

STATEMENT

Operating Principles and Areas of Exploration in the Regulation of the Cross-Border Derivatives Market

Leaders of authorities with responsibility for the regulation of the over-the-counter (OTC) derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland and the United States,¹ met on November 28, 2012 to discuss reform of the OTC derivatives market as agreed by the leaders at the G-20 Pittsburgh Summit in September 2009.

We recognize that the OTC derivatives market is a global market and firmly support the adoption and enforcement of robust and consistent standards in and across jurisdictions. This will help further the G-20 regulatory reform agenda for OTC derivatives markets to mitigate risk, improve transparency and protect against market abuse, and to prevent regulatory gaps, reduce the potential for arbitrage opportunities, and foster a level playing field for market participants, intermediaries and infrastructures. We further recognize the need to reduce regulatory uncertainty and provide market participants, intermediaries and infrastructures with sufficient clarity on laws and regulations by avoiding, to the extent possible, the application of conflicting rules to the same entities and transactions. We also acknowledge the need to take into account, among other factors, minimizing the application of inconsistent and duplicative rules.

It is clear that coordination among jurisdictions regarding the regulation of cross-border activities should facilitate the implementation of the objectives of the G-20 regulatory reform agenda for the OTC derivatives market. However, complete harmonization – perfect alignment of rules across jurisdictions – is difficult as it would need to overcome jurisdictions' differences

¹ The meeting was among leaders of the following regulatory authorities: the Australian Securities and Investments Commission, the Brazilian Comissão De Valores Mobiliários, the European Commission, the European Securities and Markets Authority, the Hong Kong Securities and Futures Commission, the Japanese Financial Services Agency, the Ontario Securities Commission, the L'Autorité des marchés financiers du Québec, the Monetary Authority of Singapore, the Swiss Financial Market Supervisory Authority, the US Commodity Futures Trading Commission, and the US Securities and Exchange Commission.



in law, policy, markets and implementation timing, as well as to take into account the unique nature of jurisdictions' legislative and regulatory processes.

We recognize that national authorities have ultimate responsibility and authority to protect against all sources of risk to their markets, and that statutory and regulatory requirements of each jurisdiction are core components of each respective market. Legal systems and market conditions differ among jurisdictions and due account should be taken of such differences in determining the cross-border application of laws and regulations.

We also recognize that conflicting or inconsistent cross-border application of rules to market participants, intermediaries, infrastructures and products may inhibit the execution or clearing of certain cross-border transactions or impose additional compliance burdens. We further recognize that regulatory gaps may present risks to financial markets and provide the potential for regulatory arbitrage.

During our series of discussions, we have identified various potential conflicts, inconsistencies, and duplicative requirements within our respective contemplated rules and we will continue to discuss measures to ameliorate the challenges they raise. In this connection, it is therefore important to (i) develop concrete and practical solutions with respect to any conflicting application of rules, (ii) identify inconsistent or duplicative requirements and attempt to reduce the regulatory burdens associated with such requirements, and (iii) identify gaps and reduce the potential for regulatory arbitrage.

In light of the above, we have reached the following understandings and identified the following areas for further exploration.

1. Understanding on Clearing Determinations

In a manner consistent with our respective legal regimes and the achievement of our policy objectives, we agree to consult with each other prior to making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement. We also commit that once one of the authorities decides that a certain product or class of products should be subject to a clearing requirement, then each of us will consider whether the same product should be subject to the same requirement in our jurisdictions, having regard to the



characteristics of our domestic markets and in accordance with the applicable determination processes in our respective legal regimes.

We agree to continue to work together to define the process pursuant to which our respective authorities will consult in making mandatory clearing determinations.

2. Understanding on Sharing of Information and Supervisory and Enforcement Cooperation

We recognize that entering into, and abiding by, supervisory and enforcement cooperation arrangements should facilitate effective coordination in implementing recognition, substituted compliance, and registration categories and exemptions approaches.

We agree to attempt to ensure that the relevant supervisory authorities:

- a. enter into supervisory cooperation arrangements with the relevant supervisory authorities (using the model supervisory cooperation arrangement adopted by the International Organization of Securities Commissions (IOSCO) as a guide) to enable effective supervision and oversight of cross-border market participants, intermediaries and infrastructures and to ensure compliance by cross-border market participants, intermediaries and infrastructures with our respective statutory and regulatory requirements; and
- b. enter into bilateral enforcement cooperation arrangements based on the IOSCO Multilateral Memorandum of Understanding (MMOU) or enter into the IOSCO MMOU.

We will make every effort to provide to each other the assistance necessary to satisfy our counterpart's statutory and regulatory requirements under the terms and conditions of these supervisory and enforcement cooperation arrangements.

We also recognize such arrangements should not preclude market participants, intermediaries and infrastructures from meeting their obligation to provide relevant information under that authority's recognition or registration (including substituted compliance, registration categories or exemptions) framework.



We agree that authorities should have appropriate and effective access to such data as required to perform properly their mandates. Consistent with our domestic law and the relevant international regulatory recommendations, standards and principles, we will work to ensure that other authorities have appropriate and effective access to data held in trade repositories consistent with their mandates.

3. Understanding on Timing

Keeping in mind the G-20 commitments to implement key OTC reforms in our respective jurisdictions with respect to clearing, reporting, trading and capital by end-2012, we recognize that differences in implementation dates may create gaps in regulations and uncertainty in the application of certain cross-border regulatory requirements, and may lead to risks to financial markets that are unaddressed, to regulatory arbitrage, and to an uneven playing field for market participants, intermediaries and infrastructures. Accordingly, we renew our efforts to implement quickly OTC derivatives reforms and in a manner consistent with an orderly implementation process in our respective jurisdictions.

Wherever possible consistent with applicable laws and regulations, the scope of market participants to whom cross border regulatory requirements apply should be clear. The absence of rules and regulations in certain jurisdictions may limit the assessments of such jurisdictions for purposes of giving effect to regimes based on recognition and substituted compliance. We will consider providing appropriate transitional implementation periods for entities in jurisdictions that are implementing comparable regulations, supervision, and comprehensive oversight.

In order to facilitate an orderly transition with respect to new OTC derivatives regulatory requirements when promulgating regulations with cross-border applicability, we agree to a reasonable, limited transition period to facilitate the implementation of such cross-border regulatory requirements in appropriate circumstances and in consultation with other jurisdictions. Consistent with the G-20 commitments, we commit to work with our legislative bodies to finalize expeditiously relevant legislation and to promulgate promptly requirements in a form flexible enough to respond to cross-border consistency and other issues that may arise, consistent with our respective legal requirements and our core policy objectives.

4. Areas of Exploration - Scope of Regulation and Recognition or Substituted Compliance for Cross Border Compliance

We discussed different possible approaches to regulating persons, transactions and infrastructures with respect to cross-border activity when more than one set of rules applies. We discussed the differences in scope of our rules and the application of requirements to foreign participants, intermediaries and infrastructures. We also noted the need to prevent the application of conflicting rules and the desire to minimize, where appropriate, the application of inconsistent and duplicative rules. We agree that one or more of the following or different approaches should be considered, consistent with our respective statutory and other legal requirements:

- a. *Recognition* – An authority could decide that market participants, intermediaries and infrastructures have substantially met some or all of its regulatory requirements if it determines that such entities are already subject to the regulation and oversight of another authority, which the first authority has recognized to be comparable or equivalent.
- b. *Registration and Substituted Compliance* – An authority requiring all relevant market participants, intermediaries and infrastructures to register with it, The authority could as part of the registration process, allow in certain circumstances for compliance with foreign regulations to substitute for compliance with otherwise applicable requirements. In permitting the use of substituted compliance, the authority must first determine that the entities are already subject to comparable regulation, supervision and comprehensive oversight of compliance, by virtue of the fact that: (i) the foreign regulation and oversight meet the same regulatory objectives; and (ii) the foreign regulator has the authority and means to support and enforce compliance by relevant foreign participants, intermediaries and infrastructures. It should be noted that in some jurisdictions’ regulatory systems, this registration process is characterized as “recognition.”
- c. *Transactions and Substituted Compliance* – An authority could allow in certain circumstances for compliance with foreign regulations to substitute for compliance with otherwise applicable transaction-level requirements (*i.e.*, requirements that apply

regardless of registration status). In permitting the use of substituted compliance, the authority must first determine that transactions are already subject to comparable regulation, by virtue of the fact that: (i) the foreign regulation meets the same regulatory objectives; and (ii) the foreign regulator has the authority and means to support and enforce compliance by relevant foreign participants, intermediaries and infrastructures.

- d. *Registration Categories and Exemptions* – An authority could require market participants, intermediaries and infrastructures to register with it. Such authority may define different registration categories to provide such market participants, intermediaries and infrastructures the opportunity to comply with different sets of regulatory requirements, or the same regulatory requirements in different ways, based upon their characteristics and activities. This provides flexibility in oversight in instances where entities are already subject to comparable regulation and oversight by another authority. The authority also may elect to exempt certain market participants, intermediaries and infrastructures, from registration or other requirements, after taking into consideration such entities' existing obligations to other regulators.

We agree that these different approaches will not be undertaken on a firm by firm basis but rather will focus on the applicable regime in a jurisdiction and will entail a review of laws, rules, supervision and enforcement.

Authorities will consider these different approaches, taking into account, among other factors, the application of conflicting, inconsistent and duplicative rules to the same entities and transactions.

Permitting compliance with another jurisdiction's rules and regulations through either recognition or substituted compliance to satisfy our rules and regulations or exempting a person from our rules and regulations does not restrict, or represent a forfeit of, our power to take appropriate regulatory, supervisory or enforcement measures over a person or transactions subject to our law. However, in this case, close consultation with relevant authorities of another jurisdiction will be needed in connection with taking such measures.

We will continue to work together to further refine the concepts of recognition, substituted compliance, registration categories and exemptions, including continued consultation in a



timely manner about our respective processes for determining when we will use recognition, substituted compliance, registration categories or exemptions and the conditions that we will require to be met for such treatment.

Next Steps

In support of these understandings and areas of exploration, we commit to regularly meet and consult with one another. We agree to next meet in Brussels in early 2013. Future meetings will address the following items:

- 1) Options to address identified conflicts, inconsistencies and duplicative rules;
- 2) With respect to the basis for determinations of comparability of regulatory regimes:
 - a. Discuss expected regulatory outcomes with regard to the regulation of market participants, intermediaries, and infrastructures;
 - b. Identify possible standards, including relevant international standards, that will help to inform an assessment of whether a given regulatory regime achieves particular outcomes; and
 - c. Identify the types of arrangements, including supervisory and enforcement memoranda of understanding, that need to be entered into by each relevant supervisory authority.
- 3) In relation to timing and sequencing, the authorities will meet in January 2013 to inform each other of the planned timing of the finalization and implementation of our rules and advise of possible transition periods and update each other on progress on the concrete steps being taken in our own jurisdictions to improve global regulatory oversight in these markets.
- 4) In relation to clearing determinations, we have reached an understanding and will:
 - a. Develop a process and a means for consulting with each other prior to making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement; and



- b. Reach an understanding of the objective of such consultation process.

5. International Engagement

We support the continued development and setting of international standards by IOSCO and other standard setting bodies and intend to remain active in the various workstreams related to OTC derivatives. We support the efforts of the Financial Stability Board (FSB) in ensuring coordination among international standard-setting bodies. We further support the efforts of the FSB to promote the implementation of the G-20 regulatory reform agenda in the area of OTC derivatives regulation.



Notes for editors

1. ESMA is an independent EU Authority that was established on 1 January 2011 and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).
2. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

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