COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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Call for evidence on mutual recognition with non-EU jurisdictions

Deadline for contributions: CESR invites responses to this consultation paper by **4 September 2009**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests their submission to be confidential.

Introduction

The globalisation of financial markets challenges securities regulators to seek appropriate mechanisms for dealing with cross-border transactions. Some differences in regulatory approaches and rules have been developed on the basis of a positive consideration of local markets characteristics. Furthermore, any regulatory differentiation was less of a problem when investors and broker/dealers were mainly focused on domestic markets and products. Firms now operate in different countries in a differentiated rules environment that inevitably imposes costs and regulatory conflicts or duplications, undermining the efficiency of cross-border transactions.

Broadly, there are three main ways (none of which is exclusive) of alleviating complexities, costs and burdens imposed by different national rules:

- *Standardisation*, i.e. a development of common approaches or international standards;
- *Exemptions*, i.e. providing exemptions from national rules to foreign entities where imposing such rules would be disproportionately burdensome;
- *Recognition*, i.e. accepting compliance by a foreign entity with its home country standards through mutual recognition.

This calls to the possibility to consider mutual recognition together with other alternatives, such as a unilateral recognition, which have been brought forward as a means in order to facilitate cross-border activities in financial services. Advantages and drawbacks of each should be carefully taken into account. In fact, despite considerable advantages that the mutual recognition of third countries' rules and regulation could bring, there are also potential drawbacks. Mutual recognition presumably does not create a level playing field across borders since rules already established continue to exist and are simply mutually accepted. Differences in these rules may cause competitive distortions between the market participants of the participating jurisdictions. Furthermore, legal questions may arise around the different existing legal regimes. The mutual recognition discussed in this call for evidence could technically be a single decision, which under certain conditions may be developed into an understanding agreed upon by the supervisors in both jurisdictions to become mutual.

EU Securities regulators are in regular contacts with some non-EU regulators to achieve agreements for limited access to markets: the case of the recognition of derivatives exchanges is just an example. More recently, in the EU, Mutual Recognition of securities markets (in particular towards the US) has been on the agenda since early 2007. The European Commission started preliminary discussions with the SEC in early 2007 in order to explore the potential for a Mutual Recognition framework. On 1st February 2008 the Commission and US SEC issued a joint press release on mutual recognition in securities markets, in which both the SEC Commissioner Cox and Commissioner McCreevy agreed to work together on this initiative. Member States (via the European Securities Committee - ESC) and CESR have been closely involved in this process. The basic steps how to arrive at a Mutual Recognition arrangement, important principles of such an arrangement and the role allocation between the Commission, the Member States and CESR in this process have been discussed and agreed on in the ESC – where CESR also participates as an observer.

Due to the financial crisis and the change in the U.S. Administration work on Mutual Recognition with the US has been delayed during the last months. However, this work is supposed to being continued in the coming months. Discussions on Mutual Recognition may also be extended to other important third countries with comparable high regulatory standards.

In order to technically support the activities carried out at EU level and to identify the economic advantages and drawbacks in entering into negotiations with third countries a CESR Task Force on mutual recognition has been set up in May 2008. The Task Force is chaired by Claudio Salini, Head of Markets Division in Consob, the Italian securities regulator. The main focus will be on the identification of the economic rationale as well as on legal issues to be considered as long as they represent regulatory constraints to mutual recognition. The recent global crisis in financial markets brought about a different prioritisation of CESR activities. However, CESR believes that openness of markets is an objective that needs to be pursued. Therefore it is considered important to continue investigating the opportunities of mutual recognition with third countries.

CESR intends to:

a) *Contribute to identify the different "regulatory areas" on which to concentrate a regulatory and economic fact-finding exercise*;

b) *conduct a microeconomic analysis of potential benefits from market integration*;

c) analyse similarities and differences in regulation and surveillance procedures in the "regulatory areas" identified;

d) analyse benefits and drawbacks arising from the various approaches in the different "regulatory areas" identified.

The technical work of the Task force should help to identify those areas where the potential gains of Mutual Recognition are considered to be the highest. Prioritization of major regulatory and securities market segments should be reached on the basis of a microeconomic analysis of benefits arising from integration as well as on investor protection and market efficiency gains.

CESR is of the view that input from market participants is essential in the various steps of the work. In particular, it is important to get the industry's views on the regulatory areas where it is facing the most significant obstacles when providing financial services to third countries and on the importance of individual third country markets for their business.
The main objective should be a fact-finding exercise to be conducted in a way that the risks from adoption of differentiated set of individual frameworks/approaches in different countries are clearly identified and minimised.

It is essential for regulators to focus on the most pressing issues facing international securities market participants in the "regulatory areas" mentioned below. To this end, the industry is requested to provide their views on the following together with any information/data/statistics available to support their comments.

In order to illustrate what could be the implications of Mutual recognition in different "regulatory areas" three areas are further described below. The industry is invited to

provide their views on the following questions together with any information/data/statistics available to support their comments:

1. ***Trading Venues***. Mutual Recognition in this respect would imply the liberalisation of access to foreign securities exchanges/regulated markets (through placement of trading screens). Topics to be included in this area refer, but are not limited, to securities exchanges, MTFs or other alternative trading platforms, market abuse and stabilisation. Foreign screens are extensions of foreign stock exchanges. Exchanges tend to be large entities, often with supervisory responsibilities, facing direct oversight by the competent authority of the jurisdiction in which they are based. In some jurisdictions, securities exchanges have been completely demutualised and function as for-profit companies that compete with other trading venues to attract market participants. Issues involved in this area refer to the potential existence of differences among jurisdictions in the registration and authorisation (and other forms of licensing of exchanges) requirements and procedures; foreign regulators' recordkeeping, reporting and electronic audit trail requirements; market governance and internal compliance; as well as exchange trading rules and approval procedures.

   In order to conduct a fact-finding exercise and analyse potential benefits and drawbacks from the liberalisation of access to foreign securities exchanges, the topic can be divided into two main parts:

   a) an EU stock exchange wishing to locate trading screens in a third country to offer exclusively EU-listed securities to third country investors;
   b) a foreign stock exchange wishing to locate trading screens in EU member States to offer exclusively foreign-listed securities to EU investors.

   It is therefore important to investigate:
   i) the main differences between "remote membership" and direct electronic access to securities exchanges through placement of trading screens, in terms of supervisory requirements and cost/benefits analysis for investors and broker/dealers in the two different environment; and

   ii) investor protection rules and market integrity safeguards; and

   iii) the costs associated (also in terms of competitive pressure) and the benefits/business case, for both market participants and exchanges, in having the possibility to have an EU stock exchange locating trading screens in a third country as well as a foreign stock exchange locating trading screens in EU member States.

2. ***Intermediaries***. The possibilities of foreign brokers/dealers' solicitation of mainly professional investors should be examined in this respect. Topics to be included in this area refer, but are not limited, to registration of market participants and conduct of business rules. It is generally very difficult to gather data on fees that EU intermediaries or the intermediaries of third countries generate from the provision of investment services provided to investors located in third countries as revenues of EU investment firms from intermediated securities from third countries to EU investors are usually mixed with other activities.

   Providing investment services to third countries has been a business case for the biggest financial institutions and even for the medium ones. Currently, most of the

biggest financial institutions have subsidiaries, under the legal figure of bank or dealer, in the main geographic areas. The main European commercial banks have set up business in US, Japan, China and India and vice versa. The medium and small financial entities have established arrangements with local brokers or dealers. The medium ones, in some cases, have joined themselves in setting up brokers in other countries[1].

In general terms, mutual recognition in the area of investment firms could be understood as allowing the freedom of providing some investment services to different types of investors among different countries. It is therefore in this context important to investigate the main differences in applicable regulation, the effects thereof on the protection of investors, and related cost and benefits associated with financial institutions establishing subsidiaries in the main geographic areas and financial institutions directly accessing institutional investors and offering cross-border financial services in third countries.

3. ***Products including collective investment schemes***. Topics included in this area refer, but are not limited, to securities offering, securities registration, company reporting, financial analysts, mergers and acquisitions and investments funds. The "regulatory area" of products encompasses various matters. Concerning units in collective investment schemes it seems that there are significant obstacles to global cross-border distribution including, but not limited to, restrictions on marketing materials and lack of convergence of private placement exemptions. Furthermore, there seems to be appetite to enhance cross-border trading of units in collective investment schemes by recognizing the authorisation of an investment fund in one jurisdiction as the basis for marketing of the same investment fund in another jurisdiction. Therefore, it is essential to gather information on current obstacles to cross-border trading of investment funds as well as on potential cost-savings and increase in trading volumes, including empirical evidence and statistical data (as far as existent).

Questions to market participants

General

Q1 Do you believe that other relevant topics should be added in the regulatory areas above? In the affirmative, please explain the reasons why the specific topic deserve attention together with costs and benefits of mutual recognition associated to the area of interest.

Q2 Focusing on the above areas and topics, would you expect benefits of mutual recognition frameworks for your own business (e.g. in terms of cost savings and business opportunities). Please provide any evidence/data/market statistic to support your view and an indicative prioritisation of the major regulatory and market segments.

[1] For example, European Securities Network (ESN) North America, inc., is a join venture set up by some members of the ESN and executes orders on the US markets.

Q3 What rules and regulations could cause the most severe distortion of competition in the field of cross-border activity with respect to a system of mutual recognition? Are there other potential risks that could result from a system of mutual recognition between Europe and third-countries? Differentiate according to third country, where necessary.

Q4 How could possible risks be mitigated?

1. Trading venues

Q5 Would the liberalisation of access to securities exchanges (through placement of trading screens) be of relevance to your business? Please provide any evidence/data/market statistic to support your view.

Q6 What are currently the main regulatory obstacles that prevent EU exchanges from setting up trading screens in third countries (differentiate according to countries). Can these obstacles in the current regulatory environment be overcome (via cooperation arrangements with third country markets etc)?

Q7 Which third countries do you consider to be the most interesting to arrange a mutual recognition on stock exchanges (given your current or future business focus)? Which economic advantages and drawbacks do you foresee?

Q8 What would you consider to be the effects on the market as a whole, in terms of liquidity and integrity, of:

a) foreign stock exchanges locating trading screens in EU Member States?
b) EU stock exchanges locating trading screens in third countries?

Q9 What are the main factors, if any, making "remote membership" different from direct electronic access? To what extent are such differences affected by:

a) amount of fees paid;
b) post-trading services;

Q10 What are in your view the main competitive risks posed by:

a) foreign stock exchanges locating trading screens in EU member States?
b) EU stock exchanges locating trading screens in third countries?

2. Intermediaries

Q11 Which third country's financial market is of interest to your business? What benefits/ costs would you expect for your business from the market opening to specific third countries? Please provide any evidence/data/market statistic to support your view)

Q12 What are currently the main regulatory obstacles that EU banks/investment firms face when providing financial services to clients located in third countries (differentiate according to countries). Can these obstacles in the current regulatory environment be overcome (via cooperation arrangements with third country firms)?

Q13 How important is the provision of cross border financial services provided to third countries (in terms of volume, generated profit) for your business? Please differentiate according to third countries and provide evidence/data if possible. How would you expect the development of this business after the implementation of a Mutual Recognition Arrangement?

Q14 What would you consider to be the effects, in terms of costs and benefits, on:

a) EU intermediaries, if non-EU brokers are allowed to do business with EU professional investors regarding listed securities of the country of the non-EU broker?

b) non-EU intermediaries, if EU brokers are allowed to do business with non-EU professional investors regarding listed securities of the EU?

c) EU investors if non-EU brokers are allowed to do business with EU professional investors regarding listed securities of the country of the non-EU broker,

Q15 Do you consider that a mutual recognition arrangement could reduce the fees in cross border investment services (due to increased cross border competition)? Would the reduction of cost make up the reduction of fees? Would the volume increase enough to match any differences?

3. Products including collective investment schemes

Q16 Do you consider the topic of collective investment schemes to be of primary relevance? Do you believe that other relevant topics should be considered and analysed first in the "products" regulatory area? Please provide reasons.

Q17 In what third countries do European asset management companies distribute shares in collective investment schemes? Please provide information on the (estimated) volume of distributed shares in collective investment schemes, distinguishing between different types of collective investment schemes (UCITS, non-harmonized investment funds) as well as different types of investors (wholesale, retail).

Q18 What are the most significant obstacles for the European asset management industry in respect to efficient cross-border marketing of collective investment schemes in third countries? What are the (estimated) costs caused by these obstacles? Please distinguish between countries.

Q19 What kind of products (UCITS, non-harmonized investment funds) should be covered by a mutual recognition agreement between EU and third countries? In terms of non-harmonized investment funds, please describe what kind of funds should be included in respective considerations (regarding investment policy, degree

of regulation/supervision, right of redemption). Please distinguish between countries.

Q20 What decisive benefits and effective gains would a mutual recognition agreement between EU and third countries bring for the EU asset management industry? Please distinguish between countries.

Q21 What kind of asset management companies would benefit from a mutual recognition agreement between EU and third countries (small and medium sized companies, bigger companies)? What size is the share of those asset management companies in the European asset management market? Please distinguish between countries.

Q22 Are there other potential risks that could result from a system of mutual recognition between EU and third countries? How could possible risks be mitigated? Please distinguish between countries.

Call for evidence

CESR invites all interested stakeholders to submit their views on this call for evidence.

All contributions should be submitted online via CESR's website (www.cesr.eu) under the heading 'Consultations' by **4 September 2009**.

Following the Consultation period on this call for evidence CESR will gather the views received in order to assist CESR in prioritising further work. CESR will hold meetings with market participants, their representative organisations as well as other regulators in order to further develop the concept of mutual recognition and assist in prioritisation of areas. CESR intends to develop a technical analysis on possible criteria and procedures that could be taken into account for mutual recognition, which will be made part of a Consultation paper.