

OTC DERIVATIVES REGULATORS GROUP (ODRG)

REPORT ON AGREED UNDERSTANDINGS TO RESOLVING CROSS-BORDER CONFLICTS, INCONSISTENCIES, GAPS AND DUPLICATIVE REQUIREMENTS

Background

At the Pittsburgh summit in 2009, the G20 leaders committed to strengthen regulatory oversight of over-the-counter (OTC) derivatives markets, including committing to implement requirements in relation to mandatory clearing through central counterparties, reporting to trade repositories and, where appropriate, trading on exchanges or electronic trading platforms.

In the Communiqué of the April 2013 Meeting of G20 Finance Ministers and Central Bank Governors, representatives urged key regulators to intensify their efforts to address cross-border derivatives issues and to resolve by the St Petersburg Summit remaining cross-border conflicts, inconsistencies, gaps and duplicative requirements.

In the Communiqué of the July 2013 Meeting of G20 Finance Ministers and Central Bank Governors, representatives noted the continued progress in implementing OTC derivatives reforms, and that further work remains to ensure greater consistency in regulatory standards. They also committed to rapidly complete the remaining legislative frameworks and regulations for these reforms.

In the Communiqué of the July 2013 meeting of G20 Finance Ministers and Central Bank Governors representatives agreed "*that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulations and enforcement regimes, based on essentially [identical] outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes.*"¹

On 11 July 2013, the European Commission (EC) and the US Commodity Futures Trading Commission (CFTC) announced that they had reached a Path Forward regarding their joint understandings on a package of measures for how to approach cross-border derivatives. Among other things, the Path Forward document explained that the EC, CFTC, and the European Securities and Markets Authority have (i) a shared goal of ensuring that overseas guaranteed affiliates and branches of US and EU persons not be allowed to operate outside of G20 reforms and (ii) agreed to "*implement [their] rules and regulations in a manner that will address conflicts, inconsistencies, and uncertainty to the greatest extent possible and consistent with international legal principles.*"²

This report represents the understandings of the Principals of authorities with responsibility for the regulation of the OTC derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland and the United States.³ This follows our joint press statement of 4 December 2012, our Report to the G20 Meeting of Finance Ministers and Central Bank Governors of 16 April 2013 and our Update to the G20 Meeting of Finance Ministers and Central Bank Governors of 19-20 July 2013.

¹ Communiqué - Meeting of Finance Ministers and Central Bank Governors, Moscow, 19-20 July 2013 available at <http://www.g20.org/load/781659263>.

² Cross-Border Regulation of Swaps/Derivatives - Discussions between the Commodity Futures Trading Commission and the European Union – A Path Forward, 11 July 2013, available at [http://europa.eu/rapid/press-release MEMO-13-682_en.htm?locale=en#PR_metaPressRelease_bottom](http://europa.eu/rapid/press-release_MEMO-13-682_en.htm?locale=en#PR_metaPressRelease_bottom) / <http://www.cftc.gov/PressRoom/PressReleases/pr6640-13>.

³ The meetings were among Principals of the following regulatory authorities: the Australian Securities and Investment 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 (OSC), the Autorité des marchés financiers du Québec, the Monetary Authority of Singapore, the Swiss Financial Market Supervisory Authority, the US Commodity Futures Trading Commission (CFTC), and the US Securities and Exchange Commission (SEC). For the OSC, CFTC and SEC, the term "Principals," refers to the Chairs of the respective agencies, and not to the full bodies.

OTC derivatives reforms

The OTC derivatives markets are global and highly interconnected in nature. Our jurisdictions are implementing legal standards, regulations and guidance that can affect cross-border entities and transactions. The adoption of consistent, effective and, to the extent practicable, non-duplicative standards in and across jurisdictions is of paramount importance in achieving the G20 regulatory reform objectives.

As our jurisdictions implement OTC derivatives reforms, local market conditions, domestic legal frameworks and varying implementation schedules have resulted in differences in the way these reforms are being implemented. These differences create a risk that conflicts, inconsistencies, gaps or duplicative requirements would reduce the effectiveness of OTC derivatives reforms.

The Principals recognise that absent appropriate co-ordination, our respective cross-border rules and implementation schedules could cause market disruption and fragmentation, reduced liquidity in certain markets, and the concentration of risks within certain jurisdictions.

The Principals have committed to avoid, to the extent possible, the application of conflicting rules to the same entities and transactions. The Principals also have acknowledged, in implementing their individual requirements, the desire to eliminate the application of inconsistent and duplicative requirements.

Considerable achievements have been made

The Principals acknowledge that despite the differing timelines for regulatory reform amongst their jurisdictions, much has been accomplished already. As likely will be set forth in the FSB Sixth Progress Report on Implementation of OTC Derivatives Market Reforms, which is due to be published in September 2013, legislative reform is complete or underway, and rulemaking should be complete in all our jurisdictions in 2014 or early 2015. Accordingly, OTC derivatives reform is well underway in our jurisdictions.

Understandings of the Principals

Differences in regulation can result when laws and regulations are developed within distinct legal structures. The following understandings have been reached within the context of complex regulatory differences. The Principals have reached a number of substantive understandings to improve the cross-border implementation of OTC derivatives reforms, and these are set out below.

Consultation and communication when equivalence or substituted compliance assessments are being undertaken is essential.

This includes early and comprehensive consultation among relevant authorities while assessments are being undertaken and before final assessments are made that will facilitate a positive equivalence or substituted compliance assessment where appropriate. Consultation on equivalence or substituted compliance should be based on mutual trust among authorities. Communication to relevant stakeholders should seek to ensure sufficient transparency about each authority's process and approach to assessments so stakeholders are able to understand the basis for a determination, including the factors considered and how such factors were applied.

A flexible, outcomes-based approach should form the basis of final assessments regarding equivalence or substituted compliance.

The final assessments of a foreign regime for equivalence or substituted compliance should be based on regulatory outcomes of that foreign regime, taking account of the different frameworks, local market practices and characteristics across jurisdictions. An equivalence or substituted compliance assessment also should be based on an understanding that similar regulatory outcomes may be achieved through the implementation of detailed rules and/or applicable supervisory framework.

Such assessments may be made on a broad category-by-category basis, rather than on the basis of the foreign regime as a whole. An equivalence or substituted compliance assessment should fully take into account international standards, where they are appropriate, regulatory arbitrage, investor protection, risk importation, prudential and other relevant considerations.

A stricter-rule approach would apply to address gaps in mandatory trading or clearing obligations

Where participants or products are subject to mandatory trading or clearing obligations in one regime but not another, transactions involving such participants or products would need to comply with such obligations, even if the two regimes are otherwise considered equivalent or comparable.

There is a framework for consultation among authorities on mandatory clearing determinations.

This framework is founded on IOSCO recommendations⁴ and aims to harmonise mandatory clearing determinations across jurisdictions to the extent practicable and where appropriate, subject to jurisdictions' determination procedures.

Jurisdictions should remove barriers (1) to reporting to trade repositories by market participants with particular attention to removing barriers to reporting counterparty data and (2) to access to trade repository data by authorities.

These barriers may include, among other laws, data protection laws, blocking statutes, penal codes, state secrecy laws and bank secrecy laws. Domestic barriers should be removed so that, for example, a foreign participant can report trades with a domestic entity pursuant to the reporting requirements applicable to the foreign participant. The Principals do not believe providing exemptions to market participants from reporting certain information concerning foreign market participants to trade repositories (e.g., on the basis that reporting is restricted by foreign law) is an acceptable arrangement, other than on a temporary, time-limited basis.

Authorities should have appropriate and effective access to data reported to trade repositories by market participants as required to perform their mandates. Consistent with 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.

In addition, the Principals note that barriers to reporting in certain jurisdictions outside the ODRG will continue to affect the effectiveness of the reporting obligation unless these barriers are removed.

There should be appropriate transitional measures and a reasonable but limited transition period for foreign entities

Introducing a global regulatory regime for highly complex activities such as trading in OTC derivatives will inevitably result in co-ordination challenges in the early stages. Thus appropriate transitional measures and a reasonable but limited transition period are necessary to avoid unintended consequences and unnecessary costs for foreign entities.

Additional topics for further discussion by Principals

The Principals agree that further work is required to address certain additional topics. These topics seek to address identified issues, including those set out below, to provide greater legal certainty to market participants while respecting the jurisdiction of each authority and to meet the G20's

⁴ IOSCO Report on Requirements for Mandatory Clearing (February 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf>.

underlying objectives of improving transparency in the derivatives markets, mitigating systemic risk, and protecting against market abuse.

Authorities' access to registrant information

Direct access to registrant information, including books and records, is a requirement in some jurisdictions. Blocking statutes and data protection laws however, may limit or prevent cross-border direct access in some jurisdictions.

Foreign Bank Branches and Guaranteed Subsidiaries

When bank branches and guaranteed subsidiaries transact in foreign jurisdictions risk can flow back to the jurisdiction of the parent entity. Inconsistent treatment of bank branches and guaranteed subsidiaries across jurisdictions could result in opportunities for regulatory arbitrage.

Next Steps

The Principals agree to deal pragmatically through the ODRG, other multilateral groups, and/or on bilateral bases, as needed, with a view to ensuring that the G20 goals are met while also aiming to minimise disruption and legal uncertainty.

Recognising that challenges continue to arise in the implementation of OTC derivatives reforms, the resolution of the unresolved issues is important. While the Principals recognise that implementation of OTC derivatives reform raises many legal and operational challenges for their jurisdictions, open communication is vital to ensure there is common understanding of each jurisdiction's processes and timelines, and flexibility in application of cross-border regulation will also be needed to make progress toward cross-border consistency.