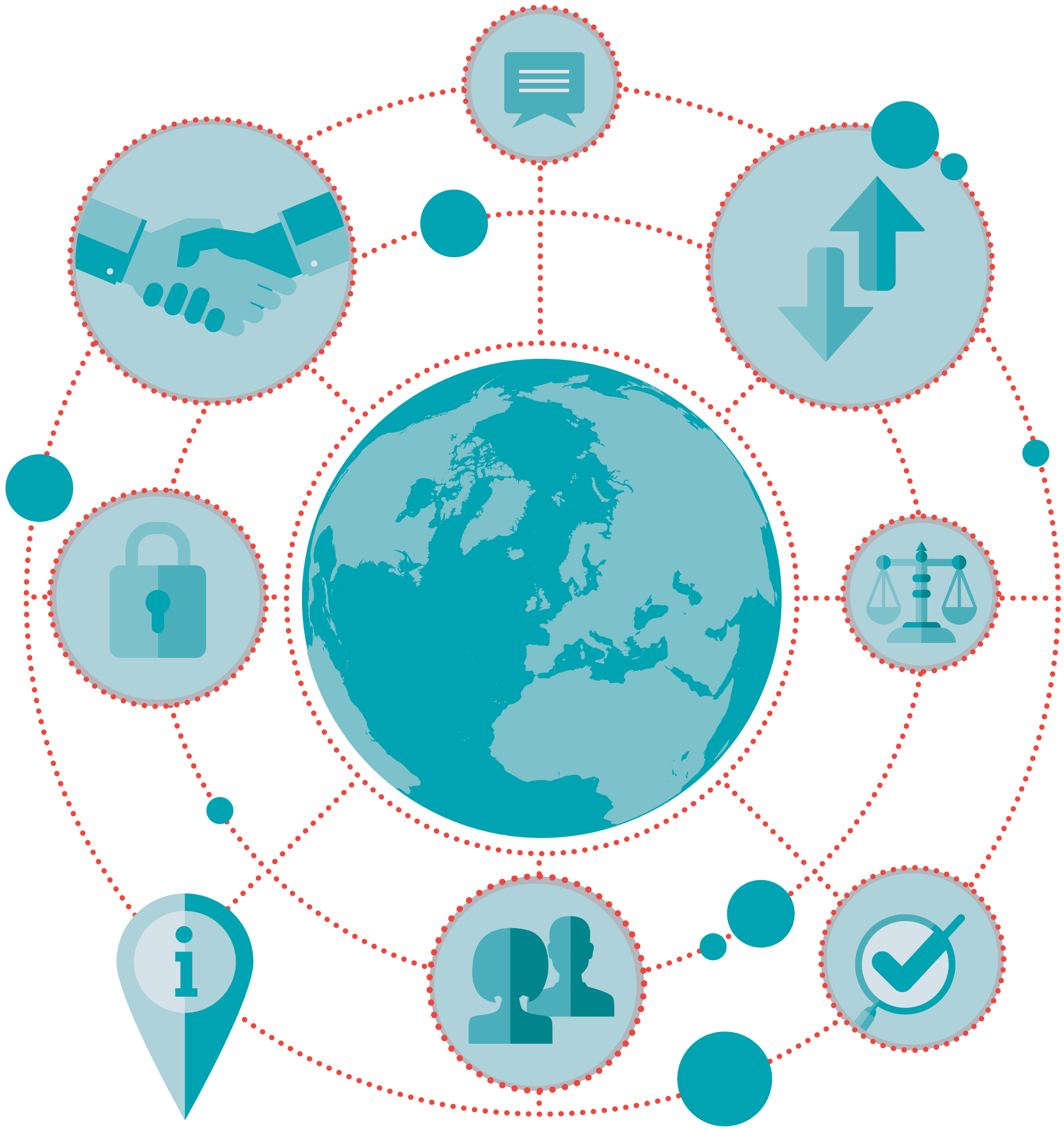
IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

Global regulatory coherence within financial services



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CITY OF LONDON

TheCityUK

The International Regulatory Strategy Group

The International Regulatory Strategy Group (IRSG) is a practitioner-led group comprising senior leaders from across the UK-based financial and related professional services industry. It is one of the leading cross-sectoral groups in Europe for the industry to discuss and act upon regulatory developments.

With an overall goal of promoting sustainable economic growth, the IRSG seeks to identify opportunities for engagement with governments, regulators and European and international institutions to advocate an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing views.

TheCityUK and the City of London Corporation co-sponsor the IRSG.

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FOREWORD

A decade on from financial crisis we take for granted the global framework for financial regulation. The Pittsburgh G20 declaration has shaped much of the new regulation affecting our sector today. Global regulation now goes hand in hand with global businesses. A coherent regulatory framework helps address the risks of market fragmentation, regulatory arbitrage and global financial instability, but also improves efficiencies for firms, benefiting consumers.

The IRSG has spent much of its time in recent years on the implementation of the global framework through changes to the EU's Single Rulebook. This report marks a refocus of its activities as we seek to increase the sector's influence on the global regulatory agenda. For our members and their customers, growing pressures on the coherence of the global framework heightens risk and potentially increases costs. In part, this is driven by Brexit, but there are other factors behind this with a move away from multilateral co-ordination and diminishing memories of the crisis. If we are to maintain the coherence of global regulation, then the voice of business needs to be heard and the IRSG has to rebalance its work towards the international agenda.

Business has an important role to play in shaping global regulation and making the argument for continued coherence, but we cannot do this in isolation. UK policymakers within government and regulators have played an important role in shaping that framework at both a personal (for example Mark Carney's chairmanship of the FSB) and institutional level. We believe that their role becomes even more important post-Brexit.

Against that backdrop, we recommend that UK Government, regulators and industry re-intensify their engagement at the global level. The IRSG will bring a new focus by establishing a new Standing Committee on Global Regulatory Coherence, which will develop forward looking and industry centric recommendations to help shape the international agenda and support UK engagement. I'm glad to say that this process is well underway, and we look forward to hearing from the new Standing Committee.

Finally, I would like to take this opportunity to personally thank Joanna Cound and Antony Manchester from BlackRock for their leadership of the IRSG workstream that delivered this report and to all the IRSG members and our stakeholders who took an active role in supporting this work and providing input to the report itself, which represents their collective views.

Mark Hoban
Chair, IRSG Council

EXECUTIVE SUMMARY

As the network of global bodies and standard-setters in financial services moves beyond the immediate period following the financial crisis of 2007-08, attention will increasingly focus on its core mission of providing the appropriate backdrop for a safe, secure and innovative global financial services sector that delivers long-term sustainable economic growth.

It is in the interests of the UK financial services industry, policy makers and regulators to ensure that global regulatory and standard-setting frameworks for financial services can evolve and deliver effective outcomes in the most efficient way over the coming years.

The aim of the report is to make the case for an ongoing industry-led dialogue on the importance of global regulatory coherence. It looks at why the financial services sector needs to argue for the most effective form of regulatory coherence in global financial markets, to allow the global sector to best serve the real economy.

Given the increasing importance of the global regulatory architecture, it is vital that the financial services industry engages with it effectively. To date, however, engagement has been partial and disjointed.

To rectify this, this report makes two primary recommendations. The first is for the UK Government, regulators and industry to enhance engagement at the global level; the second is for the International Regulatory Strategy Group (IRSG) to form a standing committee on the global regulatory architecture. These recommendations are supplemented by several secondary observations on the form this should take. In the first instance, these recommendations are aimed at the UK Government, market participants, regulators and the IRSG, with the expectation that outcomes of those recommendations will be of interest to a wider audience of global organisations, standard setters and industry-led international associations.

THE UK FINANCIAL SERVICES SECTOR AND THE GLOBAL REGULATORY ARCHITECTURE

The period following the global financial crisis ("the crisis") of 2007-08 witnessed the creation of a new global regulatory architecture. The establishment of the Financial Stability Board (FSB) in 2009 accompanied by the reform of the roles and work of many other bodies began a renewed period of global regulatory cooperation and standard setting in financial services.

In the immediate aftermath of the crisis, a global policy consensus arose; the primary objective of the G20 and the FSB was to secure and safeguard the financial system by increasing its resilience to systemic risk. A period of enhanced global regulatory co-ordination followed as global policy makers worked to deliver a reform package that included strengthening recovery and resolution planning; addressing too-big-to-fail and global systemically important financial institutions (GSIFIs); improving bank capital requirements through Basel III; and supporting reforms on over-the-counter (OTC) derivatives and shadow banking[1].

Much has been achieved through the work of the global bodies and standard setters over the past 10 years. Financial institutions are more resilient and macroprudential policy has moved centre stage as a public policy tool. The robustness of the global financial system is much improved as a result. After an era of repair, the world economy has moved into a period of renewal, with several years of continued, steady global growth. The global financial services sector, which is crucial to serving the needs of consumers and firms, is now in much better shape to perform that role without posing an undue threat to wider economies[2].

1 Speech by Mark Carney, Governor of the Bank of England and Chair of the Financial Stability Board: What a difference a Decade Makes, IIF Internal Finance's Washington Policy Summit, 20 April 2017.

2 According to the Bank of England, the loss of confidence in private finance that crystallised in the autumn of 2008 could only be arrested by public support over the following year that totalled $15 trillion in bail-outs, government guarantees of bank liabilities and special central bank liquidity schemes.

Building on these achievements, the focus has now switched to ensuring the timely and effective implementation of these reforms[3]. Work at the global level is still incomplete; to take two prominent examples, much of the final detail of the Basel III rulebooks remains to filter through and a global capital standard for the insurance industry elusive. However, recent political events, as well as general reform fatigue, pose the risk of creating divisions in the post-crisis policy consensus and moving away from a drive towards consistency and coherence of global regulatory approaches and standards.

Ten years on from the crisis, the long-term policy objective must be to create and maintain the conditions for a safe, secure global financial services sector to deliver long-term sustainable economic growth.

Maintaining a drive towards consistency and coherence, where this will deliver benefits, is very important to the UK financial services industry and, as a result, to the economy of the UK.

The UK:

- has the largest financial services trade surplus in the world: $97bn in 2015;
- is home to the world's largest number of banks, with over 259 foreign firms, and hosts the world's largest commercial insurance market;
- accounts for 40% of both global FX volumes and trades in OTC interest rate derivatives; and two-thirds of trading in international bonds[4]; and
- has the premier global offshore centre for Renminbi (RMB) trading, with over half of the market outside Asia; and is the leading centre for Islamic finance in Europe.

The UK-based financial services industry is therefore of vital importance to the wider UK economy, contributing:

- 11% of the UK's total economic output and 7% of gross value added;
- 1.1 million direct jobs (supporting a wider network of this size again);
- £79 billion of exports; and
- £72.1 billion of UK tax[5].

3 See, for instance, A. Domanski, A new era for the FSB: from policy development to dynamic implementation, speech delivered on 26 April 2018.

4 Speech by Mark Carney, Governor of the Bank of England FICC Market Standard Board, "Two years on from the Fair and Effective Markets Review", Bloomberg, London. 29 November 2017.

5 City of London Corporation Research Report, Total tax contribution of UK financial services Tenth Edition, November 2017.

Despite the current strength of the UK's financial services sector, it is critical that the UK regulatory environment remains connected and competitive within the broader global system, in response to changing global circumstances, for example:

- the increasing financing needs of the Asian economic powerhouses, including servicing $26tn of infrastructure financing demand, providing the backing for the Belt and Road initiative and the internationalisation of RMB;
- the transition to a green economy and global shifts to green financing, from green bonds to wider sustainable financing; and
- the emergence of new fintech approaches, including blockchain, big data, artificial intelligence and cloud computing.

There is no inherent reason why these activities must be located in the UK, so the extent to which the UK sits within an appropriate global network of regulation will be a significant determinant, along with access to talent, funding and liquidity, of its ability to seize the full extent of the opportunities they present.

UK industry, policymakers and regulators, therefore, have a huge stake in ensuring that the global regulatory and standard-setting frameworks for financial services can evolve and deliver effective outcomes in the most efficient way over the coming years.

Against this backdrop, this report aims to stimulate and create a structure for an ongoing industry-led dialogue on the importance of global regulatory coherence. It sets out why the financial services sector needs to make the case for the most effective form of regulatory coherence in global financial markets, to allow the global sector to best serve the real economy.

The report sets out a proposal for how the UK financial services sector can best coordinate itself, and support UK policy makers and regulators, to contribute to the development of the global regulatory agenda. It offers recommendations, aimed at HMG and the IRSG as a cross-sectoral, industry-led platform, on how it can organise itself to contribute to a successful global framework.

"THIS REPORT AIMS TO STIMULATE AND CREATE A STRUCTURE FOR AN ONGOING INDUSTRY-LED DIALOGUE ON THE IMPORTANCE OF GLOBAL REGULATORY COHERENCE."

This report follows three previous substantive pieces of work undertaken by the IRSG's Regulatory Coherence workstream, each of which has focused on the most immediate threat to the UK's regulatory coherence with major trading partners: the UK's decision to leave the European Union (EU):

- Third Country Regimes and Alternatives to Passporting (January 2017) concluded that the preferred model for a future relationship between the UK and EU is a bespoke agreement under which mutual rights of access to each other's markets would be allowed.
- Mutual Recognition – A Basis for Market Access after Brexit (April 2017) considered some of the key issues that would need to feature in any bespoke arrangement based on mutual recognition.
- A New Basis for Access to EU/UK Financial Services Post-Brexit (September 2017) set out a blueprint for an ambitious free trade agreement, including financial services, which would provide firms with mutual access to each other's markets without having to obtain a licence in the other market. Respecting stated UK and EU criteria, the report details several key elements that should be included in the free trade agreement, including mutual market access based on regulatory alignment and supervisory co-operation; a forum for regulatory alignment, where the UK and the EU can work together to implement new global and international standards; and a joint dispute resolution body, to determine whether material divergence has taken place and, if so, the impact that should have on market access.

The current report does not aim to explore the future relationship the UK should be seeking with the EU on financial services (and vice versa). Its scope is limited to considering the relationship of the UK financial services industry with the global regulatory architecture. However, there is clearly a shared interest across the two workstrands, as in both cases (albeit from very different starting conditions) regulatory coherence provides the opportunity to avoid unnecessary market fragmentation, cost and inefficiency.

THE CASE FOR INTERNATIONAL REGULATORY COHERENCE

The importance of global regulatory coherence was recognised by the G20 Leaders at the Pittsburgh Summit in 2009, where the G20 Leaders' Statements said:

"We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage[6]."

As has been set out by global policy makers[7], the aims of global standards are to promote regulatory outcomes that are consistent across jurisdictions, avoiding harmful regulatory arbitrage, to ensure the correct setting of minimum standards to enhance financial stability, and to provide a framework for cooperation between regulators and supervisors.

Given the global nature and the inter-connectedness of the industry, it follows that, in many instances, but not necessarily in every case, the global level will be the right one at which to regulate, at least in terms of high level, outcomes-focused principles and frameworks.

Driving regulatory coherence at a global level can, in the right circumstances, have a number of benefits:

Greater regulatory coherence reduces inefficiencies for firms, in complying with different standards. The need for firms to comply with multiple regulatory frameworks can create inefficiencies and costs in terms of firms having to keep up to speed with, and act appropriately to comply with, changing regulatory regimes. These include maintaining separate pools of capital and liquidity to meet the requirements of separate national supervisors; tailoring their IT systems and risk management for each jurisdiction; and incurring other compliance costs. Removing these unnecessary burdens implies that efficiencies can be passed on to the real economy via lower prices for financial services, thus supporting broader economic growth.

6 G20 Leaders Statement: The Pittsburgh Summit. 24-25 September 2009, Pittsburgh.

7 See letter from Andrew Bailey, Chief Executive, FCA, to Rt Hon Andrew Tyrie PM, Chairman of the Treasury Committee, 13 January 2017.

Consistency and predictability in regulation can support sustainable growth, both in the financial services sector and the wider economy. When financial services firms have clarity on what the future regulation affecting them is going to look like – both over time and across geographies – they can have the certainty they need to invest and grow their businesses. This can allow them to expand the amount of business they do, provide a wider range of products and services and/or push into new markets. In turn, this supports the real economy and helps to boost global growth.

On the other hand, there are negative impacts arising from not achieving appropriate global regulatory coherence:

Unnecessary financial fragmentation is bad for economic growth; open, resilient financial markets are a positive force for economic growth. Since the crisis, certain pieces of regulation (such as the ring-fencing of capital and liquidity and holding company requirements) may have contributed to the fragmentation of global capital markets[8].

A lack of regulatory coherence can undermine financial stability; when cross-border frictions impact global finance, allocative efficiency is undermined as assets can be stranded in domestic markets. Such restrictions can lead to credit expansion to already overheated markets, unnecessarily generating asset bubbles for regulators to address with national macroprudential rules. The highly interconnected nature of the international financial system and the presence of excessive imbalances in some regions require a more coordinated and adequately resourced global financial safety net and stronger frameworks for the prevention and resolution of a growing debt crisis[9].

Deviations dilute the primacy of global standards; they create inefficiencies as firms are trying to comply with inconsistent rule books across borders; they create complexity and increase the possibility of compliance mistakes; they distort competition through the functioning of un-level regulatory playing fields; and market discipline can be undermined as the comparability of rule books is eroded between jurisdictions.

On this topic, the OECD has observed: "Where financial regulation is developed internationally, coordination in implementation is important since compliance mechanisms and supervisory functions are largely organised at a national level. Any material inconsistencies in implementation could further aggravate the potential problems of regulatory duplication, burden, conflict and barriers, and create opportunities for regulatory arbitrage between countries[10]."

8 TheCityUK & PwC, A Vision For A Transformed, World-Leading Industry: UK-based financial and related professional services, July 2017.

9 IMF, 2017 Global Prospects and Policy Challenges: G-20 Finance Ministers and Central Bank Governors' Meetings, 17-18 March 2017, Baden-Baden, Germany.

10 OECD 2010, Policy Framework for Effective and Efficient Financial Regulation.

A joint international study undertaken by the International Federation of Accountants (IFAC) and Business at OECD (BIAC) on the costs and impacts of regulatory divergence found that regulatory divergence is resulting in material and increasing costs in the financial sector globally, consuming on average between 5% and 10% of annual turnover[11].

However, the fact that greater global regulatory coherence can result in these benefits does not imply that it is always desirable to seek the greatest possible level of regulatory alignment.

While it is true that the global financial services industry is highly internationalised, this does not imply that the aim ought to be complete uniformity across markets; the political, historical, social and economic context differs significantly across jurisdictions. Fragmentation of markets can come about for many reasons. In some cases, greater uniformity carries costs that would outweigh the countervailing benefits, especially where the level of international consensus on the right approach to regulation is low. Here, increased coherence may only be achievable around a lowest-common-denominator approach.

Across markets, the benefits flowing from regulatory coherence will tend to be strongest in those sectors where we see the most globally integrated markets – for example, OTC derivatives and wholesale finance, bank finance and capital markets (and, secondarily, where there is the most potential for such markets to develop). In other industry sectors, where markets remain more national, and are likely to do so for the foreseeable future, the need for global regulatory coherence is likely to be lower. This is the case with insurance markets, pensions and other retirement products, and mortgages to a certain extent – though these are generally jurisdiction-specific and shaped by many factors, some regulatory (national systems require local authorisation, capital and supervision) and others much broader, reflecting specific features and policy choices (for example, tax and public healthcare provision).

Even where there is consensus on the level of global regulatory coherence that is appropriate in a general sense, across jurisdictions differences in the wider environment may mean that different approaches to how certain aims are achieved are appropriate. For instance, in emerging markets, the short-term implementation of global standards could harm domestic markets, while in the longer term, they create conditions for generating further cross-border capital flows. The role for the global framework is to provide coherence at the appropriate level – for example, in strategic or principle-based terms, which can then be filled in as appropriate at the level of each jurisdiction. Getting this balance right is a delicate exercise, with the optimum point shifting over time.

11 International Federation of Accountants & OECD BIAC, Regulatory Divergence: Costs, Risks and Impacts, February 2018.

A good example of regulatory cooperation at the global level is the global OTC market, where steps have been taken to drive forward international regulatory coherence, as the G20 Leaders agreed at their St Petersburg's Summit in September 2013: "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[12]."

To support this work, the OTC Derivatives Regulators' Forum (ODRF) was launched in September 2009 to provide authorities interested in OTC derivatives markets and their supporting infrastructures with a means to cooperate, exchange views, and share information on OTC derivatives central counterparties (CCPs) and trade repositories (TRs). As such it has continued to engage with the practical issues of regulatory and supervisory deference[13], particularly in the light of the G20 November 2014 Declaration calling on regulatory authorities to make "further concrete progress in swiftly implementing the agreed G20 derivatives reforms[14]."

"WE ARE COMMITTED TO TAKE ACTION AT THE NATIONAL AND INTERNATIONAL LEVEL TO RAISE STANDARDS TOGETHER SO THAT OUR NATIONAL AUTHORITIES IMPLEMENT GLOBAL STANDARDS CONSISTENTLY IN A WAY THAT ENSURES A LEVEL PLAYING FIELD AND AVOIDS FRAGMENTATION OF MARKETS, PROTECTIONISM, AND REGULATORY ARBITRAGE"

G20 Leaders Statement

12 G20 Leaders' Declaration, September 2013, St Petersburg at para. 71. Available at https://g20.org/wp-content/uploads/2014/12/Saint_Petersburg_Declaration_ENG_0.pdf.

13 Deference has been identified by the G20 Leaders as a tool that authorities may use to help make reforms across jurisdictions interact better and facilitate the meeting of the objectives of the reforms.

14 The G20 Leaders noted in their November 2014 Declaration: "[W]e call on regulatory authorities to make further concrete progress in swiftly implementing the agreed G20 derivatives reforms. We encourage jurisdictions to defer to each other when it is justified, in line with the St Petersburg Declaration." See, G20 Leaders Communique, November 2014, Brisbane, available at https://g20.org/wp-content/uploads/2014/12/brisbane_g20_leaders_summit_communique1.pdf.

Example: Global Regulatory Cooperation
OTC Derivatives Market

Members of the OTC Derivatives Regulators' Forum ODRF have agreed that a flexible and outcomes-based approach should be the basis for any assessment regarding equivalence and substituted compliance as a means of regulatory deference. Assessments should focus on regulatory outcomes, taking into account different regulatory frameworks, local market practices and characteristics across jurisdictions. An equivalence or substituted compliance assessment should be based on an understanding that similar regulatory outcomes may be achieved through the implementation of detailed rules, or an applicable supervisory framework, or both.

Assessments can be made on a broad category-by-category basis, rather than on the regulatory regime as a whole. Assessment should consider international standards, where appropriate, and include regulatory arbitrage, investor protection, risk importation, prudential and other relevant considerations.

In its Report to G20 Leaders on Cross-Border Implementation Issues (November 2015) the OTC Derivatives Regulators Group (ODRG) noted that deference arrangements were in effect in three key jurisdictions (Australia, Canada and US) and several deference arrangements have been proposed in the EU.

Australia has found the EU to be equivalent with respect to central counterparty (CCP) clearing oversight and Germany, the UK and the US to be equivalent with respect to oversight of trading venues. Australia has also found Germany, Hong Kong, Singapore, the UK and the US equivalent with respect to market participant regulation (which would include OTC derivatives market participants). In June 2014, the Australian Securities and Investments Commission (ASIC) published regulatory guidance that states ASIC considers a number of jurisdictions' trade reporting requirements, including those of the EU, Japan and the US Commodity Futures Trading Commission (CFTC), to be equivalent to the Australian requirements.

In the US, the CFTC has issued eight comparability determinations related to the regulatory frameworks of Australia, Canada, the EU, Hong Kong, Japan and Switzerland.

As the Financial Stability Board (FSB) moves away from design of new policy initiatives towards an agenda focused on the implementation and evaluation of the effects of G20 reforms[15], two new evaluations are being undertaken during 2018 on infrastructure investment and incentives for market participants to centrally clear OTC derivatives. The results of these reviews will inform decisions on whether and how to adjust the relevant post-crisis regulations.

To support the FSB's increased focus on evaluation, further steps could be taken by other global institutions and standard setters to support more formal mechanisms for the continuous and systematic cross-border dialogue between regulators, thereby improving the coherence in the implementation, interpretation and evaluation of international standards.

15 Domanski, op. cit.

RISKS TO SUSTAINING GLOBAL REGULATORY COHERENCE

While the benefits of an ongoing commitment to global regulatory coherence are clear, and the post-crisis reforms took a significant step towards securing them, we cannot assume that the current level of global regulatory coherence will automatically be enhanced or even sustained. As Mark Carney, Governor of the Bank of England and Chair of the FSB, said in a speech in April 2017: "The global financial system is at a fork in the road. On one path, we can build a more effective, resilient system on the new pillars of responsible financial globalisation. On the other, countries could turn inwards and reduce reliance on each other's financial systems … The net result would be less reliable and more expensive financing for households and businesses, and very likely lower growth and higher risksin all our economies[16]."

Three major areas present themselves as likely sources of risk to ongoing regulatory coherence: stalled evolution of the global framework; reduced commitment to coherence by individual jurisdictions; and lack of broader engagement with the global processes.

Stalled evolution of the global framework: As noted above, the task of securing the global recovery in the wake of the crisis provided a significant boost to the cause of regulatory coherence, and the network of institutions that drive this agenda forward. As we move on from the crisis, it is vital that the global framework continues to ensure that the financial system is safer, simpler and more inclusive. It must be well placed to identify the emerging risks and opportunities of the future and avoid replaying the last crisis. A key issue for global bodies and standard setters concerns diversity and inclusion, ensuring that all financial sectors and jurisdictions, in both developed and emerging markets, are involved in the global financial reform process. Further diversity among representatives is also necessary, as there is still a perception of a dominance of central banks and bank regulators across global policy committees of the FSB, with an under-representation of asset management and market conduct regulators, for example.

One approach to ensuring that the global framework continues to develop in the right way would be to support the use of cost-benefit-analysis (CBA) by global standard setters to help regulators to determine if their proposals work to solve the problems they are seeking to address. The application of rigorous CBA not only helps to improve rule making and foster more effective regulation, but these steps also promote good governance and improve the accountability of the standard setters concerned.

16 Speech by Mark Carney, Governor of the Bank of England, The high road to a responsible, open financial system, Thomson Reuters, Canary Wharf, Friday 7 April 2017.

Reduced commitment by jurisdictions: Ten years after the crisis there is the prospect that jurisdictions' enthusiasm for global reform is waning; cohesion is weakening; and political focus drifting. It is important for all stakeholders to re-energise the debate on global regulatory coherence. Brexit could provide the catalyst for international institutions to design a more cooperative and cohesive policy process to reach agreements on consistent regulatory regimes and supervisory practices[17]. This aspiration was behind the approach that the IRSG proposed, a system of mutual regulatory recognition, within the context of an ambitious free trade agreement including financial services. Such an approach could also underpin the scope and processes of both sides' future equivalence decisions.

Several countries, most notably the US[18], have raised concerns on the operations of the global framework, around the process and openness of the bodies in the global regulatory framework, for instance, in their objective-setting process. It is vital for the cause of regulatory coherence that leading developed and emerging market economies remain engaged with this process. One key element of this will be ensuring that global institutions are appropriately transparent, accessible and accountable, allowing them to secure ongoing buy-in from a range of national governments, reducing the risk that global agreements are undermined when implemented at jurisdiction level.

One positive step in this regard is included in a letter by the FSB Chair to the G20, in which Mark Carney outlines a series of undertakings on how the FSB will work to maximise its effectiveness, including a thorough review by FSB members on how the organisation works. The review will consider FSB transparency, consultation, mechanisms for setting the FSB's strategic agenda, and how to ensure discipline and efficiency across member-led groups charged with analysis and policy development, implementation and evaluation[19]. The same commitment can be found in the FSB workplan for 2018 which has recommendations on improving FSB governance, including an agreement to "a review of the FSB's processes, procedural guidelines and transparency to ensure its effective operation as it enters a new stage focused on the implementation and effects of the G20 financial regulatory reforms[20]".

Additionally, cooperation and information exchange amongst financial supervisors and regulators are essential for effective oversight in an integrated financial system[21]. Financial markets are global in scope and, therefore, weaknesses in international cooperation and information exchange can undermine the efforts of regulatory and supervisory authorities to ensure that laws and regulations are followed and that the global operations of the institutions for which they have responsibility are adequately supervised.

"ONE KEY ELEMENT OF THIS WILL BE ENSURING THAT GLOBAL INSTITUTIONS ARE APPROPRIATELY TRANSPARENT, ACCESSIBLE AND ACCOUNTABLE, ALLOWING THEM TO SECURE ONGOING BUY-IN FROM A RANGE OF NATIONAL GOVERNMENTS, REDUCING THE RISK THAT GLOBAL AGREEMENTS ARE UNDERMINED WHEN IMPLEMENTED AT JURISDICTION LEVEL."

17 GFMA Principles for Achieving Consistent Regulatory Regimes and Supervisory Practices, April 2018.

18 See US Department of the Treasury Reports: A Financial System that Creates Economic Opportunities: Banks and Credit Unions, June 2017 and A Financial System that Creates Economic Opportunities: Capital Markets, October 2017.

19 FSB Chair Letter to G20 Finance Ministers and Central Bank Governors, 13 March 2018.

20 FSB Press Release, 6 October 2017, FSB discusses 2018 workplan and next steps on evaluations of effects of reforms.

21 Financial Stability Board, 19 December 2014, Global adherence to regulatory supervisory standards on international cooperation and information exchange.

Enhancing broader engagement: To drive the best possible outcomes, it is vital that the broader stakeholder community remains engaged with the global oversight framework. This is a resource challenge for firms, which are already engaging at the national and European level, as well as for the global bodies, many of which are relatively thinly staffed. While part of the solution is to make sure that adequate resources, including the right skills, are committed by both parties, a key factor will be ensuring that feedback can be sought, offered and received in the most efficient manner possible. This includes global institutions and standard setter bodies clearly identifying and making public the precise mechanisms and timetables for industry engagement and consultation.

It is important for industry, including via the relevant trade bodies and associations, to identify areas of inconsistency, gaps and unintended consequences that might arise from the application of global standards, and seek to provide evidence of the impact of these inconsistencies on markets, consumers and end users alike.

One area where there exists a real danger of market fragmentation is global clearing houses and exchanges. Securities and derivatives trading is centralised in London, with a 39% share of OTC derivatives trading through London and a 37% share of foreign exchange trades[22]. The size and centralisation of clearing in a global financial centre means reduced costs due to netting benefits and the ability to offset risks. If a segment of the euro clearing market were to fragment through onshoring to the EU, it would reduce efficiency and increase costs, as well as fracturing the relationships between UK and European regulators that have built up over many years.

22 City of London Corporation London as a European Asset, 2017 based on BIS figures.

Example: Market Fragmentation & Counterparty Clearing Houses (CCPs)

Following the crisis, there was strong support among national and international regulators to develop consistent regulation and to establish cross-border solutions on financial oversight. The G20 agreed in 2009 and 2011 on a series of reforms to global OTC derivatives markets, in part to mitigate risk and improve transparency. To ensure the reduction in systemic risk in derivatives markets, while avoiding the fragmentation of liquidity and of clearing activity into smaller centres – both factors resulting in increased costs and risks for market participants – the G20 leaders further called in 2014 "on regulatory authorities […] to defer to each other when it is justified, in line with the St Petersburg Declaration". (G20 Leaders' Communiqué Brisbane, 16 November, 2014.)

This is not, however, just a theoretical debate, as the case of Japan demonstrates. The application of location policy for the clearing of Japanese yen-denominated swaps by Japanese firms has led to a difference in price between onshore and offshore lending that tended to be in the region of 1-6 bps – leading to performance drag on savings and investment. Canada and Australia have considered similar measures. In the end, they rejected forced relocation due to the costs for their own players and the risk to global markets.

Similarly, the proposed revisions to the European Market Infrastructure Regulation (EMIR) include provisions to deny EU counterparties access to third-country CCPs by denying these CCPs recognition. If such access for the clearing of transactions involving EU clients were to be denied, it would artificially split the clearing market into the minority share that involves an EU client and the majority of the market, which is likely to remain in London. Costs would very likely go up, liquidity would go down, and all participants, investors and companies would bear the costs of market fragmentation. The strongest impact is likely to materialise in the minority EU market.

PRIVATE SECTOR ENGAGEMENT

The principle of stakeholder engagement is recognised by global institutions and standard setters, which often seek to consult stakeholders as a matter of good practice. For instance, the FSB issued 13 public consultations during 2017, ranging from technical issues (for example, Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution[23]) to strategic matters (for example, proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms[24]).

The financial services industry has a great deal to offer in responding to these consultations and it is important for industry to engage with this process and be vocal in the wider public discussion about the risks of fragmentation and what it will mean for markets and ultimately for financing the real economy. As Svein Anderson, the former Secretary General of the FSB, said in a speech in April 2017: "To avoid the potential risk of fragmentation, it is important that the private sector speaks up about this and continues to engage productively and proactively with the authorities and make a clear case for the benefits of effective international standards[25]."

Among other things, industry contributions can provide:

- an assessment of prevailing market conditions;
- an understanding of how proposed approaches are likely to be operationalised by firms; and,
- a sense of the magnitude of the impact of proposed approaches in a particular market, including pointing out potential unintended consequences.

"THE FINANCIAL SERVICES INDUSTRY HAS A GREAT DEAL TO OFFER IN RESPONDING TO THESE CONSULTATIONS AND IT IS IMPORTANT FOR INDUSTRY TO ENGAGE WITH THIS PROCESS AND BE VOCAL IN THE WIDER PUBLIC DISCUSSION ABOUT THE RISKS OF FRAGMENTATION AND WHAT IT WILL MEAN FOR MARKETS AND ULTIMATELY FOR FINANCING THE REAL ECONOMY."

23 FSB, Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution, 6 July 2017.

24 FSB, Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms, 3 July 2017.

25 Perspectives on Global Financial Regulation, remarks by Svein Andersen, Secretary General, Financial Stability Board, Eurofi, 6 April 2017.

One area where industry has actively engaged in policy development at the international level concerns the FX Global Code and associated adherence mechanisms. The code sets out global principles of good practice in the foreign exchange (FX) market and provides a common set of guidance to the market, helping to restore trust and confidence. Work on the code was the product of a public and private sector partnership involving range of market players – corporates and asset managers, along with trading platforms, non-bank participants and Foreign Exchange Committees. All parts of the market were involved in the drafting of the code, ensuring all perspectives were heard and appropriately reflected[26].

The Bank of England, the FCA and market participants in the UK have strongly supported the development of the FX Global Code and are playing a leading role in the Global FX Committee[27].

Similarly, the FICC Market Standards Board was established in 2015 as a result of the Fair and Effective Markets Review[28]. This is a practitioner led body set up to develop more transparent, fair and effective wholesale markets.

26 Opening remarks by Guy Debelle, Deputy Governor of the Reserve Bank of Australia, at the launch of the FX Global Code, London, 25 May 2017.

27 Chris Salmon was the Chair of the Global FX Committee but stepped down in March 2018 alongside his decision to leave the Bank of England.

28 The Fair and Effective Markets Review (FEMR) was a comprehensive and forward-looking assessment of the way fixed income, currency and commodity (FICC) markets operate. FEMR was led by the Bank of England, and co-chaired by the FCA and HM Treasury. A final report was published on 10 June 2015.

Examples of Private Sector Engagement

The FX Global Code of Conduct

Where the financial services sector has engaged with relevant global standard setters, the results have been encouraging, as with the launch of the FX Global Code of Conduct. The FX Global Code of Conduct sets out principles of good practice that are designed to promote the integrity and effective functioning of the wholesale foreign exchange market – developed in partnership between central banks, the private sector and market participant groups, with involvement from the top 16 global FX trading centres. This engagement programme included an extensive outreach to market participants with more than 120 sell-side and buy-side industry associations. The FX Global Code is a tool to rebuild trust in the FX market and reflects the type of partnership working between global regulators and the financial services industry that can help to promote international regulatory cooperation.

The results of the first FX Global Code Survey, undertaken in September 2017, shows that over 150 market participants have already made a Statement of Commitment to the code less than one year after its launch, with 80% of these statements made by private sector market participants[29].

The FICC Markets Standards Board (FMSB)

As a wholesale market practitioner-led organisation with active engagement and support from regulators, market participants and advisers, the FMSB has been designed to ensure there is an effective body for expressing views across the entire wholesale FICC market. This creates a dynamic and effective mechanism to develop acceptable practices not provided by existing high-level principles or detailed regulations.

Although the Code does not represent regulation, it does show the impact that industry engagement has to offer. Given the importance and global reach of these consultations, and the positive impact that financial services industry engagement could have on them, however, it is notable that the level of response to the consultations is fairly low. For example, the FSB consultation on FMI access for firms in resolution received just 29 responses from across the globe, of which the majority were from trade bodies.

The FSB does not publish the names of consultation respondents, but anecdotally it is understood that UK financial services firms do not engage with the global bodies to anything like the same extent that they do with UK and relevant EU authorities.

29 Fair and Effective Markets Review Progress Report, report to the Chancellor of the Exchequer, the Governor of the Bank of England and the Chair of the Financial Conduct Authority, May 2018.

CONCLUSIONS AND NEXT STEPS

The ongoing importance of the global regulatory architecture means that it is vital the public sector and the financial services industry engage effectively with global bodies and regulators to ensure that the global regulatory architecture is robust and fit for purpose. To date, however, industry engagement has been partial and disjointed, due in part to the absence of recognised docking points for industry with global institutions and standard setter bodies. Support by HMG and UK regulators has been critical to the development of the post-crisis regulatory framework, and while there has been a great deal of good work to date, a renewed effort underpinned by sufficient resource is called for to maintain the momentum towards open and free financial markets, based on coherent global standards where appropriate.

This report makes two primary recommendations, one outward facing and one internally focused, both supplemented by several secondary observations on the form that the implementation of those recommendations should take.

Primary recommendations

First, we call on UK Government, regulators and industry to enhance engagement at the global level building on the significant level of work already undertaken at the International level. The UK should play a leading role in shaping the global regulatory architecture; sharing regulatory insights with other jurisdictions and supporting regulatory exchanges with industry.

Second, the IRSG should form a standing committee on the global regulatory architecture comprised of representatives of the UK-based financial services industry and their trade bodies and accountable to the IRSG Executive and Council. Representatives from the official sector should be invited as observers as appropriate. The goal is to set out an approach that enables financial services firms, complementing the work of trade bodies, to engage in a coordinated and strategic way with global institutions and standard setters to support the creation of the appropriate level of regulatory coherence.

Secondary observations

- The committee should 'horizon scan' existing arrangements for engaging with industry counterparts in other countries – for example, through the IRSG dialogues and TheCityUK's Market Advisory Groups (MAGs) – and share information and examples of the benefits of global regulatory coherence.

- The committee should monitor the workplans and publications of the global bodies and standard setters, and alert members to opportunities for engagement.

- It should also identify consultations and other engagement opportunities where it is best placed to respond itself, and then seek an industry consensus position where possible and engage appropriately based on this. This should not imply that the committee will have the primary responsibility for responding to all global institution consultations; in many cases, one of the financial sector trade bodies will be better placed to do so. The committee will need to define its own operating model so that it genuinely adds to the work of trade bodies and firms, and secures wide support across the industry.

- It should monitor the overall flow of interactions between the UK-based financial services industry and global bodies and, where appropriate, seek to make this as joined-up as possible.

- It should flag areas of inconsistency in the implementation of global standards and provide evidence on the impact of inconsistency on markets and end-users. The ability to refer any divergences back to global regulators would encourage consistent implementation and adherence to international standards.

- It should act as the focal point for the industry's communication with the relevant UK authorities, HM Treasury, the Bank of England and the FCA. In particular, it should:

    - write to them at least once a year setting out the industry's strategic priorities for the global regulatory agenda;

    - seek to brief them on industry views in advance of events (for example, FSB Plenary) and developments; and

    - maintain working level dialogue to further mutual understanding of the authorities' and industry's thinking on global regulatory issues.

- It should work openly and in partnership with firms and trade bodies, recognising their expertise and deferring to them where they are best placed to respond to a particular engagement opportunity with the global bodies.

The initial workplan for the new standing committee could include all or some of the following:

- A review of the governance, transparency and consultation processes of each of the global standard setters: to include accounting and auditing standard setters, and the standard setters for market infrastructure, such as the Committee on Payments and Market Infrastructures (CPMI).

- A review of the criteria to which international standards could refer when adopting standards, such as the balance between efficiency, which requires identical standards, and freedom to have regulatory flexibility for justified reasons.

- Development of high-level principles to determine the factors that would indicate the appropriate level of regulatory convergence in a particular area.

- Consideration of areas where new international standards might be developed, or existing ones amended, and where frameworks for mutual recognition, equivalence or deference arrangements could deliver significant benefits, and

- A review of the effectiveness of Industry engagement at the global level.

Next Steps

The IRSG Executive Board will, with the approval of the Council, agree terms of reference for the new workstream and appoint a Chair. The Chair will, in consultation with the Executive Board, formulate the membership of the committee which will in turn set out its workplan and processes.

The IRSG wishes to thank the members of the workstream which have overseen the production of the Report. Please note that this Report should not be taken as representing the view of any individual firm which took part in the discussions:

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