities affecting the global financial system; to promote coordination and information exchanges among national and international financial authorities; to monitor and advise on market developments and their implications for regulatory policy; to review and coordinate the work of the international standard-setting bodies; and to promote member jurisdictions' implementation of the G20 commitments.

Before it can promote implementation at the national level, however, the FSB must assess the degree of implementation which has occurred or is occurring in members' jurisdictions. In conducting its review, the FSB and its secretariat may be assisted in part by other international bodies. Progress updates are achieved by peer reviews and questionnaires, which are conducted on a "desktop" basis, accompanied by follow up dialogue and an on-site visit. In areas where an international framework for regulation and information exchange does not already exist, this oversight and assessment function may be rendered more difficult and require increased resources. For example, collecting data regarding the size of the "shadow banking" system is difficult because many non-bank financial entities are not required to report to regulators. In carrying out its assessments, the FSB does not have the power of compulsion.

3.7 Concerns regarding regulatory cooperation, supervision and enforcement

Consistent implementation requires more than harmonisation of legislative approaches; it also requires adequate and effective supervision and enforcement. A considerable degree of cross-border cooperation is necessary in situations where a regulated entity provides services in multiple jurisdictions and is subject to regulation by multiple regulators.

Cross-border cooperation in banking supervision has been developed by the work of the BCBS on consolidated supervision. In the EU, supervisory cooperation has intensified with work on agreeing MoUs and cooperation between banking supervisors for the development of supervisory colleges under the second of the Basel Accords ("Basel II"), and for the cooperation on the procedures related to the Single Supervisory Mechanism under the third of the Basel Accords ("Basel III").[26] In 2003, EU national banking supervisors and central banks agreed on a multilateral MoU on high-level principles for cooperation in crisis management, later revised and expanded to include Ministries of Finance. In the context of the securities markets, the IOSCO Multilateral Memorandum of Understanding (MMoU) has been agreed by various securities regulators.[27]

MoUs of this kind are helpful in terms of facilitating information exchange and protocol for multilateral cooperation but their effectiveness is limited in that they are usually the subject of interpretive disagreement, are not legally binding, do not benefit from any binding dispute resolution mechanisms, and do not prevent national authorities from acting unilaterally.

Legal barriers, such as restrictions on information sharing (e.g. data protection, confidentiality and secrecy requirements), have also been a significant hindrance to cooperation in some cases. This issue is discussed in greater detail in sections 1.3.2 and 6 of the Annex.

3.8 Lack of a formal grievance procedure

Whilst the G20 countries have made political commitments to achieve certain regulatory outcomes, an international framework does not exist for the resolution of disagreements between different jurisdictions—particularly where a jurisdiction has failed to implement one or more commitments or has introduced provisions which are inconsistent with those produced and endorsed at the G20 level.

The FSB peer-reviews and recommendations and standards and principles published by international bodies are non-binding and there is no clearly established process for escalating areas of disagreement for multilateral consideration or mediation at the international level. This imposes practical limitations on the ability of the G20 and international organisations to ensure consistent implementation in every jurisdiction.

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[26] The ECB published the *Memorandum of Understanding between the Council and the ECB on the Cooperation on Procedures Related to the Single Supervisory Mechanism* in December 2013, available at: https://www.ecb.europa.eu/ecb/legal/pdf/mou_between_eucouncil_ecb.pdf. It covers the accountability and reporting obligation of the ECB to the Council and the Euro Group under Regulation (EU) No 1024/2013.

[27] International Organization of Securities Commissions, *Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information* (May 2012), available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf.

The Secretary-General of the IOSCO, David Wright, has highlighted the lack of a dispute resolution procedure (and an international body with enforcement powers) as a key issue in resolving disagreements between national regulators.[28]

4 SOLUTIONS: PROPOSALS FOR DISCUSSION

Within the forum provided by the FMLC, market participants, professionals, regulators and other representatives of national authorities were able to discuss whether anything more might be done to rise to the challenges outlined above and thereby to facilitate the effective, consistent and coordinated implementation in national law of G20 commitments. The following are among the solutions which were most commonly raised for discussion.

4.1 Formalising early multilateral discussion and consultation among regulators and standard-setters

There has been increasing recognition that a greater degree of global coordination is necessary for the achievement of common goals in the implementation of the G20 commitments. The current framework adopts a "top-down" approach whereby, once the commitments have been adopted, the FSB is tasked with providing high level principles to which governments and regulators are expected to conform when introducing national legislation or regulation for the purposes of implementation. The detail of implementation is, however, not specified under this framework and will not necessarily be the subject of further international discussion. Some discussions on this may take place bilaterally, for example between the US and the EU, but the impact of the legislative initiatives being discussed is rarely assessed in a multilateral context. This top-down approach has given rise to some of the challenges of coordination noted in the previous section.

An alternative "bottom up" approach has been adopted in one area in particular: the reform of financial benchmarks. In this field, new regulatory standards for benchmarks were identified by IOSCO and its members, following which the FSB set out the objective of market transition from "risky" IBOR financial benchmarks to benchmarks compliant with the IOSCO principles and made recommendations concerning the process by which that transition would be coordinated. The FSB managed its work in this area through the agency of the Official Sector Steering Group

[28] Wright, D., (Secretary-General, IOSCO), "Future challenges in global securities regulation" (5 November 2013), FMLC Autumn Seminar. See also Huw Jones, "Markets need global watchdog group with power, officials say", Reuters (London, 5 November 2013), available at: http://www.reuters.com/article/2013/11/05/us-g20-regulation-idUSBRE9A40RN20131105.

(the "OSSG"), comprising capital markets regulators and representatives of central banks, and garnered relevant industry expertise by establishing the Market Participants Group (the "MPG") to undertake research.[29] Thus, when the FSB came to make its recommendations[30] it had the benefit of detailed input and guidance from another international standard-setting body and a wide array of regulators and supervisors from multiple jurisdictions (the latter keenly aware of the limitations and challenges that they face when required to implement international commitments), as well as the expertise of industry participants to draw upon.[31] Given the high degree of market sensitivity on the subject of benchmark transition, this "bottom up" approach may be regarded as having been successful. The FSB recommendations have met with a high degree of support and acquiescence and, indeed, are being proactively implemented by regulators and market participants.[32]

Consequently, consideration may be given to whether a permanent forum or working group, in the manner of the OSSG, could be established to formalise discussions between the FSB and IOSCO and their respective members.

If this idea were to be developed further, such a working group could be empowered to lead a consultation process that would invite the G20 national regulatory authorities, the FSB, other international standard setters—as well as market participants and technical experts—to provide detailed views and analysis on potential issues for implementation and suggestions for solutions. This would enable the G20 members to optimise the available international resources when considering cross-border issues for national implementation. Even where it is agreed that action should proceed at the national level, multilateral consultation of this kind might still enable members to coordinate timetables and approaches to some degree, particularly as regards provisions with extraterritorial effect.

Through early multilateral discussion and consultation amongst regulators and others in the G20 countries, common principles and timelines could be established. This would help to meet the

29 The OSSG was assigned responsibility for coordinating and maintaining the consistency of reviews of existing interest rate benchmarks and for guiding the work of a Market Participants Group, which was in turn tasked to examine the feasibility and viability of adopting additional reference rates and potential transition issues. The FSB decided that the OSSG should focus its initial work on the interest rate benchmarks that are considered to play the most fundamental role in the global financial system, namely LIBOR, EURIBOR and TIBOR.

30 The FSB, *Reforming the Major Interest Rate Benchmarks*, (July 2014) available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140722.pdf.

31 The members of the MPG represent a wide range of expertise and market experience, covering most of the target markets with both providers and users of relevant financial services. The MPG engaged in outreach to a wide range of market participants and on several occasions turned to external experts to cover specific technical or operational issues.

32 See, for example, Christopher Condon, "Powell Says Fed Working With Dealers to Find Libor Alternatives" (20 January 2015), available at: http://www.bloomberg.com/news/articles/2015-01-20/powell-says-fed-working-with-dealers-to-find-libor-alternatives and William Dudley, "Restoring Confidence in Reference Rates" (2 October 2014), available at: http://www.newyorkfed.org/newsevents/speeches/2014/dud141002.html.

challenges outlined above and would, arguably, go some way to addressing issues of legal uncertainty akin to those set out in sections 1 to 6 of the Annex.

4.2 Early and ongoing engagement with national legislatures

Several stakeholders have suggested that early engagement with representatives from national legislatures would provide valuable input during the process of formulating and agreeing G20 commitments. It is said that this would meet the challenge identified in section 3.3 above. A parallel point has been made elsewhere about national regulators and their early engagement with the FSB.[33]

National lawmakers may be best-placed to identify any legislative or political obstacles to the approaches or timetables contemplated. Engaging lawmakers early would identify key practical and legal points of difficulty in achieving more international consistency and might increase the perceived democratic legitimacy of approaches developed at the G20 level.

The G20 could convene an advisory group with extensive experience of the challenges involved in national constitutional and legislative processes to provide expert advice at meetings of the G20 "finance track" and/or the FSB. The membership of this group might comprise representation from legislative groups and select committees, or expert agencies.[34]

Through early and ongoing engagement with national legislatures in the G20 countries, some of the legislative and political difficulties likely to be encountered in the course of implementation in national law could be assessed at an early stage. This may help to address issues of legal uncertainty in the implementation of regulatory reforms similar to those set out in sections 1 to 6 of the Annex.

4.3 Further development to the G20 commitments and phased timetables set between the G20 and the FSB

The G20 commitments are typically expressed in the form of high level policy objectives but these do not provide a sufficient level of detail to enable consistency in interpretation and

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33 Institute of International Finance, "Promoting Greater International Regulatory Consistency" (June 2013), available at: https://www.iif.com/system/files/2013_06_IIF_PromotingGreaterInternationalRegulatoryConsistency_1.pdf, p. 2.

34 One of the functions of a G20 secretariat (see below, section 4.7) could be to invite jurisdictions to nominate persons with experience of legislation. By way of example and for the purposes of illustration only, the five most systemically significant jurisdictions might nominate permanent legislative representatives, with a further five to be nominated by the G20 secretariat on a revolving basis.

implementation by national authorities. In many cases, key terms and concepts require more detailed definition. As a result of the need to ensure a higher level of consistency in its commitments at an early stage, the G20 is only able, as a practical matter, to set a realistic timeframe once the FSB (or other relevant international standard-setters) has a chance to assess the recommended approach to implementation.

Rather than committing to firm deadlines *ab initio*, the G20 might ask the FSB (and/or an appropriate international body) to develop, by a specific date, a timetable or framework for implementation that is reasonably practicable for international standard-setters and for lawmakers in G20 countries. With the benefit of this forward plan, the G20 could—at a subsequent meeting—set a firm deadline for implementation.

Whilst the G20 members are, no doubt, encouraged to implement commitments in a timely manner, experience to date suggests that deadlines should be capable of being reconsidered if it becomes clear that they are unachievable. Where national implementation is closely synchronised across jurisdictions, there is less risk of creating transitional issues for financial institutions with cross-border operations.

The development of detailed and practical timetables for implementation could help to address some of the issues of legal uncertainty such as those set out in sections 1 to 6 of the Annex and the transitional issues noted, for example, in section 1.5 thereof.

4.4 Common principles regarding consistency and assessments of comparability

FMLC stakeholders are clear that, in establishing a general framework for the implementation of future G20 commitments, the development of a set of common understandings regarding the concepts of deference for the purpose of mutual recognition (for example, approaches to "substituted compliance" or "equivalence") are a concern of the highest priority. Given the divergence in the different ways of achieving mutual recognition across jurisdictions, it has been suggested that there is a role to be played by international bodies in assisting with the development of a globally acceptable mutual recognition framework or benchmark. Alternatively, a broad, international consensus, endorsed at the G20 level, would serve as a useful point of reference in discussions between regulators in specific cases.

In its report to G20 Finance Ministers and Central Bank Governors on *Jurisdictions' Ability to Defer to Each Other's OTC Derivatives Market Regulatory Regimes*,[35] the FSB noted that

[35] Available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140918.pdf.

> [w]hile there are some broad similarities in how jurisdictions approach the application of "deference", there are nevertheless still differences in the circumstances under which deference would be applied, and how it would be applied.
>
> […] The authority (or types of authority), standards and processes for making determinations vary across jurisdictions and, in some instances, within jurisdictions, depending on the entity requesting deference or the scope of deference being granted.[36]

The process of determining equivalence or "substituted compliance" is currently unfolding as a bilateral process between the G20's member jurisdictions. Suggestions that a third party multilateral organisation may have a role as mediator in such bilateral negotiations have been raised. For example, the Transatlantic Coalition on Financial Regulation (the "TCFR") has proposed that IOSCO might act as a mediator for negotiations about comparability but that an "overall determination of equivalence by IOSCO… would not of itself be legally binding".[37] The point that any determinations by IOSCO would most likely not be legally binding has recently been emphasised by the IOSCO Consultative Report of the IOSCO Task Force on Cross-Border Regulation.[38] Research undertaken in the course of preparing that report suggests that there is, however, more support for a "conflict of regulations" framework which could be used to determine the regulation that applies and the regulator which has jurisdiction in a specific cross-border situation rather than a formal dispute resolution mechanism:

> From the information and analysis derived from consultation so far, no consensus exists on the question of whether cross-border regulation of the securities markets would best be achieved by full coordination and total harmonization of cross-border rules among jurisdictions, even if those goals were somehow achievable. The responses, however, make clear that such a result is not achievable in the current context, noting the absence of any supranational institution with legal authority to impose harmonized regulations from the top down.

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36 The FSB, *Jurisdictions' Ability to Defer to Each Other's OTC Derivatives Market Regulatory Regimes*, available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140918.pdf, p. 2.

37 Transatlantic Coalition on Financial Regulation, "IOSCO: facilitating mutual recognition and substituted compliance" (November, 2012), available at: http://www2.isda.org/attachment/NTIzMA%3D%3D/IOSCO%2520paper%2520-%2520FINAL%2520091112.pdf+&cd=1&hl=en&ct=clnk&gl=uk, p. 6.

38 See footnote 17.

> […] Based on the survey responses, there was little support for IOSCO to attempt to coordinate the timing among jurisdictions' implementation of cross-border regulatory tools or to facilitate the settlement of disputes arising from the assessment of foreign regulatory regimes.
>
> As such, if IOSCO was to have a role in dispute settlement it would most likely be informal and non-binding.[39]

A multilateral approach to assessments of comparability is preferable to a unilateral or bilateral determination, although, for the time being, the latter clearly have an important role to play. The OTC Derivatives Regulators Group (the "ODRG") recently published a report on agreed understandings to resolving cross-border conflicts etc., which stated that a "flexible, outcomes-based approach should form the basis of final assessments regarding equivalence or substituted compliance".[40] The work of the ODRG as regards derivatives market reforms is to be welcomed; however, it would be desirable for a detailed methodology to be developed and reflected in national legislation.

Common principles and standards for deference could help eliminate or minimise conflict and duplication between regulatory requirements. This would address issues of legal uncertainty and a lack of coordination in the development and implementation of regulatory reforms, particularly those set out in section 1 of the Annex.

4.5 Refreshing the FSB's mandate

The FSB, which has a broad mandate to promote financial stability with a strong institutional basis and enhanced capacity,[41] plays a key role in steering regulatory change on behalf of the G20. In many of the suggested solutions above, stakeholders recommended that the FSB could usefully adopt an enhanced role in facilitating coordination when it comes to implementing G20 commitments in national law. Were the mandate of the FSB to be refreshed, in light of its recent incorporation as a separate legal entity, this could assist in maintaining momentum towards international regulatory harmonisation.

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39 *Ibid.*, pp. 44 and 46.

40 ODRG, *Report on Agreed Understandings to Resolving Cross-border Conflicts, Inconsistencies, Gaps and Duplicative Requirements* (August 2013), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf, p. 2.

41 G20 Leaders' Declaration, *Declaration on Strengthening the Financial System* (2 April 2009), available at: http://www.g20.utoronto.ca/2009/2009ifi.html.

In this context, one question which could be addressed is whether the FSB should be granted a formal mandate to settle principles for equivalence/substituted compliance (as discussed in the section above). Another question might be whether the FSB should acquire formal powers (and necessary resources) to establish working groups or, even standing committees, of market participants to provide technical expertise in the manner of the MPG established by the OSSG to examine benchmark transition (discussed in section 4.1 above).

Strengthening the role of the FSB could help to address some of the issues of legal uncertainty and lack of coordination in the development and implementation of regulatory reforms set out in sections 1 to 6 of the Annex.

4.6 Mechanisms to assist the functioning of the G20

The character of the G20 as an informal, flexible forum without a legal or treaty basis has been seen as a positive advantage and one of the reasons for its ability to act quickly and consider a wide range of issues. The benefits of the informal nature of the G20 are cited as key to its ability to focus on activities such as agenda-setting, policy coordination, consensus-building and the distribution of tasks across existing institutions.[42] The range of issues on the G20's agenda has expanded significantly since its inception, as has its role in leading international co-operation on policy issues.

As the agenda of the G20 continues to swell, there is arguably a need to balance the advantages of the G20's decentralised management against the continuity challenges it presents for the further development and/or re-examination of its commitments. Means by which this balance could be achieved are set out below.

4.6.1 A framework for agenda-setting at the G20

The financial sector reform agenda has grown substantially in complexity, particularly in terms of the range of institutions covered, the breadth of instruments subject to regulation, the level of detail involved, and their cross border implications.[43] A common view expressed by regulators, commentators and stakeholders is that the focus of the G20 going forward should—or, indeed,

[42] Jan Wouters and Dylan Geraets, "The G20 and Informal International Lawmaking" (March 2012), Leuven Centre for Global Governance Studies Working Paper No. 86, available at: http://ghum.kuleuven.be/ggs/publications/working_papers/new_series/wp81-90/wp86.pdf, p. 5.

[43] Callaghan, M., Jorgensen, H., Pickford, S., Gray, R., Buckley, R., Bardy, S., Hodges, G., "Financial Regulation and the G20", No. 4, July 2013, Lowy Institute for International Policy, available at http://m.lowyinstitute.org/publications/financial-regulation-and-g20.

will—be one of consolidation and implementation. This was recently articulated by the Governor of the Reserve Bank of Australia, Glenn Stevens:

> […] [a]bsent some major new development, which brings to light some major reform need not hitherto visible, to task the regulatory community and the financial industry with further wholesale changes from here would risk overload.[44]

If this view presages a new period of consolidation, rather than change, it is likely to prove a useful opportunity to take further steps towards the coordination and alignment of national regulatory initiatives.

If, however, reform remains a priority for the forward G20 agenda, the complexity and diversity of the changes introduced could arguably be reduced—and the benefits of continuity increased—by the adoption of soft-constraints on the G20 agenda. Under some Presidencies, the G20 has adopted meta-objectives (e.g. "growth" or "transparency") to constrain the agenda in this way.

Further and/or alternatively, some have advocated introducing a review process to assess the cumulative impact of the regulatory reform agenda itself, particularly in terms of balancing financial stability with market impact and compliance costs, as well as progress in international coordination and consistent implementation by regulators.[45] It is said that such a review process could provide a useful guide to the development of the forward agenda.[46]

4.7 A permanent secretariat

Stakeholders have also suggested that further consideration should be given to the idea of equipping the G20 with a permanent secretariat. This might improve continuity between presidencies and maintain focus on key commitments at meetings between G20 Summits. Alternatively, given that the "Troika" is the mechanism by which agenda-continuity is facilitated at the G20, thought could be given to establishing a small secretariat to serve the Troika. This alternative might offer the advantages of flexibility which might be lost in the case of a larger G20 secretariat.

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44 Stevens, G. "Financial Regulation: Australia in the Global Landscape", Address to the Australian Securities and Investments Commission (ASIC) Annual Forum, Sydney, 26 March 2013, Reserve Bank of Australia, available at: http://www.rba.gov.au/speeches/2013/sp-gov-260313.html.

45 *Ibid*.

46 See footnote 43.

A secretariat of either kind could be involved with meetings of the finance track and G20 summits, so that it has an effective understanding and oversight of commitments and can provide a constant line of communication between the G20, FSB and international bodies. A permanent secretariat would also be useful in assisting with the yearly handover process.

A permanent secretariat was proposed by Nicolas Sarkozy (France) in 2010. Recently, others have made similar recommendations for a small, dedicated G20 office to provide continuity and maintain momentum regarding G20 commitments.[47] The idea of a secretariat within the G20 was addressed in David Cameron's report presented to the G20 Leaders at the G20 Cannes Summit 2011 (the "Cannes Summit") in November 2011.[48] One proposal in the report was to formalise the "Troika" "of past, present and future presidencies; and underpin it with a small secretariat, possibly staffed by officials seconded from G20 countries and based in and chaired by the Presidency."[49] The report reiterated the informal, member-driven nature of the G20 and noted that the secretariat would mainly exist to maintain

> continuity in the G20's engagement efforts, and to ensure that progress is being made across its inherited agenda and ongoing work programme.[50]

The final declaration released at the end of the Cannes Summit echoed the call to formalise the Troika but omitted to mention the idea of a secretariat.[51] In October 2013, a representative of the European Central Bank (the "ECB") made a similar recommendation to increase continuity and momentum in the G20 commitments:[52]

> This would help to stay focused and avoid proliferation of new topics, which each new G20 Presidency introduces, often with limited results. It would also foster continuity on technical topics, especially on work streams which span over several years, such as financial regulation.[53]

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47 See footnote 18. See also C. Bradford, J. Linn, P. Martin, *Global Governance Breakthrough the G20 Summit and the Future Agenda*, Brookings policy brief series, available at http://www.brookings.edu/research/papers/2008/12/g20-summit-bradford-linn.

48 David Cameron, "Governance for growth: Building consensus for the future" (The Cameron Report) (Prime Minister's Office, November 2011), available at: http://www.g20.utoronto.ca/2011/2011-cameron-report.pdf.

49 *Ibid.,* p. 5.

50 *Ibid.,* p. 18.

51 G20 Leaders' Cannes Summit Final Declaration, *Building Our Common Future: Renewed Collective Action for the Benefit of All* (4 November 2011), available at: https://www.g20.org/sites/default/files/g20_resources/library/Declaration_eng_Cannes.pdf.

52 See footnotes 18 and 47.

53 *Ibid.*

With a permanent G20—or Troika—secretariat, the G20 agenda could benefit from even greater continuity of administrative support. This could assist in ensuring, *inter alia*, that commitments are revisited where necessary to address issues arising in the context of implementation.

4.8 Multilateral understandings regarding supervision and enforcement

Consistency in financial regulation requires not only increased harmonisation of rules but also consistency, cooperation and predictability in supervision and enforcement. This is an area where the development of multilateral memoranda of understanding between regulators has proved highly beneficial.

In the securities markets, the foremost of these multilateral memoranda is the IOSCO MMoU on the exchange of information.[54] This IOSCO MMoU is the key instrument used by market regulators around the world to request assistance in securing compliance with and enforcing securities and derivatives laws and regulations.

Some thought might usefully be given to how the scope of this IOSCO MMoU and the coordinating role of IOSCO could be extended. For example, it might be considered whether national authorities could further coordinate approaches to supervision and enforcement, sharing best practice within colleges and crisis management groups, and maintaining shared databases of supervisory and enforcement actions to increase trust and transparency.

Examples of measures by which inter-jurisdictional cooperation could usefully be developed can be found in the Canadian provincial framework for the regulation and supervision of securities markets. In its report dated February 2014, *IOSCO Objectives and Principles of Securities Regulation: Detailed Assessment of Implementation*, the International Monetary Fund (the "IMF") observed that

> The provincial regulators have increasingly achieved a high degree of harmonization of their regulatory frameworks and significant efforts have been made at the supervisory front to coordinate, and streamline processes and procedures and to achieve convergence in supervisory practices.[55]

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54 Another example of such an understanding is the Multilateral Memorandum of Understanding adopted by the IAIS.

55 IMF, *IOSCO Objectives and Principles of Securities Regulation – Detailed Assessment of Implementation,* March 2014, IMF Country Report No. 14/73 Canada Financial Sector Assessment Program available at http://www.imf.org/external/pubs/ft/scr/2014/cr1473.pdf, p. 5.

The report singles out for commendation initiatives for cooperation on the supervisory front, including joint investigations and the use of a system of committees to coordinate enforcement action:

> In the area of enforcement, regulators have made use of joint investigations, joint adjudications and reciprocal orders to coordinate their actions. Finally, a system of committees serves as a forum to coordinate and discuss topics, including on novel issues, and to set up national priorities.[56]

This system of committees operates under the umbrella of the Canadian Securities Administrators (the "CSA"), which is a non-statutory association, without regulatory or supervisory functions, constituted to foster collaboration and coordination.[57] It provides a forum within which provincial regulators agree on policy and supervisory initiatives, with the overall goal of achieving harmonization in laws and regulations and streamlining processes and procedures.

The IMF report also commends the provincial securities regulators' passport system for issuers and intermediaries and the establishment of a "principal regulator" approach to supervision. On the regulatory front, the report observes that legal harmonisation of provincial securities regulation has been very significantly advanced by the adoption of some 40 national and multilateral instruments codifying standards, rules and guidelines agreed between securities regulators.

National rules on data protection and bank security have been identified as an obstacle to efficient cross-border cooperation in the field of financial regulation.[58] The FSB and other international standard-setting bodies will undoubtedly continue to work with national regulators and legislators to identify and reduce obstacles to information sharing between regulators posed by data protection or bank secrecy rules. The G20's Data Gaps initiative is an example of this work to overcome the gaps in information that exist in certain sectors of the financial markets. While this initiative has made significant progress despite the limitations posed by confidentiality and data-protection regulations, the FMLC's research shows that further work to remove

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56 *Ibid.,* p.10.

57 The CSA works through committees composed of staff of the provincial regulators that meet periodically. Standing committees include Enforcement, Market Oversight, Registrant Regulation, Investment Funds, Compliance, Systemic Risk and Investor Education. In addition, project committees are formed to work on specific policy projects; for example there are project committees dealing with over-the-counter (OTC) derivatives, securitization and financial innovation, credit rating agencies and takeover bids.

58 See the letter on bank secrecy sent by the European Financial Markets Lawyers Group to the European Commission and the European Banking Authority" (30 October 2014), available at: http://www.efmlg.org/Docs/Documents/2014-10-30%20EFMLG%20letter%20to%20the%20EC%20and%20EBA%20-%20Banking%20secrecy.pdf, pp. 6–11.

obstacles and promote data sharing is still necessary (see section 1.3.2 of the Annex for further details).

4.8.1 Formal and informal dispute resolution procedures for cross-border supervision and enforcement

Within the context of a growing reliance on multilateral memoranda of understanding between regulators, one proposal to minimise conflicts on the interpretation of the provisions of these instruments has been the establishment of a standing dispute settlement forum or mechanism.

It has been suggested that such a forum could also be used for firms or industry bodies to raise difficulties they face in complying with regulation due to divergence or inconsistences in different regimes (for example, between the US and the EU on bank structural reforms as set out in section 5 in the Annex). The extent to which such a mechanism could evolve into a formal dispute resolution process would depend on the will of the G20 countries, and what sanctions they are willing to impose collectively on non-complying states. At this stage, the FMLC understands that appetite among G20 members for a formal dispute resolution forum is low.

Were this to change, however, the model for formal dispute resolution most frequently put forward by proponents of the idea is the Dispute Settlement Body (the "DSB") of the World Trade Organisation (the "WTO"). The DSB—effectively a session of the WTO's General Council—has authority to establish a panel of three (or, less commonly, five) experts to consider a dispute between WTO members and thereafter to accept or reject a panel's findings or the results of an appeal. Panels are normally appointed with the agreement of the parties but will be appointed by the Director General of the WTO when no agreement can be reached. The DSB also monitors the implementation of the rulings and recommendations. Notably, the DSB has the power to authorize retaliation—in the form of sanctions—when a country does not comply with its ruling.

An alternative, less ambitious approach might be the establishment of a registry of finance and dispute resolution experts who could advise on—or assist in mediating disputes concerning—questions including those on the interpretation of the provisions of international memoranda.

CONCLUSION— THE NEED FOR AN INTERNATIONAL CONSENSUS

The G20, FSB, other international standard-setters and many national regulators have recognised and responded to the need for increased consistency and cooperation in the sphere of financial regulation. Many challenges, however, still remain.

In the global financial markets, international consistency and cooperation increase legal certainty for market participants, end-users, regulators and supervisors alike. Unless the obstacles to achieving consistent implementation and cooperation are addressed, legal and operational uncertainty and complexity will proliferate—particularly in the context of cross-border market activity.

The premise of this discussion paper is that action should be taken to address the causes of legal uncertainty in the global wholesale financial markets—uncertainties like those set out in the Annex. This paper has examined the challenges encountered in implementing the G20 agenda for financial reform and has proposed a number of steps which could be taken to ameliorate regulatory conflicts and inconsistencies arising in the process of national implementation. The FMLC would like to hear from any stakeholders and others who may have comments on the above or recommendations to make.

Comments are invited on the themes and considerations raised in the paper by 17 April 2015.

by email to: contact@fmlc.org

or by post to:

Financial Markets Law Committee
8 Lothbury
London
EC2R 7HH
United Kingdom

The FMLC will publish a summary of comments received.

ANNEX

EXAMPLES OF LEGAL UNCERTAINTY CAUSED BY SHORTCOMINGS IN THE COORDINATION OF INTERNATIONAL FINANCIAL REGULATION

This Annex sets out instances of shortcomings in the coordination of international financial regulation which have produced material uncertainty for financial market participants and regulators alike.[59] The examples set out in this Annex support the need for a better coordinated international approach, a formalised and well-organised mechanism to facilitate coordination at an early stage and the other recommendations made in this Discussion Paper.

1 INTERNATIONAL DERIVATIVES REGULATION

1.1 Clearing of swaps and territorial scope

The G20 Leaders' Statement for the Pittsburgh Summit in 2009 (the "Pittsburgh Summit") stated that

> [a]ll standardized OTC derivative contracts should be […] cleared through central counterparties by end-2012 at the latest.[60]

In 2009, the G20 Leaders committed to ensure that all standardised OTC derivatives contracts be cleared through central counterparties ("CCPs") by end-2012. The FSB recommended in its October 2010 Report on *Implementing OTC Derivatives Market Reforms* that IOSCO,

> working with other authorities as appropriate, should coordinate the application of central clearing requirements on a product and participant level, and any exemptions from them

in order to minimize the potential for regulatory arbitrage.[61] In the G20 Seoul Summit 2010 (the "Seoul Summit"), the Leaders' Declaration noted that the regulation and supervision of OTC

59 This Annex is intended to provide a limited number of material examples, rather than constitute an exhaustive *exposé*, of such instances or a comprehensive survey of all relevant aspects relating to each issue outlined here.

60 *G20 Leaders Statement: The Pittsburgh Summit, September 24-25, 2009,* Pittsburgh, available at: http://www.g20.utoronto.ca/2009/2009communique0925.html, para. 13.

61 The FSB, *Implementing OTC Derivatives Market Reforms* (25 October 2010), available at: http://www.financialstabilityboard.org/publications/r_101025.pdf, p. 5.

derivatives reforms should be implemented in an internationally consistent and non-discriminatory manner, recognising the importance of a level-playing field.[62]

The mandatory clearing requirement is implemented in the US by the Dodd-Frank Act and in the EU by the EMIR. The FMLC has previously reported on the legal uncertainties to which EMIR gives rise in conjunction with reforms in the US and other countries, in particular, focusing on the territorial scope of the mandatory clearing requirement and other obligations and their exemptions:

> For both financial and non-financial counterparties, the Regulation creates uncertainty with respect to its territorial scope. As many countries have subscribed to the G20 agenda to encourage the clearing of OTC derivatives, there is a danger of overlap and inconsistency with the mandatory clearing requirements in these countries and the requirement under the Regulation. In particular, the FMLC understands that some of the exemptions for non-financial counterparties in the US Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") are of different scope from those in the Regulation; however, the FMLC notes that in June 2011, a technical working group consisting of US regulators, the Commission and ESMA was established to examine the alignment of US and European derivatives regulations.
>
> There is also uncertainty as to the application of the Regulation to non-EU establishments of entities established in the EU (whether financial counterparties or non-financial counterparties). For instance, it is not clear whether the Regulation applies to activities carried out by a non-EU branch of an entity established in the EU, although it is proposed that the Clearing Requirement and risk mitigation procedures set out in Article 6 will apply to contracts concluded "between third country entities that would be subject to the [Clearing Requirement and risk mitigation procedures] if they were established in the EU, provided that the contract has a direct, substantial and foreseeable effect within the EU or where such obligation is necessary or appropriate to prevent the evasion of any provisions of [the] Regulation."Without further clarification as to what would constitute a

62 *The G20 Seoul Summit Leaders' Declaration* (11-12 November 2010) available at http://www.g20.utoronto.ca/2010/g20seoul.html.

> "direct, substantial and foreseeable effect within the EU", however, the proposal would give rise to uncertainty if adopted.
>
> Another area of uncertainty relates to the fact that there will always be two parties to an OTC derivative contract. If one party is subject to a mandatory clearing, risk mitigation or reporting requirement under a third country's laws, it is unclear how the counterparty subject to the Regulation will be able to comply with the Regulation where the third country clearing, risk mitigation or (as the case may be) reporting requirement is inconsistent with the clearing, risk mitigation or (as the case may be) reporting requirement under the Regulation [("EMIR")].[63]

In respect of the US rules, under section 2(i) of the Commodity Exchange Act (the "CEA"), as amended by the Dodd-Frank Act, the swaps provisions of the CEA and other relevant rules and regulations apply to cross-border activities when certain conditions are met, namely, when such activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or when they contravene CFTC rules or regulations as are necessary or appropriate to prevent evasion of such provisions. The US authorities' collective approach, however, reflects a degree of divergence. The CFTC and the SEC are understood to differ in their respective approaches to the application of substituted compliance to cross-border activities and the level of transparency required for substituted compliance determinations, with the former agency being more prescriptive.[64]

1.2 Execution of swaps

The G20 Leaders' Statement for the Pittsburgh Summit in 2009 states that

> [a]ll standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate.[65]

This objective was implemented in the US by way of the Dodd-Frank Act, which requires that, as of 2 October 2013, a person operating a facility for the trading or processing of swaps must be

63 Financial Markets Law Committee, "The European Market Infrastructure Regulation", pp. 10-11.

64 A key issue relates to the definition of "US person" under the Commodity Exchange Act. See also commentary referred to in the footnotes to section 3.5 above.

65 See footnote 60, para. 13.

registered as a Swap Execution Facility ("SEF") or Designated Contract Market ("DCM").[66] Under Section 2(h)(8) of the Commodity Exchange Act (as modified by the Dodd-Frank Act), swaps subject to the clearing requirement must be executed on a DCM or a registered (or exempt) SEF, subject to certain exceptions. One such exception is that no board of trade or SEF makes the swap in question available to trade.[67] *A contrario*, swaps made available to trade will generally be subject to mandatory trade execution on a DCM or SEF. Under the CFTC regulations, a swap transaction will be made subject to mandatory execution on a SEF or DCM 30 days after the available-to-trade determination, submission or certification for that swap is deemed approved or certified.[68] The first swaps became subject to the mandatory trade execution requirement on 15 February 2014.[69] Other swaps will become subject to the mandatory execution rule on a staggered basis.[70] As a result, in the intervening period, swaps of a type determined to be "available to trade" and entered into by US persons must be traded on a SEF or DCM, while those not entered into by US persons are not (yet) subject to a mandatory trade execution requirement.

Regulators in most other G20 countries have adopted the necessary legislative frameworks to support increased use of exchanges and electronic trading platforms for OTC derivatives contracts, where appropriate, but progress in adopting specific requirements is more limited.[71] In the case of the EU, the objective that appropriate OTC derivative contracts be traded on exchanges or electronic trading platforms is addressed in the Markets in Financial Instruments Regulation (the "MiFIR"). The MiFIR provides that transactions in derivatives declared subject to the trading obligation must, if concluded between certain within-scope parties,[72] be entered into only on a Regulated Market, Multilateral Trading Facility ("MTF"), Organised Trading Facility ("OTF"), or equivalent third-country trading venue.[73] The obligation does not, however,

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66 7 U.S. Code § 7b–3(a)(1).

67 Section 2(h)(8)(B) of the CEA.

68 17 CFR § 37.12.

69 The CFTC first certified a self-certification determination of certain swap contracts on 16 January 2014, in relation to a number of interest rate swaps self-certified by Javelin SEF, LLC.

70 The list of swaps subject to a trade determination is available at: http://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination.

71 See Table 2.1 of the FSB's *Eighth Progress Report on Implementation of OTC Derivatives Markets Reforms*, as at November 2014, available at: http://www.financialstabilityboard.org/wp-content/uploads/8th-OTC-derivatives-progress-report-for-publication-7Nov.pdf.

72 Broadly, as defined under the EMIR, financial counterparties or non-financial counterparties subject to the clearing obligation ("NFC+s").

73 Article 28 of the MiFIR.

apply until 3 January 2017.[74] In Japan, mandatory trade execution is applicable to dealers registered as Financial Instruments Business Operators etc. ("locally-registered dealers").[75] More specifically, the Financial Instruments and Exchange Act requires locally-registered dealers to execute certain OTC derivative transactions using an electronic trading platform operated by such or other locally-registered dealers which operate such a platform or by an overseas trading platform operator which has obtained a license in Japan.[76] In order to implement this requirement, the amendments to the subordinate legislation were published on 19 November 2014. This trade execution requirement will come into force on 1 September 2015.

Empirical evidence appears to suggest that this dislocation in the timing of the implementation of mandatory trade execution rules has led to a fragmentation in global derivatives markets.[77]

1.3 Reporting

1.3.1 Conflicting and Duplicative Reporting Requirements

Conflicts exist between the reporting requirements under the EMIR and the Dodd-Frank Act. The EMIR places reporting requirements on both parties to a swap but the Dodd-Frank Act, which places reporting requirements on swap dealers, major swap participants and financial entities. Accordingly, all entities that are subject to the EMIR, including derivative end-users, have reporting requirements under EMIR for derivative transactions undertaken with third parties and intra-group. Under the Dodd-Frank Act, derivative end-users are eligible for no-

74 Article 55 of the MiFIR.

75 English translation of the Financial Instruments and Exchange Act (Act No. 25 of 1948) is available at: http://www.fsa.go.jp/common/law/fie01.pdf. Article 34 of the Financial Instruments and Exchange Act defines "Financial instruments Business Operators etc." as Financial Instruments Business operators or Registered Financial Institutions. Overseas derivative dealers would be required to register in Japan where they conduct business in Japan (e.g. through a local branch or other physical establishment) and enter into transactions with counterparties in Japan. Such registration, however, would not be required if they enter into OTC derivative transactions with certain professional institutions only or fall under the scope of certain other exemptions.

76 See, in particular, Article 40-7 stipulating the swap execution requirement which was introduced by amendment in 2012. The OTC derivative transactions in question are "Specified OTC Derivative Transactions" as defined in Article 125-7 of Order for Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No. 52 of 2007).

77 See, for example, in the case of Euro and US dollar interest rate swaps markets: ISDA Research Note, July 2014, "Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-year 2014 Update", available at: http://www2.isda.org/search?headerSearch=1&keyword=Revisiting+Cross-Border+Fragmentation+of+Global+OTC+Derivatives%3A+Mid-year+2014+Update; ISDA Research Note, April 2014, "Made-Available-to-Trade (MAT): Evidence of Further Market Fragmentation", available at http://www2.isda.org/search?headerSearch=1&keyword=Made-Available-to-Trade+%28MAT%29%3A+Evidence+of+Further+Market+Fragmentation; and ISDA Research Note, January 2014, "Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis", http://www2.isda.org/search?headerSearch=1&keyword=Cross-Border+Fragmentation+of+Global+OTC+Derivatives%3A+An+Empirical+Analysis. (noting, in each case, a rise in European-to-European inter-dealer activity and a decrease in European-to-US inter-dealer activity following the entry into force of the obligation to register as a SEF or DCM).

action relief from reporting requirements for intra-group derivative transactions, but such relief is not available under the EMIR.

Where the counterparties to a derivatives transaction subject to mandatory reporting are located in two different jurisdictions, each of which has in effect legislation prescribing the mandatory reporting of information relating to such transaction, in the absence of sufficient cooperation between the relevant regulators in the jurisdictions in question (e.g. mutual recognition or an equivalence determination), multiple separate reports may be required to be filed with respect to the same transaction in order to comply with national reporting requirements in each jurisdiction. For example, a trade entered into between an EU financial counterparty and a US swap dealer or major swap participant will generally be subject to reporting requirements under each of the EMIR and Dodd-Frank Act.[78] There is currently no comprehensive equivalence or substituted compliance regime in place between the US and EU with regard to the reporting regimes under the EMIR and the Dodd-Frank Act, respectively, which would avoid the risk of application of duplicative reporting requirements.[79]

Complications could arise if a derivatives dealer subject to the reporting regime under the EMIR or the Dodd-Frank Act is also a locally-registered dealer in Japan, as that dealer is required under the Financial Instruments and Exchange Act to maintain a record of trade data on non-cleared OTC derivatives transactions and report it to the relevant authority.[80] This reporting requirement is exempt where such locally-registered dealers have reported the data to domestic trade repositories or overseas equivalent trade repositories which were designated by the relevant authority in Japan.[81] If such locally-registered dealers report the trade data to an overseas trade repository which is not designated by the Japanese authority, they may be subject to duplicative reporting requirements.

In addition, national regulators face challenges regarding the usability of, and access to, data held by trade repositories due to the differences in the content and format of reporting requirements. The FSB has published a feasibility study that reports on how OTC derivatives data from trade repositories can be aggregated so as to facilitate comprehensive monitoring of

[78] Article 9(1) of the EMIR; Section 729 of the Dodd-Frank Act.

[79] ESMA has, in fact, advised the European Commission in the context of trade reporting that "the US legal, supervisory and enforcement arrangements [are] not equivalent to the requirements laid down in Article 9 of EMIR for the purpose of Article 13 of EMIR", which would, had the Commission adopted an implementing measure to that effect, have enabled the counterparties to be deemed to have fulfilled the relevant obligations under the EMIR. See ESMA, *Final Report - Technical advice on third country regulatory equivalence under EMIR – US* (1 September 2013), available at: http://www.esma.europa.eu/system/files/2013-1157_technical_advice_on_third_country_regulatory_equivalence_under_emir_us.pdf, p. 24.

[80] Article 156-64, Paragraphs 1 and 2 of the Financial Instruments and Exchange Act.

[81] Article 156-64, Paragraph 3 of the Financial Instruments and Exchange Act.

risks to financial stability.[82] The FSB has asked the CPMI and the IOSCO to develop global guidance on harmonisation of data elements that are reported to trade repositories and are important to aggregation by authorities.[83] Legal and regulatory changes may be necessary to establish a global aggregation mechanism which will to meet the range of authorities' data access needs.

1.3.2 Conflict with Data Protection Legislation and Other Barriers

Reform of the global derivatives markets has given rise to the risk of inconsistency with national data protection regimes.

For example, the reporting regime under the Dodd-Frank Act requires the disclosure of detailed information to a third party: sections 727 and 729 of that Act require that trade participants report transaction and/or position data (including the identities of counterparties of cleared and uncleared swap transactions) to regulators or to swap data repositories which collect and maintain such data. The ODRG has noted, however, that barriers, including national data protection laws, blocking statutes, state secrecy laws and bank secrecy laws, exist which can prevent reporting to trade repositories and that such barriers will continue to have a negative impact on the effectiveness of reporting obligations unless they are removed.[84]

1.4 Product Scope

Differences in the scope of application of national derivatives regimes give rise to a risk of regulatory arbitrage and market fragmentation.

For example, the Dodd-Frank Act and the EMIR differ in their scopes of application with respect to the types of products subjected to their respective requirements. The Dodd-Frank Act regulates, *inter alia*, foreign exchange swaps and forwards (excluding spot transactions[85] and physically-settled foreign exchange swaps or forwards—although the reporting requirements and

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82 The FSB, *Feasibility study on aggregation of OTC derivatives trade repository data* (19 September 2014), available at: http://www.financialstabilityboard.org/2014/09/r_140919/?page_moved=1.

83 *Ibid.*, p. 3. See also The FSB, *FSB publishes feasibility study on aggregation of OTC derivatives trade repository data and announces next steps* (19 September 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/pr_140919.pdf.

84 Letter from the ODRG to the FSB on OTC Derivatives Regulators Group – Barriers to Reporting Trade Repositories (12 August 2014), available at: http://www.esma.europa.eu/system/files/letter_to_fsb_08122014.pdf.

85 Defined as foreign exchange transactions settled on the customary timeline of the relevant spot market (which the CFTC recognises as being, in general, T+2): 77 Fed. Reg. 69, 694.

business conduct standards nevertheless apply to such products).[86] In contrast, as highlighted by the European Commission,[87] a harmonised definition of foreign exchange financial instruments (which are subject to the obligations under the EMIR)[88] will not come into force until 3 January 2017;[89] until then, the scope of foreign exchange transactions subject to the EMIR obligations depends upon the definition of foreign exchange financial instruments as implemented in the national law of each Member State. As a result, certain foreign exchange swaps subject to mandatory trade reporting requirements under the Dodd-Frank Act are not currently subject to the reporting obligation under the EMIR.[90]

1.5 CCPs: "Equivalence" and "Substituted Compliance"

Under the EMIR, the adoption of a positive equivalence decision by the European Commission is a pre-condition (amongst others) to ESMA's recognition of a non-EU CCP (or trade repository).[91] Non-EU CCPs recognised in accordance with Article 25 of the EMIR are granted favourable capital treatment with respect to own funds requirements under the Capital Requirements Regulation (the "CRR")[92] with respect to the risk-weighting applied to exposures.[93] Trades cleared with non-EU CCPs that do not receive recognition under Article 25

86 Section 722(h) of the Dodd-Frank Act; 77 Fed. Reg. 69, 694.

87 See the letter from Jonathan Faull (Director General, DG Internal Market and Services, European Commission) addressed to Steven Maijoor (Chair, ESMA), dated 23 July 2014, available at: http://www.esma.europa.eu/system/files/ec_letter_to_esma_on_classification_of_financial_instruments_23_07_2014.pdf

88 The EMIR defines the term "derivative" or "derivative contract" by way of cross-reference to the definition of "financial instrument" under paragraphs (4) to (10) of Section C of Annex I to the MiFID (now replaced by MiFID II and MiFIR).

89 When the MiFID II enters into force: Article 55 of the MiFID II.

90 For example:

(1) Foreign exchange forwards entered into for a commercial (as opposed to an investment purpose) are not "specified investments" under the implementing measures in the UK: paragraph 84(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001; and

(2) The Luxembourg Commission de Surveillance du Secteur Financier has stated that it

> will not ensure the implementation of the relevant provisions of EMIR for forex derivatives up to 7 days, forex derivatives for commercial purposes, and physically settled commodity forwards, since those contracts are not clearly identified as derivatives contracts across the European Union.

The guidance is available at: http://www.cssf.lu/fileadmin/files/Publications/Communiques/Communiques_2014/CP1411__EMIR_reporting_obligation_120214.pdf.

91 See Articles 25(2)(a), 25(6) and 75(1) of the EMIR.

92 Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms.

93 Article 4(88) and 107 of the CRR.

of the EMIR (and therefore do not constitute "qualifying CCPs" under Article 4(88) of the CRR) are subject to significantly higher capital charges. A further extension to the transitional period during which CCPs with which EU institutions clear transactions are deemed to constitute "qualifying CCPS" (and, therefore, are subject to favourable capital treatment under the CRR) will expire on 15 June 2015.[94]

Different jurisdictions have introduced different frameworks for the recognition of overseas regulatory regimes, which could arguably represent the absence of common international standards for deference to other jurisdictions.

In order to provide clearing services to counterparties in Japan, CCPs, which have been incorporated in accordance with overseas laws and conduct clearing business in an overseas jurisdiction, are subject to licensing requirements in Japan and can apply for a foreign CCP licence in Japan instead of a local CCP licence.[95] According to a summary of national regulators' responses to a questionnaire published in an annex to a recent FSB report, some domestic requirements in Japan are exempted for foreign CCPs which are subject to "the same" licensing requirements in their home jurisdiction and where a cooperative supervision/information sharing arrangement is in place.[96] This has been described by the Japan Financial Services Authority (the "JFSA") as "an outcomes based approach".[97]

In contrast, the European Commission has adopted equivalence decisions in relation to the CCP regulatory regimes of only four jurisdictions.[98] To date, no equivalence decision has been adopted in respect of US CCPs. The ongoing discussions in relation to the reciprocal "equivalence" (in the EU) and "substituted compliance" (in the US) determinations became contentious in 2014,[99] being described as a "looming trade war" by CFTC Commissioner J.

94 Paragraph 5 of Commission Implementing Regulation (EU) No 1317/2014 of 11 December 2014 on the extension of the transitional periods related to own funds requirements for exposures to central counterparties in Regulation (EU) No 575/2013 and Regulation (EU) No 648/2012 of the European Parliament and of the Council, available at: http://www.nbb.be/doc/cp/eng/ki/wg/pdf/Regulation_1317.pdf.

95 Articles 156-20-2 of the Financial Instruments and Exchange Act.

96 The FSB, *Jurisdictions' Ability to Defer to Each Other's OTC Derivatives Market Regulatory Regimes* (18 September 2014), see footnote 33.
According to the website of the Japan Financial Services Agency, the list of licensed CCPs as of 10 December 2014 does not include any foreign CCP, available at: http://www.fsa.go.jp/menkyo/menkyoj/kinyuusyouhintorihikiseisan.pdf.

97 *Ibid.*

98 The jurisdictions are: Australia, Hong Kong, Japan and Singapore. Details of the equivalence decisions are available on the website of the European Commission: See http://europa.eu/rapid/press-release_IP-14-1228_en.htm?locale=en.

99 Becker, L., Madigan, P., "EC to snub US in first wave of CCP equivalence decisions", 16 June 2014, available at: http://www.risk.net/risk-magazine/news/2350239/ec-to-snub-us-in-first-wave-of-ccp-equivalence-decisions.

Christopher Giancarlo.[100] The recent extension to the transitional period in the EU signifies that the negotiations with the US have not yet been completed, but the Commission recently expressed that they were "almost there" and the remaining outstanding issue centred on the registration of overseas clearing houses under US rules.[101]

2 SECURITISATION RISK RETENTION

The G20 Leaders' statement from the Pittsburgh Summit in September 2009 set out the following objective with regard to risk retention in the context of securitisation:

> Securitization sponsors or originators should retain a part of the risk of the underlying assets, thus encouraging them to act prudently.[102]

This objective was pursued in the US by way of section 941 of the Dodd-Frank Act and the final rules which implement the credit risk retention requirements;[103] in the EU, it is implemented by way of the CRR and accompanying regulatory and implementing technical standards.[104] Significant differences exist between these regimes, giving rise to the risk of duplication and inconsistency in the context of cross-border securitisations.

The following are among the fundamental differences in the two regimes.

- the US regime applies directly to the entity required to retain the risk in question: section 941 of the Dodd-Frank Act requires that a "securitizer"[105] (broadly covering the issuer or originator and the sponsor) of asset-backed securities must retain at least five percent of the credit risks for the assets collateralising the asset backed securities. By contrast, the EU regime operates indirectly upon an originator, sponsor or original lender with respect to the securitisation by precluding EU institutions from gaining exposure to the credit

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100 Giancarlo, J., C., "The Looming Cross-Atlantic Derivatives Trade War: "A Return to Smoot-Hawley", Keynote Address of CFTC Commissioner J. Christopher Giancarlo at The Global Forum for Derivatives Markets, 35th Annual Burgenstock Conference, Geneva, Switzerland, available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlos-1.

101 Stafford, P., "Europe to delay new capital rules for banks", available at: http://www.ft.com/cms/s/0/09349ed8-7563-11e4-a1a9-00144feabdc0.html#axzz3NOVDClBl.

102 See footnote 60, para. 12.

103 On 22 October 2014, the Securities and Exchange Commission and five other federal agencies adopted the final rule with respect to the risk retention requirements under section 941 of the Dodd Frank Act, available at: http://www.sec.gov/rules/final/2014/34-73407.pdf, pp. 1–2.

104 The risk retention rules are also implemented in the Alternative Investment Fund Managers Directive for fund managers and to be implemented in the Solvency II Directive for insures.

105 "Securitizer" is defined as an issuer of an asset-backed security or a person who organises and initiates an asset backed securities transaction by selling or transferring assets to the issuer: section 15G of the Securities Exchange Act of 1934.

risk of a securitisation position[106] unless the originator, sponsor or original lender has explicitly disclosed to the institution that it will retain, on an ongoing basis, a material net economic interest which, in any event, shall not be less than 5 percent.[107]

- many transactions will be subject to both the US and the EU regimes. For example, a US originator issuing asset-backed securities to EU regulated banks (or their US affiliates) and a non-US originator issuing asset-backed securities to both US investors and EU bank investors. Where both regimes apply, the entity required to retain the relevant interest may be different. The US regime requires the interest to be held by the securitizer; whereas the EU regime requires the interest to be held by one of the originator, sponsor or original lender. The securitizer under the US regime does not always fall within the definitions of the originator, sponsor or original lender under the EU regime and *vice versa*. As a consequence of this difference in approach, the EU regime will need to be complied with (in addition to the US regime) in order for covered EU institutions to obtain exposure to a US-originated securitisation position, except where the safe harbour or exemption applies. The EU regime applies irrespective of the jurisdiction of origination of the securitisation: it can apply wherever a covered EU institution gains exposure to the credit risk of a securitisation position.[108] Further, non-compliant securitisation may still be marketed and sold to investors that are not covered EU institutions and as a result are not subject to the EU requirements.

- the scope and availability of certain exemptions from the risk retention requirements vary across jurisdictions. Transactions exempted from the scope of the US regime may nevertheless fall within the scope of the EU regime and *vice versa*. For instance, section 941 of the Dodd-Frank Act and the final rule contain an exemption for asset-backed securities that are collateralised exclusively by residential mortgages that qualify as "qualified residential mortgages", but this exemption is not available in the EU. There are limited exemptions under the EU regime, including that for exposures guaranteed by certain public sector entities, but this exemption is much wider than that in the US.

- the form and calculation method of the risk retention requirement is not necessarily equivalent under the US and the EU regimes. For example:

106 Article 4(1) of the CRR defines "securitisation position" as an exposure to a securitisation.

107 Under Article 405 of the CRR, the disclosure requirement effectively creates an incentive for originators, sponsors and original lenders to retain a five percent net economic interest in the securitisation in order for certain EU institutions to participate in the securitisation.

108 Article 4(1) of the CRR defines "institution" as a credit institution or an investment firm.

(i) the US final rule provides that the five percent risk retention amount will be measured using "fair value" for horizontal risk retention but "at par" for vertical risk retention, whereas, under the EU regime,[109] the five percent risk retention amount will be measured using "nominal value";

(ii) the US regime provides specific exemptions from or downward adjustments to the minimum retention level; and

(iii) the EU regime allows unfunded commitments but the US would not.[110]

Although risk retention requirements for originators have not been fully implemented in Japan, the JFSA proposed an amendment to its Supervisory Guidelines for various financial institutions on 12 September 2014,[111] which requires regulated financial institutions to check whether the originators continue to retain risks of a securitisation position and to conduct an in-depth analysis of the originators' involvement in the underlying assets if they do not retain such a risk.

3 BASEL CAPITAL REQUIREMENT

The G20 Leaders in the Seoul Summit in September 2010 endorsed the agreement[112] on Basel III framework established by the BCBS as follows:

> We endorsed the landmark agreement reached by the BCBS on the new bank capital and liquidity framework, which increases the resilience of the global banking system by raising the quality, quantity and international consistency of bank capital and liquidity, constrains the build-up of leverage and maturity mismatches, and introduces capital buffers above the minimum requirements that can be drawn upon in bad times.[113]

109 Commission Delegated Regulation supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council by way of regulatory technical standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk.

110 As contemplated by section 15G of the Dodd-Frank Act, the final rule adopts exemptions for securitizations consisting solely of automobile loans, commercial real estate loans, commercial loans, and residential mortgage loans that satisfy certain specific underwriting standards that indicate a low credit risk with respect to the loan.

111 For example, Comprehensive Guidelines for Supervision of Financial instruments Business Operators, etc., its English translation is available at: http://www.fsa.go.jp/en/refer/guide/instruments.pdf.

112 Details of the agreement are available at: http://www.bis.org/press/p100726/annex.pdf and http://www.bis.org/press/p100912.pdf.

113 The Seoul Summit Document: *The Seoul Summit*, 12 November 2010, Seoul, available at: http://www.g20.utoronto.ca/2010/g20seoul-doc.pdf, p. 7.

Basel III is a set of reform measures to enhance the banking regulatory framework including capital adequacy and liquidity requirements. The implementation of Basel III in the EU and the US has exceeded the original Basel III requirements in different respects. In the EU, Basel III has been implemented through the Capital Requirements Directive IV ("CRD IV")[114] and the CRR covering, *inter alia*, requirements for the quality and quantity of capital, liquidity, leverage, and countercyclical capital buffers.[115] The EU requirements go beyond Basel III and broadly apply to all credit institutions and also investment firms (with certain exceptions). Certain requirements are not endorsed as binding rules in the Level 1 measures, but are subject to discretion by individual Member States' regulation through a Pillar 2 process. The US has implemented Basel III through the Dodd-Frank Act and the final rules established by relevant bank regulatory agencies, which also set out requirements for the items as being referred to above in respect of the CRD IV and the CRR.[116] The Dodd-Frank Act, however, contains several provisions which introduce capital-related requirements unique to US financial institutions, but are inconsistent with or stricter than Basel III. Furthermore, the types of institutions subject to US and EU requirements are different.

Although the EU and the US have established rules which have a degree of commonality, there remains significant divergence. In addition to the inconsistencies outlined above, there is a lack of coordination in timing and requirements in a number of core areas:

- owing to the differences in the assessment criteria of regulatory capital, capital instruments which qualify as regulatory capital in the US may not qualify as such in the EU and *vice versa*.[117] The qualification standards of certain investments may also be subject to phase-out schedules;

- there are also certain jurisdictional-specific requirements. For example, the US has significantly modified the methodology for risk-weighted asset calculations under the

114 Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

115 See Article 412 of the CRR (liquidity); Article 87 of the CRD IV and Articles 429, 430 and 451 of the CRR (leverage); and Title VII, Chapter 4 of the CRD IV and Article 440 of the CRR (capital buffers).

116 In particular, the final rule issued by the Office of the Comptroller of the Currency, Treasury and the Board of Governors of the Federal Reserve System on 11 October 2013 is available at: http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

117 For example, European Union, *Basel III regulatory consistency assessment (Level 2) Preliminary report* (October 2012) points out that the CRR definition of CET1 for joint stock banks includes the Basel framework criteria, "but does not specify that the criteria must be met by common shares." This report is available at: http://www.bis.org/bcbs/implementation/l2_eu.pdf, p. 8.

standardised approach.[118] The EU has not implemented similar modifications in these respects;

- in the US, the final rule requires a covered entity to "maintain an amount of high-quality liquid assets[…] that is no less than 100 percent of its total net cash outflows over a prospective 30 calendar-day period", which goes beyond Basel III.[119] In the EU, rules on the Liquidity Coverage Ratio (the "LCR") follow the Basel III standards to a large extent and have been implemented in the CRR. Article 421 of the CRR requires institutions to maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of thirty days. Although the deadline for the implementation of the LCR requirement under Basel III is 2019, the US requirement became effective in January 2015 with a two-year phase-in period and will become fully applicable in January 2017, whilst the EU requirement will become fully applicable in 2018;[120]

- the leverage ratio requirement in the US is stricter than Basel III. Under the final rules adopted by the US Federal Deposit Insurance Corporation (the "FDIC"), Office of the Comptroller of the Currency, Treasury, and the Board of Governors of the Federal Reserve, banking organisations are generally required to comply with the following requirements:[121]

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118 This amended requirement became effective in January 2015. The minimum capital requirements for banks subject to the internal models approach are subject to a floor and would not be able to benefit from capital relief. The Dodd-Frank Act also prevents banks which employ advanced approach from having minimum capital requirements below the level of general risk-based capital requirements as a result of the Collins Amendment of the Dodd Frank Act.

119 U.S. Department of the Treasury, "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards", available at: http://usbasel3.com/docs/LCR%20Rule.pdf, p. 2.
A final rule that implements a quantitative liquidity requirement consistent with the liquidity coverage ratio standard established under the Basel III was issued by the Office of the Comptroller of the Currency, Department of the Treasury, Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation on 10 October 2014. The final rule is available at: http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

120 The rules on the required LCR will be introduced in accordance with Article 460 of the CRR as follows: 60 percent of the liquidity coverage requirement from 1 October 2015, 70 percent from 1 January 2016, 80 percent from 1 January 2017, and 100 percent from 1 January 2018. Before the LCR becomes a binding minimum standard in 2015, EU Member States may maintain or introduce binding minimum standards for liquidity coverage requirements and require LCR levels up to 100 percent before the LCR is fully introduced at a rate of 100 percent in 2018. This may cause an inconsistency of the timing when the LCR requirements would come into force within EU Member States.

121 The final rule issued on 3 September 2014 by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, available at: https://www.fdic.gov/news/board/2014/2014-09-03_notice_dis_c_fr.pdf.

Prior to this, the FDIC issued the final rule on 9 July 2013, available at: https://www.fdic.gov/regulations/laws/federal/2013/2013-09-10_final-rule-interim.pdf.

This final rule substantially adopted the interim final rule published on 10 September 2014 by the FDIC, available at: https://www.fdic.gov/news/board/2013/2013-07-09_notice_dis_a_res.pdf; and Office of the Comptroller of the Currency's final rule.

(i) a minimum leverage ratio requirement of 4 percent (the former 3 percent leverage ratio exemption for banking with strong supplementary ratings or bank holding companies that are subject to the market risk rule was removed for banking organisations as of 1 January 2014 for all other banking organisations as of 1 January 2015);

(ii) for advanced approaches banking organisations, a disclosure requirement of supplementary leverage ratios from 1 January 2015; and

(iii) for advanced approaches banking organisations, a supplementary leverage ratio requirement of 3 percent of tier 1 capital to on- and off-balance sheet exposures starting on 1 January 2018.[122]

In the EU, the leverage ratio rules have not been implemented as a binding requirement, but as a Pillar 2 measure. Therefore, each Member State has some discretion in determining the level of leverage ratio required in respect of particular financial institutions.[123] Article 430 of the CRR requires institutions to submit information on the leverage ratio and its components and Article 451 sets forth the disclosure requirement on the leverage ratio. Furthermore, in accordance with Article 87 of the CRD IV, institutions would be required to have in place policies and procedures for the identification, management and monitoring of the risk of excessive leverage; and

- in addition to the items listed above, there are other differences in significant areas such as the timing for ceasing the use of and reliance on external credit ratings, the availability of a credit valuation adjustment exemption and the rules on measuring and controlling exposures to a large counterparty in the US and the EU.

4 BANK RESOLUTION

At the Pittsburgh Summit of 2009, the G20 Leaders stated that

> Systemically important financial firms should develop internationally-consistent firm-specific contingency and resolution plans. Our authorities should establish crisis management groups for the major cross-border firms

[122] In addition, as applicable, enhanced supplementary leverage ratio standards that the federal agencies finalized in May 2014 will become applicable from January 1, 2018. The relevant final rule is available at: http://www.gpo.gov/fdsys/pkg/FR-2014-05-01/pdf/2014-09367.pdf.

[123] The EU proposal for a delegated act introducing a binding leverage ratio (or different leverage ratios for different business models) is expected from January 2018 onwards.

> and a legal framework for crisis intervention as well as improve information sharing in times of stress. We should develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future… The FSB should propose by the end of October 2010 possible measures including more intensive supervision and specific additional capital, liquidity, and other prudential requirements.[124]

In 2011, the FSB published the Key Attributes of Effective Resolution Regimes of Financial Institutions 2011 (the "Key Attributes") as the new international standard for resolving Systemically Important Financial Institutions ("SIFIs") which has been endorsed by the G20 at the Cannes Summit in 2011. The Key Attributes set out the core elements of effective resolution regimes, namely: scope; resolution authority; resolution powers; set-off; netting; collateralisation; segregation of client assets; safeguards; resolution funding; legal framework for cross-border cooperation; crisis management groups; institution-specific cross-border cooperation agreements; resolvability assessments; recovery and resolution planning; access to information; and information sharing. The FSB urged the G20 Leaders to commit to implementing the Key Attributes by the end of 2015.[125]

Implementation of the Key Attributes is at different stages in respective G20 countries. The US introduced a new resolution framework in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act")[126] prior to the publication of the Key Attributes; and the UK established a special resolution regime[127] which implemented the Key Attributes in advance of the European Bank Recovery and Resolution Directive (the "BRRD").[128] The Japanese Deposit Insurance Act was revised in 2013 to implement the Key Attributes, the revised Act entered into force in March 2014.[129] Hong Kong's supervisory authorities[130] published a

124 See footnote 60, para. 13.

125 The FSB, *Progress and Next Steps towards Ending Too-Big-To-Fail*, available at: http://www.financialstabilityboard.org/publications/r_130902.pdf, p. 3.

126 Title I and Title II of the Dodd-Frank Act equips the federal Deposit Insurance Corporation with powers to address the failure of a systemically important financial institution.

127 The regime was established by the Banking Act 2009 and applies to banks and building societies. The Financial Services Act 2012 widened the regime to include undertakings in the same group as a failing entity, investment firms, and central counterparties. The Banking Act was amended by the Financial Services (Banking Reform) Act 2013 which expands the powers available to UK resolution authorities so as to include the power to bail-in unsecured creditors. The UK Government concluded consultation seeking to amend the regime in line with the BRRD.

128 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms. The BRRD was adopted by the European Parliament in May 2014.

129 Masamichi Kono, "An Overview of work on Resolution at the Financial Stability Board", presentation at the 2014 IADI APRC International Conference, available at: https://www.dic.go.jp/katsudo/kokusai/koryu/h26/0423-3h.pdf.

consultation paper on an effective resolution regime for financial institutions in January 2014, with a view to publishing a second stage consultation before introducing a draft Bill to the Legislative Council in 2015.[131] Under the prevailing fragmentary implementation of the Key Attributes, a significant number of legal uncertainties would undoubtedly be faced by national authorities seeking to resolve a GSIFI. If a resolution event were to occur for example, host authorities of a GSIFI may be hindered by the lack of a cohesive international framework for resolving conflicts of law.[132]

Notable disparities have emerged in the approaches taken by the FSB members in implementing the Key Attributes. Drawing on the resolution regimes in the US and the EU by way of example, the following inconsistencies are easily identified:

- loss absorption (creditor hierarchy): section 210(a)(1)(M) of the Dodd-Frank Act states

> the Corporation,[133] as receiver for a covered financial company[134]…shall terminate all rights and claims that the stockholders and creditors of the covered financial company may have against the assets of the covered financial company or the Corporation arising out of their status as stockholders or creditors, except for their right to payment, resolution, or other satisfaction of their claims …. The Corporation shall ensure that shareholders and unsecured creditors bear losses, consistent with the priority of claims under this section.

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130 The supervisory authorities comprise the Financial Services and the Treasury Bureau, the Hong Kong Monetary Authority, the Securities and Futures Commission, and the Insurance Authority.

131 The Hong Kong Monetary Authority, *An Effective Resolution Regime for Financial Institutions in Hong Kong*, available at: http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/RR_Consultation_Paper.pdf.

132 The FSB in its September 2013 report to the G20 (available at: http://www.financialstabilityboard.org/wp-content/uploads/r_130905c.pdf?page_moved=1) identified legal uncertainties arising from the cross-border effectiveness of resolution measures as one of the main obstacles to the resolution of SIFIs. At the St. Petersburg G20 Summit of 2013, the FSB committed to developing policy proposals on how legal certainty could be further enhanced in a cross-border resolution. On 29 September 2014, the FSB published a consultative document on cross-border recognition of resolution action (available at: http://www.financialstabilityboard.org/2014/09/pr_140929/) which proposes a package of policy measures and guidance on the contents of statutory cross-border recognition frameworks and contractual approaches to cross-border recognition pending widespread adoption of comprehensive statutory frameworks.

133 Section 2(7) of the Dodd-Frank Act defines "Corporation" to mean the FDIC.

134 Covered financial company is defined to include (i) any U.S. bank holding company that has $50 billion or more in consolidated assets, (ii) any foreign bank or company that is a bank holding company, or that is treated as a bank holding company, with $50 billion or more in total consolidated assets, and (iii) any nonbank financial company supervised by the Board. *See* sections 115 and 165 of the Dodd-Frank Act.

Section 210(b)(1) of the Dodd-Frank Act sets out the priority of claims. Insured and uninsured depositors rank ahead of unsecured creditors.

In the EU, Article 34(1)(b) of the BRRD requires that creditors bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings save as expressly provided otherwise in the BRRD.[135] Article 108 of the BRRD introduces a two-tier depositor preference with higher ranking than ordinary unsecured, non-preferred creditors.[136] EU depositors with funds exceeding the covered and eligible deposits will be bailed-in. This difference in the priority of claims may impede cross-border resolution as it creates an uneven level playing field for uninsured depositors. It is worth flagging that the amount of guaranteed deposits in the EU and US differ: the EU's Deposit Guarantee Scheme guarantees deposit amount up to EUR100,000.00. In the US, the FDIC insures an amount of USD250,000.00 per depositor.[137]

The lack of harmonised creditor hierarchies between jurisdictions was identified by the IMF as a key obstacle to the allocation of losses to private stakeholders.[138]

- loss allocation: Article 210(b)(1) of the Dodd-Frank Act requires the FDIC to ensure that shareholders and unsecured creditors bear losses, consistent with the priority of claims. There is no further requirement determining the allocation of the losses. The FDIC launched a consultation paper, however, in 2013 requesting comment on, *inter alia*, the Global Loss Absorbing Capital (the "GLAC") level and cost concerns.[139] Article 45(1) of the BRRD requires Member States to ensure that institutions meet, at all times, a Minimum Requirement for own funds and Eligible Liabilities ("MREL"). Article 45(6) of the BRRD sets out a minimum list of criteria on the basis of which MREL should be determined. The European Banking Authority (the "EBA") is

135 Priority of claims may differ under national insolvency laws thereby raising the prospect of different creditor hierarchy within the EU.

136 Covered deposits have a higher priority ranking than eligible deposits. Article 2 of the Deposit Guarantee Scheme Directive defines covered deposits to mean the part of eligible deposits that does not exceed the coverage level of EUR100,000.00. "Eligible deposits" means deposits that are not excluded from protection pursuant to Article 5 of the Deposit Guarantee Scheme Directive.

137 Section 11(a) (3) of the Federal Deposit Insurance Act, available at: https://www.fdic.gov/regulations/laws/rules/1000-1200.html#fdic1000sec.11a.

138 The IMF, *Cross-border bank resolution: recent developments*, available at: http://www.imf.org/external/np/pp/eng/2014/060214.pdf, pp. 13 - 15. The IMF noted that the Key Attributes leave unanswered questions on the treatment of insured and uninsured deposits in the creditor hierarchy and was of the view that greater specificity on this question would facilitate he resolution of banks, particularly on a cross-border basis

139 The FDIC, Federal Register (18 December 2013), available at: https://www.fdic.gov/news/board/2013/2013-12-10_notice_dis-b_fr.pdf.

required to draft regulatory technical standards to further specify these criteria by June 2015.[140] The discussion on MREL is closely tied to the FSB's work on adequacy of global systemically important financial institutions' loss-absorbing capacity in resolution. This lack of uniformity in determining how losses are to be allocated to private sector stakeholders is being considered on an international level, with the FSB working on a proposal on total loss absorbing capacity.[141]

- Resolution tools (public support): the BRRD allows the use of public funding in a very extraordinary situation of systemic crisis and subject to certain condition precedents being met.[142] The Dodd-Frank Act makes no provision for public ownership.[143]

The FSB recently issued a consultation on cross-border recognition of resolution action,[144] which sets out measures aimed at developing and reinforcing the statutory framework and contractual measures to enhance legal certainty in the recognition of the resolution actions within a cross-border context. The consultation proposes (i) a set of elements to be incorporated in Member States' statutory cross-border recognition frameworks, and (ii) the use of contractual mechanisms in the interim to achieve cross-border recognition in two areas: temporary restrictions or stays on early termination rights in financial contracts, and "bail-in" of debt instruments governed by the laws of a jurisdiction other than that of the issuing entity. Measures in this area are required, in part, because many jurisdictions currently do not have statutory powers to recognise and enforce foreign resolution measures. Such powers were identified as critical to an effective cross-border resolution process by the FSB's Key Attributes but there has been considerable disparity in national approaches to the implementation of the Key Attributes. The consultation envisages the continued use of contractual mechanisms for reinforcing the legal certainty and predictability of recognition under the statutory frameworks once adopted.

The FMLC responded to the consultation to highlight that a statutory framework for cross-border recognition remains an important global regulatory objective even though contractual

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140 HM Treasury, *Transposition of the Bank Recovery and Resolution Directive—Consultation Document* (paragraph 11.30, available at: https://www.gov.uk/government/consultations/transposition-of-the-bank-recovery-and-resolution-directive.

141 The FSB, *Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banks in resolution* (10 November 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf.

142 Article 57 of the BRRD provides for the public equity support tool. Article 58 of the BRRD provides for a temporary public ownership tool.

143 Title II, Section 206(6) of the Dodd-Frank Act states that the FDIC shall not take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary.

144 The FSB, *Cross-border recognition of resolution action – Consultative Document* (29 September 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/c_140929.pdf.

measures are helpful in the shorter term and may continue to support any statutory measures.[145] The FMLC has previously emphasised—in a published paper on a legislative proposal for the (subsequently enacted) BRRD—the need to examine the interaction of statutory and contractual measures, for example in relation to bail-in

> Legal uncertainty is likely to arise from the fact that contractual bail-in provisions may not operate in the same way as statutory bail-in provisions under the [B]RRD. The governing law of a contractual bail-in provision will be the applicable law of the contract. The law governing statutory bail-in is, in contrast, the law of the resolution forum. This may give rise to a situation where two different laws are applicable to the bail-in of a single claim. The effect of this could be to give rise to conflicting rights and obligations; it can be expected, in any case, to lead to complexity and uncertainty.[146]

In addition, the FMLC has also identified in the same paper that the interaction between the laws of a resolution forum and the applicable foreign laws governing the contracts, liabilities or assets of a financial institution undergoing resolution proceedings, could create complications and unpredictable outcomes:

> …the most challenging area of legal uncertainty generated by the application of the [B]RRD to derivatives transactions is likely to be the interaction of the law of the resolution forum and the applicable law of the contract, particularly where the applicable law is the law of a third country outside the EU. The fact that the resolution forum will have implemented the [B]RRD's provisions on the exclusion and suspension of termination rights may have no effect whatsoever if the counterparty is in a position to claim under the terms of the contract, applying the law of a third country, in a third country jurisdiction against assets in that jurisdiction of the institution under resolution. In other cases, e.g. where the counterparty's rights are governed by the law and jurisdiction of a third country but any judgment in favour of a counterparty must be enforced against assets in the resolution forum, laws implementing the [B]RRD's provisions on the suspension and exclusion of termination rights will *prima facie* conflict with the international obligations of the resolution

145 The FMLC response to the FSB*'s Consultative Document on Cross-border Recognition of Resolution Action* (28 November 2014), available at: http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_response_to_consultation_on_cross-border_recognition_of_resolution_action.pdf.

146 FMLC, "Discussion of certain legal uncertainties arising from the proposal for a Recovery and Resolution Directive" (February 2013), available at: http://www.fmlc.org/uploads/2/6/5/8/26584807/issue_149_fmlc_paper_february_2013.pdf, p. 14.

forum to recognise the foreign judgment. And in cases where the counterparty's rights are governed by the law of a third country but fall to be adjudicated in the courts of an EU Member State (whether or not this is the resolution forum), the approach adopted by the adjudication forum to resolving the conflict between the terms of the contract and legal provisions implementing the [B]RRD will presumably depend on the interpretation and application of the provisions of EU Regulation 593/2008 on the Law Applicable to Contractual Obligations (Rome I Regulation) regarding the overriding mandatory provisions and public policy of the *lex fori*, and will be affected by those provisions' inherent tendency to lead to unpredictable and varying outcomes between different *fora*.[147]

5 BANK STRUCTURAL REFORM

In response to concerns that the failure of GSIBs would be detrimental to the financial system as a whole and to improve the resolvability of such banks, the US, the EU, various EU Member States (including the UK, France and Germany) and other jurisdictions have found it necessary to implement bank structural reform measures. While such reforms are largely perceived as consistent with the international G20 reform agenda on financial stability and the development of effective resolution regimes as part of the "too-big-to-fail" initiative, the concept did not originate from the G20 Pittsburgh Summit Leadership Commitments but from the later G20 Seoul Summit Leadership Commitments.[148]

Divergent approaches to structural reform have been taken in different jurisdictions. In October 2014, the FSB issued a Report to the G20 Leaders for the November 2014 Summit on "Structural banking reforms cross-border consistencies and global financial stability implications", which recognised that inter-jurisdictional differences may affect the flexibility of the banking groups' funding, as well as other entities in the economy and the flow of cross-border capital.[149]

Inconsistencies arising from national bank structural reforms comprise, *inter alia*, a split between approaches which focus on wholesale prohibition or limitation of certain "risky" activities and

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147 *Ibid.,* p. 30.

148 *G20 Seoul Summit Document* (11 November 2010), Seoul, available at: https://g20.org/wp-content/uploads/2014/12/Seoul_Summit_Document.pdf, at p. 2.

149 The FSB, *Structural banking reforms: Cross-border consistencies and global financial stability implications* (27 October 2014), available at: http://www.financialstabilityboard.org/2014/10/r_141027/, pp. 8–9.

approaches which focus on the differentiated separation of "protected" activities. The former approach has been adopted by the US Volcker rule's prohibition on certain trading activities and the EU's proposed ban on more narrowly defined proprietary trading. Examples of the latter approach often take the form of functional separation of "protected" activities through a ring-fenced entity and operational subsidiarisation within the same banking group and include the UK Vickers structural ring-fencing reforms, the Likannen-style regimes in France and Germany, and the EU discretionary option to include a form of functional separation.

The US Volcker rule became effective on 1 April 2014 and banking entities must conform their activities and investments to comply with the Volcker rule by 21 July 2015. This unilateral action came much earlier than the other jurisdictions. The US regime and the EU proposal are extra-territorial in scope, applying to the branches of foreign banking groups operating in their jurisdictions and the overseas subsidiaries of US- or EU-based banking groups. The US lacks a deference mechanism that mirrors the EU's equivalence assessment framework. Even given the EU's proposal for recognition of third country regimes, unless and until the Commission deems the US regime equivalent to the proposed EU regulation, there is potential for substantial overlap and conflict between the two regimes, which could affect, for example, US entities' branches in the EU (in addition to their subsidiaries in the EU). As a result, international GSIBs and other credit institutions are unclear as to how best to reform their structures in such a way as to comply satisfactorily with multiple regimes.

There are also differences in the scope of application of the regimes in different jurisdictions in terms of both the delineation of the relevant activities to be prohibited, limited or circumscribed and the available exemptions. Such differences exacerbate the impact of the inconsistencies for banking groups operating cross-border that might need to comply with multiple and overlapping regimes. For example, the definition of "proprietary trading" under the US Volcker rule is wider than in the ban on proprietary trading in the EU. There are a number of conditional exclusions and exemptions which narrow the scope of both the US and the EU regimes, which may reduce their extraterritorial impact, but there is a lack of coordination in the scope and application of such limitations. A review of the current status suggests that it is necessary for jurisdictions to agree on common definitions, such as "proprietary trading" and "market-making", and the approach to differentiate customer-oriented and proprietary activities, in order to delineate the scope of application of the regimes and their exceptions.

In addition, there are other associated structural reforms in the US, such as the Swap Push-Out Rule, which further complicates the issue of comparability with other regulatory systems. The effect of this provision is to limit the types of swaps activity US insured depository institutions and US branches and agencies of foreign banks can engage in. Further, the trend towards subsidiarisation and the exercising of control at the level of the host state is also present in the US, which has imposed asset-holding subsidiarisation requirements on foreign banking groups under the Enhanced Prudential Standards for Foreign Banking Organisations rule on Foreign Banking Organisations ("FBOs"). The primary rule requires FBOs with US non-branch assets of US$50 billion or more to hold their US subsidiaries through a US intermediate holding company, which is subject to capital, capital planning, liquidity and stress testing requirements similar to those applicable to US bank holding companies. FBOs with combined US assets (including US branches) of US$50 billion or more will be subject to liquidity and risk management requirements in the US. Again, these rules further complicate the issue of comparability.

Amongst jurisdictions that have chosen the ring-fencing approach, including the UK, the degree of functional separation required differs. To complicate matters further, the EU proposes that this requirement should be discretionary rather than mandatory, as it is in some Member States. Article 21 of the proposed EU regulation for a regulation on bank structural measures provides that the Commission may, upon request by a Member State, grant a derogation from the requirements regarding the separation of specified trading activities.[150] Given that the EU proposal on banking structure reforms comes much later than other jurisdictions and has not yet been finalised, the question whether the implementation of the domestic ring-fencing regimes of some EU Member States by EU banking groups would be recognised by the European Commission as an accepted derogation from the ring-fencing requirements is uncertain; as, indeed, is the question whether the derogation will survive the legislative process of co-decision between the European Council and Parliament.

The FMLC understands that a legal opinion of the European Council Legal Service may have been issued in or about June 2014, calling into question the validity of the derogation under EU law.[151] What is certain is that the ECB has since provided an opinion suggesting that Article 21 of the proposed regulation, which introduces the derogation, should be deleted on the grounds of

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150 On 29 January 2014, the European Commission published a proposal for a regulation on structural measures improving the resilience of E.U. credit institutions, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014PC0043.
The availability of the derogation is subject to national primary legislation having been adopted in the Member State in question before 29 January 2014, which would include the UK, France and Germany.

151 Barker, A., "Vickers reforms fall foul of EU lawyers", 16 June 2014, Financial Times. Press reports on the subject can be found at: http://www.ft.com/cms/s/0/8e451f24-f590-11e3-be21-00144feabdc0.html#axzz38Bme8myp; and Jones, H., "EU legal opinion says exemption for UK bank rules from EU curbs 'illegal'", 17 June 2014, Reuters News. http://uk.reuters.com/article/2014/06/17/uk-banks-britain-eu-idUKKBN0ER2I220140617. See FMLC's letter on 18 August 2014 to Jonathan Faull, Director General, DG Internal Market & Services, European Commission: available at: http://www.fmlc.org/uploads/2/6/5/8/26584807/banking_reform_ring-fencing_-_letter_to_european_commission.pdf.

its incompatibility with EU law.[152] Article 21 provides that the Commission may, upon request by a Member State, grant a derogation from the requirements in Chapter III (Separation of Certain Trading Activities) to a credit institution. The availability of the derogation is subject to national primary legislation having been adopted in the Member State in question before 29 January 2014. This limits the availability of the derogation in practice to France, Germany and the UK. The FMLC drew attention to this issue in a letter published on 18 August 2014 which highlighted the issues of legal uncertainty:[153]

> …doubts have been expressed as to the compatibility of the derogation with, inter alia: (i) the requirement that a regulation have general application, as prescribed by Article 288 of the Treaty on the Functioning of the European Union (the "TFEU"); (ii) the requirement that provisions taking the form of derogations to the internal market must be of a temporary nature, as set out in Article 27 of the TFEU; and (iii) the supremacy of E.U. law.
>
> Questions as to the validity under E.U. law of the derogation give rise to legal uncertainty, and specifically to the risk that certain banks may be required to comply with two differing regimes when the Proposed Regulation takes direct effect. This, in turn, would give rise inter alia to the issues identified in an appendix to this letter, in the case of the U.K. The FMLC would, therefore, recommend that the Commission clearly set out the basis for claiming that Article 21 of the Proposed Regulation is compatible with E.U. law; alternatively, where necessary, the FMLC would welcome further consideration of whether the Proposed Regulation might be reframed as a directive, thereby allowing Member States the time and opportunity to align their national regimes with the proposal in the course of implementation.[154]

Even if the derogation is valid under EU law, whether the UK (for example) could benefit from the derogation may still be uncertain, as there are significant differences in the UK and the EU regimes, with the EU protecting a wider range of deposits than the UK. Given the wide-ranging scope of the reforms and the accompanying restructuring implications, banking groups with a UK and EU presence are currently contending with a significant level of uncertainty as to their

152 The ECB, *Opinion of the ECB of 19 November 2014 on a proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions*, available at: https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2014_83_f_sign.pdf, pp. 7–8.

153 *See* the FMLC's letter to European Commission on *Legal Uncertainties Arising from the Proposed Regulation on Structural Measures Improving the Resilience of EU Credit Institutions*, available at: http://www.fmlc.org/uploads/2/6/5/8/26584807/banking_reform_ring-fencing_-_letter_to_european_commission.pdf.

154 *Ibid.*, p. 2.

future structural configuration. There have been continuous debates at the EU level as to whether any compromise would need to be forged.[155]

6 DATA SHARING

In addition to the difficulties posed for the reform of derivatives trade reporting and disclosure noted in section 1.3.2 of this Annex, data protection rules which restrict data sharing between regulators in different countries, or between market participants and regulators, also pose problems for the application of a number of other regulatory reform initiatives, including those relating to the prevention of fraud, market abuse and money laundering; to prudential supervision and to anti-competitive practices.

By way of example, in the context of the EU, the FMLC has identified a number of issues arising in regard to the restrictions on data sharing set out in the European proposals for a Regulation and a Directive on the protection of individuals with regard to the processing of personal data and on the free movement of such data.[156] These were set out in a letter to the European Commission and comprised three principal concerns: the lack of any express safe-harbour for the exchange of information between national regulators pursuant to the international agreements, such as IOSCO MMoU; a lack of clarity in the application of various exemptions establishing legitimacy for data sharing between market participants and regulatory authorities (in particular sharing that occurs without the consent of the data subject); and the likelihood of conflict between the restrictions imposed by the proposals and market participants' obligations to provide information to third country regulators under the terms of their authorisation to conduct business in that jurisdiction.[157]

The Committee has also identified legal uncertainties that could arise as a result of the broad territorial scope of the draft proposed EU data protection regulation:

> The FMLC observes that, in the case of third country entities caught by the provisions of the Draft Regulation, the entities in question are likely to be subject to overlapping regulation, i.e. under their own home legal or regulatory system and under the Proposals. Evidently, this may lead to legal and/or

155 Barker, A., "EU reforms to break up big banks at risk", Financial Times (29 January 2015), available at http://www.ft.com/cms/s/0/09025d06-a7d1-11e4-97a6-00144feab7de.html#axzz3QaAUxAv8.

156 The proposal for a Regulation: COM(2012) 11 final; 2012/0011 (COD) and the proposal for a Directive: COM(2012) 10 final; 2012/0010 (COD).

157 See a letter sent by the FMLC to Francoise Le Bail (Director General, DG Justice, European Commission) of 8 July 2014, available at: www.fmlc.org.

regulatory conflicts. As a general principle, such regulatory conflict, exacerbated by the application of different standards and rules, causes significant legal uncertainties […]

It was noted above that Article 6(1)(c) provides that processing may be legal where it "is necessary for compliance with a legal obligation to which the controller is subject". Paragraph 3 of that article stipulates that the legal obligation referred to must be one of Union law, or "the law of the Member State to which the controller is subject." This introduces a further issue of uncertainty in addition to those discussed above. First, there is uncertainty as to the boundaries of Union law. This gives rise to the question, for example, whether international conventions entered into by the EU, on behalf of its Member States, can impose a legal obligation. Second, there is the practical question of the position of entities established in third countries that are required to process data to comply with obligations imposed by their "home" legal system and the confusion likely to be caused in these circumstances, where data processing is unlawful under the Regulation but obligatory in their home jurisdiction.[158]

Such issues will continue to have a negative impact on the effectiveness of cross-border regulation unless these uncertainties are resolved in such a way as to permit data sharing where to do so would enhance international supervision and enforcement.

158 See FMLC, "Discussion of legal uncertainties arising in the area of EU Data Protection Reforms" (October 2014), available at: www.fmlc.org.

INDEX OF DEFINED TERMS

"Annex" refers to the annex to this discussion paper

"Basel II" means the Basel Accords setting the minimum capital requirements of financial institutions with the goal of ensuring institution liquidity

"Basel III" means the Basel Accords setting voluntary regulatory standard on bank capital adequacy, stress testing and market liquidity risk

"Single Supervisory Mechanism" refers to the mechanism that places the ECB as the central prudential supervisor of financial institutions in the euro area and in those non-euro EU countries that choose to join the SSM

"BCBS" means Basel Committee on Banking Supervision

"Brisbane Summit" refers to the G20 Summit held in Brisbane on 15 November 2014

"BRRD" means "Bank Recovery and Resolution Directive", Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms

"Cannes Summit" refers to the G20 Summit held in Cannes on 3-4 November 2011

"CCP" means central counterparty

"CEA" means Commodity Exchange Act of 1936 (P.L. 74-765, 49 Stat. 149)

"Central Bank Governors" means governors of central banks of the G20 countries

"CFTC" means U.S. Commodity Futures Trading Commission

"CPMI" means Committee on Payments and Market Infrastructures

"CRA" means Credit Rating Agency

"CRR" means "Capital Requirements Regulation", Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms

"CRD IV" means "Capital Requirements Directive IV", Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms

"ComFrame" means Common Framework for the Supervision of Internationally Active Insurance Groups

“DCM” means designated contract market

“DSB” refers to the Dispute Settlement Body of the World Trade Organisation

“Dodd-Frank Act” means Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111–203, H.R. 4173)

“ECB” refers to the European Central Bank

“EMIR” means “European Market Infrastructure Regulation”, Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

“EU” refers to the European Union

“European Commission” or “Commission” is the EU’s executive body

“European Council” or “Council” refers to a body composed of representatives of the Member States of the European Union and is one of the two main law making institutions of the European Union (together with the European Parliament)

“European Parliament” or “Parliament” refers to a body composed of elected representatives and is one of the two main law making institutions of the European Union (together with the European Council)

“EU Member States” or “Member States” refers to member states of the European Union

“ESMA” refers to the European Securities and Markets Authority

“FASB” refers to the US Financial Accounting Standards Board

“Federal Reserve” refers to the central banking system of the United States of America

“FBOs” means foreign banking organisations

“FDIC” refers to the US Federal Deposit Insurance Corporation

“FSF” refers to the Financial Stability Forum

“FSB” refers to the Financial Stability Board

“GLAC” means Gone-Concern Loss-Absorbing Capacity

“Group of Twenty Finance Ministers” means finance ministers of the G20 countries

“GSIBs” means global systemically important banks

“GSIFIs” means globally systemically important financial institutions

“G20” refers to the Group of Twenty Finance Ministers and Central Bank Governors

“G20 Leaders” means leaders of the G20

“HM Treasury” means Her Majesty's Treasury, the United Kingdom government department responsible for developing and executing the British government's public finance policy and economic policy

“IAIS” refers to the International Association of Insurance Supervisors

“IASB” refers to the International Accounting Standards Board

“IBOR” refers to major interbank interest reference rates, including: LIBOR, EURIBOR and TIBOR

“IMF” refers to the International Monetary Fund

“IOSCO” refers to the International Organization of Securities Commissioners

“IOSCO MMoU” refers to the IOSCO Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information

“ISDA” refers to the International Swaps and Derivatives Association, Inc.

“JFSA” refers to the Japan Financial Services Authority

“Key Attributes” refers to the Key Attributes of Effective Resolution Regimes for Financial Institutions published by the FSB on October 2011 and updated on 15 October 2014

“LCR” means liquidity coverage ratio as defined in Basel III, and for example in the CRR which implements Basel III

“London Summit” refers to the G20 Summit held in London on 2 April 2009 with the heads of government or heads of state from the Group of Twenty Finance Ministers and Central Bank Governors (G20), plus some regional and international organisations attended

“MiFID” means “Markets in Financial Instruments Directive”, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC

“MiFID II” means “Markets in Financial Instruments Directive II”, Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

“MiFIR” means “Markets in Financial Instruments Regulation”, Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments

“MoU” means a memorandum of understanding

“MPG” refers to the Market Participants Group, a committee of experts established by the OSSG to review IBOR benchmarks

“MREL” means minimum requirement for own funds and eligible liabilities

“MTF” means multilateral trading facility as defined under the MiFID II

“ODRG” refers to OTC Derivatives Regulators Group

“Office of the Comptroller of the Currency” means Office of the Comptroller of the Currency in the United States of America, an independent bureau of the U.S. Department of the Treasury

“OSSG” refers to the Official Sector Steering Group, a committee of regulators established by the FSB

“OTC” means over-the-counter

“OTF” means organised trading facility as defined under the MiFID II

“Pittsburgh Summit” refers to the G20 Summit held in Pittsburgh on 24 and 25 September 2009

“SEC” refers to the US Securities Exchange Commission

“SEF” means swap execution facility and refers to a regulated platform for swap trading

“SIFIs” means systemically important financial institutions

“Seoul Summit” refers to the G20 Summit held in Seoul, South Korea 11 November 2010

“Sydney Summit” refers to the G20 Young Entrepreneur’s Alliance Summit, Australia 2014

“Treasury” refers to the United States Department of the Treasury

“WTO” refers to the World Trade Organisation

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