

February 23, 2015

Ms. Rohini Tendulkar
IOSCO General Secretariat,
C/ Oquendo 12, 28006 Madrid.

Re: Public comment on the IOSCO Task Force on Cross-Border Regulation Consultation Report

Dear Ms. Tendulkar,

The International Swaps and Derivatives Association, Inc. (ISDA)¹ appreciates the International Organization of Securities Commissions (IOSCO) Task Force on Cross-Border Regulation's engagement with the industry throughout this consultation process. ISDA has previously submitted comments to the Task Force on a number of specific issues, and highlighted how over-the-counter (OTC) derivatives markets have been affected by a lack of effective cross-border regulatory harmonization². OTC derivatives markets have historically been the most global in nature of all financial markets, and the absence of consistency in regulatory reform is having a direct impact on these markets as a result. This also affects other product areas and, more importantly, threatens the efficiency with which 'real economy' end-users can manage and transfer business risk to financial markets.

We appreciate the efforts of the Task Force, in this latest Consultation Report, to identify tools at a regulator's disposal to address cross border regulation. In this letter, ISDA reiterates how cross-border regulatory harmonization could be achieved, and suggests ways in which IOSCO can reduce undesirable regulatory outcomes that threaten the efficient functioning of markets. ISDA's sees this harmonization as the start to assisting the market generally, with respect to the application of any tool by the relevant competent authority(ies) in the context of the cross border regulation of securities market activities.

¹ Since 1985, ISDA has worked to make the global OTC derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

² ISDA comment letter dated May 29, 2014; <http://www2.isda.org/functional-areas/public-policy/united-states>

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With respect to the cross-border regulatory tools identified in the consultation paper, ISDA considers that recognition offers most flexibility and adaptability across different markets whilst also being consistent with the statement of the G20 Leaders in 2013 that “jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulatory regimes”³.

1. Managing cross-border regulatory conflict – IOSCO role

IOSCO is one of a number of international organizations that have the ability to influence cross-border regulatory coordination. The Basel Committee on Banking Supervision (BCBS) has a significant role in many areas, as does the Financial Stability Board (FSB). Notwithstanding this, ISDA believes the IOSCO task force can realistically propose improvements in the way its members coordinate activities that have cross-border implications, as well as the future role of IOSCO in the international regulatory community. To this end, we note and generally support the suggestions on IOSCO’s role regarding cross-border issues set out in section 8 of the consultation paper and have identified several specific areas where IOSCO’s expertise and leadership can make a significant improvement in the consistency of current and pending rules.

As noted by ISDA in its previous comment letter⁴, many of the current cross-border challenges exist due to the fact that there is an inherent focus on domestic markets at the IOSCO member level. National securities regulators are generally explicitly required to consider the impact of their conduct (including rule-making, supervision and enforcement) on their domestic market as a priority, rather than consider any effect outside their jurisdiction. Further, securities regulators may face constraints in fully implementing IOSCO standards or recommendations, particularly in the realm of rule-making.

This domestic focus explains some of the challenges IOSCO and its members have faced in implementing the Group of 20 (G-20) commitments in a way that avoids fragmentation of markets, protectionism and regulatory arbitrage between different jurisdictions⁵. Smooth global implementation of the G-20 commitments has been further impeded by insufficient cooperation and coordination among securities regulators as the assessment of the various principal regulatory tools currently utilized by surveyed jurisdictions to regulate cross-border securities market activities identifies.

We note that the consultation paper reports “little support” for IOSCO to facilitate the settlement of disputes arising from the assessment of foreign regulatory regimes. However, it is ISDA’s view that IOSCO is uniquely placed to facilitate resolution of disputes between jurisdictions and ISDA supports a stronger, more active role for IOSCO in this field. In certain areas of international rulemaking, such as benchmarks, margin for uncleared trades and principles for

³ G20 Communique: Meeting of Finance Ministers and Central Bank Governors, Sydney, 22-23 February 2014.

⁴ See footnote 2, above.

⁵ <http://www.mea.gov.in/Images/pdf/pittsburgh.pdf>.

financial market infrastructure, IOSCO has taken a lead in developing international rule standards ahead of national implementation, and we strongly support this template for future rulemaking. In the case of many of the cross-border challenges, however, national rules were written ahead of international consensus, but there is a role for IOSCO here also. IOSCO should develop and implement principles-based standards for resolution of differences between jurisdictions, provide a forum for discussion of disputes and consider the institution of an arbitration or college type process for resolution of matters of international importance.

In section 2, we repeat a number of proposed principles that we believe IOSCO and its members could adopt to promote cross-border regulatory coordination. Whilst we appreciate that the principles focus on coordination on the development and implementation of IOSCO standards that may have a cross-border impact, we believe that ultimately, such common standards are necessary to facilitate cross-border supervisory coordination and the application by each national authority of the tool most suited to its jurisdiction on the basis of a harmonized outcomes based approach.

In section 3, we discuss the cross-border regulatory tools identified and discussed in the consultation paper.

In section 4, we highlight specific areas in which we see opportunities for leadership of cross-border harmonization initiatives.

2. ISDA principles for inter-jurisdictional recognition of derivatives regulation

ISDA supports adherence to the following principles, as regulators address the causes of and solutions for harmful extraterritorial regulation.

1) An effective framework should be grounded in the declarations issued by the G-20 following the Pittsburgh and Cannes meetings.

The five G-20 goals are the basis of derivatives regulatory reform and should be met through regional or national efforts to achieve consistency and avoid fragmentation of global markets. These goals include: clearing of standardized derivatives; exchange/electronic trading, where appropriate; reporting to trade repositories; higher capital requirements for non-cleared trades; and margin requirements for non-cleared trades.

2) In order to minimize burdens on regulators, maintain global markets and avoid market fragmentation, regulators at international, regional and national level should evaluate individual regimes to allow for a principles-based approach to cross-border compliance.

Such evaluation should take place throughout the regulatory process, to facilitate early and preventative identification of issues in the formation of regulation and to assist in the resolution of disputes concerning the application of any embedded regulation.

3) For purposes of substituted compliance or equivalence, comparisons of one jurisdiction's requirements to another's may use a variety of analytical methods, all of which must start with identification of a set of common principles that elaborate on the G-20 regulatory goals.

In this way, regardless of the tool employed by a jurisdiction, the burden of inconsistent and conflicting regulatory requirements can be minimized.

4) Ultimate decisions regarding comparability require not only a bilateral dialogue between regulators, but also a transparent process.

Decision by national authorities regarding substituted compliance and comparability determinations must be done in consultation with industry participants.

5) Regulators should consult and cooperate with each other before implementing their derivatives regulations.

ISDA believes that IOSCO can play a vital role in facilitating bilateral or multilateral inter-jurisdictional recognition efforts, which will greatly help markets to progress to a consistent international framework that avoids duplication or jurisdictional over-reach.

ISDA has (in August 2013) published examples of how these principles can apply to various areas within derivatives regulation. These examples have been developed and organized in relation to three of the five primary goals of derivatives regulation issued by the G-20⁶.

3. The cross-border regulatory toolkit

ISDA continues to maintain that cross-border regulatory harmonization is key to addressing the negative impacts of conflicting extra-territorial regulation. With harmonized regulatory principles, the application of any of the tools identified in the consultation paper is facilitated and the negative impacts of conflicting requirements mitigated.

That said, of the three tools identified, ISDA considers that national treatment does not really constitute regulatory coordination, as such. Whilst we acknowledge the concept of accommodations for foreign entities, such accommodations are limited in scope and do not prevent market participants from being subject to duplicative regulatory regimes. Even where regulatory harmonization has or can be achieved, the duplicative nature of national treatment would still have at least financial consequences for the regulated entities which in turn would undoubtedly impact end-users. This duplication also contradicts one of the reported aims of national treatment, namely, to treat all relevant entities the same and to create a level playing field.

⁶ Please see the links below, to access these examples, as well as a more detailed methodology for regulatory comparisons:
<http://www2.isda.org/attachment/NTgwOA==/Common%20Principles%20-%20Examples%2020130820.pdf>
<http://www2.isda.org/attachment/NTgwNw==/Methodology%20for%20Regulatory%20Comparisons%2020130820.pdf>

Concerning passporting, ISDA supports this tool where available however does not consider it suitable for all markets. To be effective, any regulatory tool has to give all affected markets the security that it continues to offer appropriate protections for domestic investors and market participants and the stability of domestic markets. ISDA does not consider that passporting offers the flexibility required to accommodate developing markets.

It seems to ISDA that of the three tools discussed, recognition is the most adaptable across markets and regions. It also offers the potential to reduce the burden of duplicative regulation. Again, however, the utility of recognition does depend upon regulatory harmonization.

We would also observe that in the interests of certainty, the guidelines applied by regulators should be consistent and transparent and focused on outcomes rather than a line-by-line comparison of regulation. As flagged in section 2 above, we consider this to be a role that IOSCO would be well placed to facilitate.

4. Opportunities for Leadership

As we noted in our prior letters, there are specific areas of conflicting regulations that require immediate resolution. These problematic areas are: (1) clearing, (2) trade reporting, (3) trade execution, (4) resolution and recovery regimes, and (5) margining for non-cleared derivatives.

(1) Clearing

One of the most urgent cross-border issues that has to be tackled is clearing.

US rules require foreign central counterparties (CCPs) to either register as derivatives clearing organizations (DCOs) with the Commodity Futures Trading Commission (CFTC) or obtain exemption from registrations with the CFTC. These rules prevent US clients from clearing with foreign CCPs that are not registered or exempt from registration with the CFTC.

To complicate things further, Europe's equivalence determinations for US central counterparties (CCPs) and other European and non-European banks have not been completed. Absent such determinations, US CCPs, and European banks are not allowed to act as clearing members of any CCP in a non-equivalent jurisdiction, while Europe's Capital Requirements regulation prevents these entities from applying the lowest possible 2% risk-weight for cleared exposures.

If the equivalence issue is not resolved as soon as possible, European, US, South Korean and Indian clearing members will face potentially large losses unwinding cleared position in a market that knows that these unwinds must take place.

To prevent such a devastating outcome, we encourage IOSCO to assert its leadership role in bringing the appropriate national authorities to the table to resolve these pressing issues.

(2) Trade Reporting

The other area that deserves immediate attention is trade reporting. Implementation of the G-20

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trade reporting commitment across jurisdictions has lacked the necessary coordination to achieve harmonized reporting regimes. This has caused a disjointed and costly network of reporting obligations, with market participants reporting to a multiplicity of trade repositories on different bases.

As a result, despite having access to more information than ever before, regulators lack a completely consolidated view of the true risk picture, and they currently have no means of aggregating data.

For example, single-sided reporting is required for OTC derivatives in the US⁷, while Europe requires double-sided reporting of OTC and exchange-traded derivatives⁸, as well as collateral reporting⁹. The differences between the US and European reporting requirements mean that separate systems need to be built to meet each reporting requirement. This is costly and duplicative.

In the meantime, Hong Kong, Singapore, Australia, Malaysia, Taiwan, China, India and South Korea have all been developing their own reporting regimes. There are differences in reporting fields, reportable products and other elements in each jurisdiction, and this only makes it more challenging to build an efficient data capture system.

A consistent cross-border trade reporting regime will promote comity and will allow national authorities to conduct a meaningful oversight of the derivatives market.

(3) Trade Execution

ISDA believes that it is critical that G20 members, under IOSCO's leadership, start the process of translating the G20's general intent to encourage centralized trading into a set of common principles to avoid regulatory disparity, market fragmentation, low trading liquidity, and duplicative compliance requirements.

In this regard, we urge IOSCO to engage with other national authorities to achieve mutual recognition of various trading venues based on substituted compliance to ensure regulatory consistency across jurisdictions.

(4) Resolution and Recovery regimes

In our past submissions we listed a host of issues that have to be addressed in this area. One significant issue that is worth reiterating here is that the current legal framework in Europe does not guarantee that the resolution measures taken by the home jurisdiction of a bank will be

⁷ Part 45, Dodd-Frank Wall Street Reform and Consumer Protection Act

⁸ EMIR Regulation, Article 9

⁹ EMIR delegated regulation (ESMA regulatory technical standard) n°148/2013, article 3 and annex I for application of EMIR regulation article 9.5.

recognized by a host country where the bank has significant assets. This poses a serious issue for resolving systemically important financial institutions (SIFIs).

(5) Margining for non-cleared derivatives.

The conclusions reached by BCBS-IOSCO on margining for non-cleared OTC derivatives is an example of positive global-level regulatory coordination, in an effort to avoid fragmentation, protectionism and regulatory arbitrage.

Nevertheless, there remain potential differences at the national and regional level, either due to insufficient granularity in the BCBS-IOSCO rules or because of differences in scope in primary legislation in different jurisdictions. For example, without an agreement on the scope of entities subject to the margin requirements, national level rules could apply to swap dealers and major swap participants in one jurisdiction or to all financial counterparties and certain non-financial counterparties in another. Similarly, the treatment of certain instruments, such as foreign exchange swaps and forwards, may be inconsistent across jurisdictions due to statutory restrictions.

Conclusion

Insufficient cross-border cooperation risks market distortion, fragmentation, a reduction in competition and higher costs for end-users seeking to hedge commercial risks, with negative consequences for investment and economic growth and ultimately end-users. Inconsistencies and divergences in the regulatory approach of different jurisdictions can subject market participants to duplicative and/or conflicting requirements and creates the potential for regulatory arbitrage.

Whilst we fully appreciate the requirement for authorities to maintain appropriate levels of investor protection and to prevent the importation of risks, such assessment cannot be done without considering cross-border issues and the potential impact on fair and effective global financial markets. There needs to be a renewed and concerted international focus to avoid further fragmentation and to remediate existing fractures.

Ultimately, cross-border harmonization is key but cross-border cooperation and recognition also play a fundamental part in avoiding unnecessary duplicative or conflicting regulation. To this end, ISDA sees recognition as the most adaptable of the tools discussed in the consultation paper.

Additionally, ISDA considers that IOSCO is uniquely placed to facilitate resolution of disputes between jurisdictions and supports a stronger, more active role for IOSCO in this field. In certain areas of international rulemaking, such as benchmarks, margin for uncleared trades and principles for financial market infrastructure, IOSCO has taken a lead in developing international rule standards ahead of national implementation, and we strongly support this template for future rulemaking. In the case of many of the cross-border challenges, however, national rules were

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written ahead of international consensus, but there is a role of IOSCO here also. IOSCO should develop and implement principles-based standards for resolution of differences between jurisdictions, provide a forum for discussion of disputes and consider the institution of an arbitration or college type process for resolution of matters of international importance.

Such an international forum for dialogue and resolution of potential national concerns is central to developing trust between regulators and to ensuring that workable implementation initiatives and timelines are agreed. ISDA considers such global cooperation the optimal way to ensure consistent global general principles and effective outcomes-based cross-border recognition whilst allowing each market to adopt the tool best suited to its needs, provided that its application meets the agreed general principles.

As the trade association representing the world's most global financial business – OTC derivatives – ISDA appreciates the opportunity to comment on extraterritoriality issues. We also welcome the initiative taken by IOSCO to address extraterritoriality-related concerns in its Task Force on Cross-Border Regulation. We would be happy to elaborate on these concerns should IOSCO have any further questions on the views expressed herein.

Sincerely,



Scott O'Malia
Chief Executive Officer
International Swaps and Derivatives Association, Inc.