OTC DERIVATIVES REGULATORS GROUP

REPORT TO THE G-20 MEETING OF FINANCE MINISTERS AND CENTRAL BANK GOVERNORS OF 18-19 APRIL 2013

Introduction

The principals of the 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], have held four meetings to discuss reform of the OTC derivatives market[2].

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

The principals recognise 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

[1] The meetings were among principals of the following regulatory authorities: the Australian Securities and Investment Commission, the Brazilian Comissao De Valores Mobiliarios, 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 (SEC). For the U.S. regulatory authorities, the term "principals," refers to the Chairs of the respective agencies, and not to the full bodies. In addition, for the purposes of this document, the term "SEC" refers to the Chair and staff of the SEC and not to the full Commission.

[2] Paris, 8 Dec 2011; Toronto, 1 May 2012; New York, 28 November 2012; Brussels, 6 February 2013.

conditions differ among jurisdictions and due account should be taken of such differences in determining the cross-border application of laws and regulations.

The principals also recognise 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. The principals further recognise that regulatory gaps may present risks to financial markets and provide the potential for regulatory arbitrage.

Progress

During discussions, various potential conflicts, inconsistencies, and duplicative requirements within authorities' respective contemplated rules have been identified and measures will continue to be discussed 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.

The principals' discussions have resulted in a significant step forward in understanding one another's respective approaches to the application of rules to cross-border activities, the extent to which substituted compliance, equivalence or recognition would be available for market participants and infrastructures and the processes for making such determinations.

The principals have reached agreement on the way forward in a number of areas.

- **Agreement was reached on a common approach to both the treatment of gaps between laws in respect of clearing and trading obligations and the process for consulting one another on clearing determinations.**

- **It was further agreed that the authorities would provide information to the group on (i) the timing of the implementation of their respective rules (ii) the scope and conditions of their substituted compliance, equivalence or recognition regimes and (iii) the approaches the authorities will take to determining comparability of foreign laws for the purposes of granting substituted compliance, equivalence or recognition.**

- **In a manner consistent with their respective legal regimes and the achievement of their policy objectives, the principals agreed that the authorities would consult with each other prior to making any final determinations regarding which derivatives products will be subject to a mandatory clearing requirement. The principals also committed that once one authority decides that a certain product or class of products should be subject to a clearing requirement, then they will each consider whether the same product should be subject to the same requirement in their jurisdictions, having regard to the characteristics of their domestic markets and in accordance with the applicable determination processes in their respective legal regimes.**

- **The principals agreed to a documented process for consulting one another on mandatory clearing determinations, founded on the recommendations of the IOSCO requirements for mandatory clearing.[2] The objective of the agreed process is to harmonize mandatory clearing determinations across jurisdictions to the extent possible and where appropriate, subject to jurisdictions' determination procedures.**
    - **It was agreed to add an element of exchanging information on any phase-in periods to the documented process in respect of mandatory clearing determinations.**

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[2] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf.

Scope of Regulation and Recognition, Equivalence or Substituted Compliance for Cross Border Compliance

The principals discussed different possible approaches to regulating persons, transactions and infrastructures with respect to cross-border activity when more than one set of rules applies.

It was acknowledged that the G20 commitments and the various initiatives of CPSS, BCBS and IOSCO have encouraged broad harmonization on the scope and content of rules in the group's respective jurisdictions. The EC and ESMA referenced a comparison chart they drafted which largely demonstrated consistency between the EU and US with respect to OTC requirements, but also noted inconsistencies and overlaps.

It was agreed that, in theory and absent legal and policy constraints, substituted compliance, equivalence or recognition may resolve many conflicts, inconsistencies and duplication, but that they may not be the appropriate solution in every case, and cannot resolve gaps.

- The EC stated its view that substituted compliance should be available for all market participants and infrastructures transacting or operating cross-border where the relevant third country has comparable rules, citing its view of the principle of international comity and how it applies in these circumstances. The EC also stated that substituted compliance, equivalence or recognition should apply to transactions between domestic and foreign entities.

- The EC stated that its legislative framework provided for this possibility, subject to certain conditions.

- The CFTC described its proposed cross-border guidance, which set forth, among other things, a substituted compliance regime under which non-US swap dealers and non-US major swap participants (and in some cases, foreign branches of US swap dealers) may comply with the requirements of their home jurisdictions (or in the case of foreign branches, local jurisdictions) under certain circumstances. The CFTC also noted that in general CFTC rules would apply to transaction-level requirements between a US and a non-US person. The CFTC further stated that CFTC rules would not apply to foreign boards of trade but may apply to other foreign infrastructures operating in the US, including CCPs.

- Japan confirmed that although it would require licensing and registration for foreign entities and infrastructures operating in its country much less onerous conditions would apply under its statute to such infrastructures when foreign regulation could be relied upon and foreign entities which are already registered under its statute do not need separate registration.

- Hong Kong stated that although it would require authorisation for foreign infrastructures providing services in Hong Kong, it would base its authorisation assessment primarily on international standards and rely on foreign regulators for day-to-day supervision

- Ontario and Quebec confirmed that they would apply substituted compliance using an outcomes based approach.

The members of the group committed to continuing discussion of the scope of substituted compliance, equivalence or recognition and to exchanging detailed outlines of their respective cross-border approaches, once defined, in order to provide sufficient clarity for other jurisdictions. In this regard, in July 2012, the CFTC published a proposed interpretative guidance and policy statement addressing cross-border issues. In late 2012, SEC staff provided the group with its then-current thinking on the regulation of cross-border OTC derivatives activities. The CFTC and SEC intend to update the group as appropriate. Certain principals urged further development of more detailed international principles in order to eliminate differences in rules.

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

Bases for determinations of comparability of the applicable regime in a jurisdiction

The principals discussed the respective processes that authorities would use for determining whether the rules of another jurisdiction are comparable for the purposes of applying substituted compliance, equivalence or recognition. Several members of the group expressed a strong preference to develop a multilateral process with common principles for assessment. Others stated that a multilateral process was unattainable owing to the mechanisms embedded in their laws.

It was discussed that the objectives of international principles can serve as a guide in order to determine overall outcomes of legal, regulatory and supervisory regimes, but several members stated that many international principles were not sufficiently detailed.

The principals committed to exchanging their authorities' approaches to comparability assessments in their respective jurisdictions in order to ensure a fuller understanding of what could be expected from one another's regimes.

Treatment of Regulatory Gaps

The principals agreed that substituted compliance, equivalence or recognition would not solve the problem of gaps between the rules of different jurisdictions. For example, a gap would be deemed to occur when:

(i) A category of counterparties or products are exempt ex ante from clearing or trading obligations in one jurisdiction but not in another;

(ii) A product is subject to a clearing or trading obligation in one jurisdiction but not in another.

In such cases, the principals agreed to take a 'stricter rule applies' approach, in which case the rules in the jurisdiction that would apply the requirement would prevail. In other words, clearing and trading obligations would apply and exemptions would not be imported.

Examples

(i) US small financial institutions (SFIs) are exempt from clearing pursuant to US law. However, when transacting with a non-US counterparty that is subject to mandatory clearing in its own jurisdiction, the SFI cannot carry its exemption cross-border and the transaction must be cleared.

(ii) EU rules provide for a temporary clearing exemption for pension funds. In a case where an EU pension fund engages in a transaction with a non-EU counterparty with a clearing obligation, the EU pension fund cannot carry its exemption cross-border and the transaction must be cleared.

(iii) If jurisdiction A imposes a clearing obligation on product X but jurisdiction B does not, a transaction between a counterparty in jurisdiction A and a counterparty in jurisdiction B in respect of product X the transaction must be cleared.

Understanding on Timing

Keeping in mind the G-20 commitments to implement key OTC reforms in their respective jurisdictions with respect to clearing, reporting, trading and capital by end-2012, the principals recognise 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, the principals renew their efforts to implement quickly OTC derivatives reforms and in a manner consistent with an orderly implementation process in their respective jurisdictions.

Wherever possible, and 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. The principals agreed to 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, the principals agreed 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, the principals committed to work with their 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 their respective legal requirements and core policy objectives.

Several members of the group noted that the application of rules to cross-border transactions before foreign jurisdictions had their own rules in place could lead to a fragmentation of markets. The possibility of transitional periods (for example, EU and US transitional periods) and time limited relief (for example, US 'No Action' letters and exemptive orders) were mentioned as options for avoiding possible negative consequences. The work of the BCBS and IOSCO on international principles should serve to help align implementation timing on margin requirements. However, some jurisdictions noted limitations on the transitional relief they were able to provide in other areas.

The principals committed to exchanging more granular implementation timetables for each area of their respective rules in order to enable a better understanding of where there may be differences in the timing of implementation.

Understanding on Sharing of Information and Supervisory and Enforcement Cooperation

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

The principals agreed to attempt to ensure that the relevant supervisory authorities:

a. enter into supervisory cooperation arrangements with other 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 their 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.

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

The principals also recognised 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, equivalence, registration categories or exemptions) framework.

Data Access

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

It was noted that data protection laws, blocking statutes, state secrecy laws, bank secrecy laws or other similar restrictions in some jurisdictions may be a barrier to market participants producing information, including revealing their counterparties' identities, as required under reporting obligations under domestic and foreign requirements. In some cases, this could be overcome by consent or, in the case of the EU, through a combination of recognition and access arrangements, in respect of reporting to trade repositories. However, in jurisdictions where this was not possible, obstacles would remain.

In addition, such restrictions may also impose a barrier that prevents regulators from obtaining access to relevant supervisory data that a firm has reported to a trade repository.

The principals agreed to identify, as a matter of urgency, issues with respect to producing information to trade repositories, and access by regulators from a trade repository, and to develop further possible options to overcome such barriers.

It was noted that such restrictions may also impede the ability of regulators to supervise firms in foreign jurisdictions where access to books and records is denied due to data protection, secrecy or blocking laws.

Next Steps

Consistent with the request by the Chair of the FSB, the principals expect to discuss during their next meeting in June 2013 reporting to the G20 Leaders' Summit in September 2013.

In addition, the principals agreed to provide one another with information on:

(i) the timing of the implementation of their respective rules, including any transitional periods or time limited relief;

(ii) the scope and conditions of their substituted compliance, equivalence or recognition regimes; and

(iii) the approaches regarding comparability assessments, including the timing for determining such assessments, based on overall outcomes of legal, regulatory and supervisory regimes.

Further, the principals will continue to discuss a number of remaining outstanding issues over the coming months. As part of this, the principals will work to identify practical options to resolve identified conflicts, inconsistencies, and duplication and to agree on an on-going process to identify and resolve any new issues, including the practical application of comparability assessments.

The principals will also aim to identify issues with respect to producing information to trade repositories, and access by regulators from a trade repository, and develop further possible options to overcome such barriers.

ODRG Participants

Australia :

- Greg Medcraft, Chairman, Securities and Investments Commission
- Steven Bardy, Senior Executive Leader International Strategy, Australian Securities and Investments Commission

Brazil :

- Otavio Yazbek, Commissioner, Comissão de Valores Mobiliários

Canada :

- Kevin Fine, Director, Ontario Securities Commission
- Louis Morisset, Superintendant, Autorité des marchés financiers
- Derek West, Senior Director, Autorité des marchés financiers

European Commission :

- Jonathan Faull, Director General, DG Internal Market & Services
- Emil Paulis, Director, DG Internal Market & Services
- Patrick Pearson, Head of Unit, DG Internal Market & Services
- Hannah Rayner, Administrator, DG Internal Market & Services
- Peter Kerstens, Administrator, Delegation to the United States of America

European Securities and Market Authority

- Steven Maijoor, Chairman
- Martin Wheatley, Board Member
- Rodrigo Buenaventura, Head of Markets Division

Hong Kong :

- Ashley Alder, CEO, Securities and Futures Commission
- Daphne Doo, Director, Securities and Futures Commission

Japan:

- Masamichi Kono, Vice Commissioner, Financial Services Agency
- Jutaro Kaneko, Director, Financial Services Agency
- Toshitake Inoue, Director, Financial Services Agency
- Makato Sonoda, Deputy Director, Financial Services Agency

Singapore:

- Chuan-Teck Lee, Assistant Managing Director, Monetary Authority of Singapore
- Tiak-Peow Phua, Deputy Director, Monetary Authority of Singapore

Switzerland:

- Urs Zulauf, General Counsel, FINMA
- Rupert Schaefer, Senior Specialist Regulation, FINMA

United States:

- Gary Gensler, Chairman, Commodity Futures Trading Commission,
- Jacqueline H. Mesa, Director, Commodity Futures Trading Commission
- Elisse Walter, Chairman, Securities and Exchange Commission
- Ethiopis Tafara, Director, Securities and Exchange Commission
- Brian Bussey, Associate Director, Securities and Exchange Commission
- John Ramsay, Acting Director, Securities and Exchange Commission