IRSG response to IOSCO consultation on cross-border regulation

The International Regulatory Strategy Group (IRSG) welcomes IOSCO's report examining the issue of cross-border regulation in securities markets.

IRSG is a practitioner-led body comprising leading figures from the financial and professional services industry. It aims to contribute to the shaping of the European and international regulatory regime, at global, regional and national levels, so that it promotes open, competitive and fair capital markets globally, supporting sustainable economic growth. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views. It is an advisory body both to the City of London Corporation, and to TheCityUK.

Every day, firms interact through the global capital markets in many different and sometimes complex ways. These activities are fundamental to funding and managing the real economy. **Therefore, international capital flows are a key enabler for growth globally and needs to be taken into account in global regulation.** Financial markets are global in nature and regulatory divergence, therefore, carries a variety of costs. It enables regulatory arbitrage that can undermine the effectiveness and stability of the global financial system and introduces duplicative or inefficient practices for both providers and users of capital. **Therefore, effective cross-border regulation should be seen as a complement to preserving financial stability and maintaining high standards of investor protection and market integrity.** Restoring trust between regulators is crucial to prevent disruption to cross-border capital flows and fragmentation of global markets. Extra-territoriality in regulation should be avoided.

London has traditionally been open to global capital flows given its role as an international financial centre. However, this has been threatened by recent moves in EU regulation **to restrict access of third country firms to the EU market,** whether it is in AIFMD, MiFID or more recently in the Benchmarks regulation through the equivalence regime (unilateral recognition). The potential consequence would be to cut the EU off from global markets.

One source of conflict is the nature of the rules themselves. Clearly, **a greater degree of harmonisation would facilitate cross-border regulation**. While a lot of effort has gone in to develop international standards to promote international consistency, divergences still exist. We would support the view in the report **that a greater level of granularity in the internal standards to try to improve international consistency would be helpful**. However, we accept that when legislation remains national or regional, divergences are inevitable. We also note that in some areas where the EU has legislated, for example MiFID, there is no single international standard to act as a reference point.

Turning to the issue of how regulators grant access to their markets, we agree that **there is no "one size fits all" approach and that regulators will need to take into account various considerations when deciding which tool to use**. As noted in the report, there needs to be a clear distinction drawn between wholesale and retail markets- **wholesale markets are inherently more international and require a greater degree of cooperation between regulators to ensure their smooth functioning, whereas**

retail markets are primarily domestic and therefore national treatment may be justified. Another consideration is the sophistication of other markets. As noted in the report, recognition can discriminate against firms based in less developed markets, at the expense of this in more mature markets. Therefore, regulators should consider using a range of tools depending on the context, rather than relying on just one.

In terms of mutual and unilateral recognition, we support the view that **any assessment should be outcomes-based and use international standards as a benchmark**. While there are clearly benefits of mutual recognition over unilateral recognition in terms of the regulatory outcome, this tool is only feasible where the number of regulators is involved is small and where their markets are of a similar maturity. In other instances, unilateral recognition is clearly favourable.

Case study- Third country provisions in EU MiFIR proposal

The Commission's original proposals would have limited investment and funding opportunities by imposing barriers to third country firms providing valuable services. They would have prohibited firms outside the EU from providing MiFID services and activities in the EU unless the relevant third country was judged by the Commission to have regulation with equivalent effect to MiFID and CAD (Capital Adequacy Directive) requirements, and to provide reciprocal recognition of the EU prudential regulatory framework. The only exception is where the service is provided at the initiative of the EU firm for cross border provision of services (the so-called solicitation test).

Equivalence

A strict equivalence regime cannot accommodate the wide range of circumstances in which EU investors and issuers benefit from services provided by third country firms. It would be disproportionate to the risks involved in many MiFID services. Some regimes do not, for example, apply prudential regimes to asset managers (eg US). The EU should adopt a cooperative model based on a common or comparable set of laws and rules. Imposing equivalent regulation would have the effect of deterring services from third countries and imposing extraterritorial requirements. EU investors and issuers could be harmed, rather than protected.

Reciprocity

The application of reciprocity would operate against the EU's best interests. Some third country jurisdictions require the use of locally regulated firms. However to exclude these countries on reciprocity grounds would deny EU investors and issuers access to those markets. Access by governments, central banks and debt management agencies would similarly be blocked. It is furthermore unrealistic to expect all those countries, with whom EU firms currently interact, to agree to accept a regime based on equivalence. Many developing markets may not be resourced to do so.

The proposed solicitation test would help in many circumstances. However such a test cannot address the wide range of interactions and communication that are common in financial markets. Brokers for example will typically call their clients with research ideas. A narrow solicitation test could in fact prevent EU investors from getting the information and advice they need.

Regardless of the tool used, we would also urge regulators to begin discussions with their counterparts that may be affected by third country provisions early in the process, i.e. during the legislative process. We support the view that IOSCO could usefully play a role here.

In the longer term, **IOSCO could play a more prominent role in recognition assessments**, for example, by conducting peer reviews to assess whether national legislation is consistent with international standards, thereby reducing the need to individual regulators to undertake separate recognition assessments. More granular standards would make this more feasible.

We also believe that **the suggested "conflict of regulations" framework would be very helpful** in providing clarity on which regulation applies and which regulator has jurisdiction in specific cases.

An issue which is somewhat neglected in the report is that of transitional measures. In the post-crisis period, a number of entities and activities which have never been subject to regulation have been brought in to the regulatory perimeter. More developed markets, including in the EU, have reacted quickly to these developments, but other less developed jurisdictions will take time to implement the necessary reforms in their markets. Even amongst the more developed markets such as the EU and US, discrepancies in timings have emerged, partly due to the different ways in which these jurisdictions legislate (for example the US employs a top-down approach versus the EU's bottom-up approach) but also due to the political focus being different in each jurisdiction. This divergence in timings between different jurisdictions means that there is often a time lag between a jurisdiction implementing legislation and the ability to enter into recognition procedures with other jurisdictions, which causes uncertainty for market participants and could lead to preventing market access to foreign institutions during the intervening period.

Furthermore, as noted in the report, recognition assessments are a lengthy process. When the number of relevant jurisdictions involved is limited, in the case of CCPs for example, this is manageable. But in the case of investment firms, where there are potentially a great number of jurisdictions involved, long transition periods and satisfactory transitional measures are needed. **It is therefore necessary to also develop a toolbox of transitional measures to ensure that there continues to be cross-border access in the intervening period.** One useful example was the Common Path Forward agreed between the EU and CFTC in July 2013, which granted transitional relief to EU actors pending the implementation of EU rules.

Finally, we note that these issues are not exclusive to securities markets but affect all areas of financial regulation, in particular banking regulation, and therefore **a similar exercise by the FSB that would encompass the broader regulatory community would be helpful**.

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