

Report of the OTC Derivatives Regulators Group (ODRG)ⁱ to G20 Leaders on Cross-Border Implementation Issues

November 2015

Background

Jurisdictions have been implementing the G20's OTC derivatives reform agenda through legislative and regulatory action. Since 2011, the ODRG has sought to identify and resolve cross-border issues associated with this implementation.

In this report, the ODRG updates the G20 Leaders since the ODRG's report from November 2014ⁱⁱ on how the ODRG has addressed or intends to address a number of identified cross-border issues.

A focus of the ODRG has been the issue of deference in the context of central counterparties (CCPs), in line with the G20 Leaders' St. Petersburg and Brisbane declarations. There has been further substantial progress in implementing OTC derivatives reforms within ODRG jurisdictions, and continued bilateral progress in addressing cross-border issues amongst them.

CCP Deference

The ODRG has focused on addressing deference in the context of CCPs in view of the importance of CCPs in the global OTC derivatives markets. Annex A of this report is a paper on deference in the context of CCPs.

Monitoring of Substituted Compliance and Equivalence Assessments

The ODRG agreed that monitoring of substituted compliance and equivalence assessments is necessary to ensure these assessments and determinations remain up-to-date, and the sharing of information on legal or regulatory changes is essential to such monitoring.

ODRG members should share information about legal or regulatory changes to help to ensure that existing substituted compliance or equivalence determinations are kept up-to-date. ODRG

ⁱ The ODRG includes Principals of the following regulatory authorities with responsibility for regulation of over-the-counter (OTC) derivatives markets: the Australian Securities and Investments Commission (ASIC), the Brazilian Comissao de Valores Mobiliarios, the European Commission (EC), the European Securities and Markets Authority (ESMA), the Hong Kong Securities and Futures Commission (SFC), the Japanese Financial Services Agency (JFSA), the Ontario Securities Commission (OSC), the Autorité des marchés financiers du Québec (AMF), the Monetary Authority of Singapore (MAS), the Swiss Financial Market Supervisory Authority, the U.S. Commodity Futures Trading Commission (CFTC), and the U.S. Securities and Exchange Commission (SEC). For the OSC, CFTC and SEC, references to "Principals" and "ODRG members" are to the Chairs of their respective agencies and not the full bodies. This report should not be read as reflecting a judgment by, or limiting the choices of, the participating authorities with regard to the content of their proposed or final versions of their relevant rules or standards, nor their timing of implementation.

ⁱⁱ See Report of the OTC Derivatives Regulators Group (ODRG) to G20 Leaders on Cross-Border Implementation Issues, November 2014

http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/oia_odrgreportg20_1114.pdf.

members should also share experiences from undertaking substituted compliance and equivalence assessments and the monitoring of such assessments.

Cooperation on Clearing Obligation Mandates

ODRG members previously agreed to a framework for consulting one another on mandatory clearing determinations, with the aim of harmonizing mandatory clearing determinations across jurisdictions to the extent practicable and as appropriate, subject to jurisdictions' determination procedures. Inconsistent clearing mandates across jurisdictions may create the potential for regulatory arbitrage. ODRG members are considering ways to enhance the existing framework for such cooperation.

Other Work Previously Identified

As part of its work on addressing regulatory conflicts, inconsistencies, gaps and duplicative requirements in the treatment of branches in cross-border situations, the ODRG has discussed the application of rules to branches of financial institutions that operate across multiple jurisdictions. As a result of this work, ODRG members have a fuller understanding of the regulation of the cross-border activity of branches which will assist them in addressing these issues on a bilateral basis.

Continued progress in addressing cross-border issues among ODRG jurisdictions:

Following the four equivalence decisions made by the EC in October 2014 (and referenced in last year's report) with respect to the regulatory regimes for CCPs for Australia, Hong Kong, Japan and Singapore, ESMA has signed the related Memoranda of Understanding (MOUs) with the relevant authorities from these countries. The MOUs were instrumental in enabling ESMA to recognise eleven CCPs established in these four countries. The four MOUs signed by ESMA were:

- In November 2014, ESMA, ASIC and the Reserve Bank of Australia signed an MOU.
- In December 2014, ESMA and the SFC signed an MOU.
- In February 2015, ESMA and the JFSA signed an MOU.
- In February 2015, ESMA and MAS signed an MOU.

In February 2015, the OSC published amendments to its OTC derivatives trade reporting rule (OSC Rule 91-507) to permit certain market participants subject to Ontario trade reporting obligations to benefit from substituted compliance when they report trades pursuant to European Union (EU) trade reporting rules. The OSC conducted a comparability analysis using an outcomes-based approach to determine whether the EU rules and regulations are sufficiently equivalent for the purposes of the substitute compliance provision of OSC Rule 91-507.

In February 2015, the SEC adopted rules related to security-based swap regulatory reporting and public dissemination (Regulation SBSR) and rules related to trade repositories (TRs), including rules that established a procedure for requests for substituted compliance for foreign regulatory regimes for reporting and public dissemination requirements.

In August 2015, the SEC adopted new rules to provide a comprehensive process for security-based swap dealers and major security-based swap participants (collectively “SBS entities”) to register with the SEC, including provisions for non U.S. SBS entities.

In August 2015, the CFTC issued an order of exemption from registration as a derivatives clearing organization to ASX Clear (Futures) Pty Limited, based in Australia. Subject to the terms and conditions of the order, ASX is permitted to clear proprietary swap positions for U.S. persons that are clearing members or clearing member affiliates.

In October 2015, the CFTC issued an order of exemption from registration as a derivatives clearing organization to Japan Securities Clearing Corporation (JSCC), based in Japan. Subject to the terms and conditions of the order, JSCC is permitted to clear proprietary swap positions for U.S. persons that are clearing members or clearing member affiliates.

In November 2015, the SFC and ESMA reached an agreement on an MOU on cooperation arrangements for the exchange of information related to the information on derivative contracts held in TRs established respectively in Hong Kong and in the EU. This is to enable the SFC and ESMA both to have indirect access to the information on derivative contracts that they need to fulfil their responsibilities and mandates.

Forms of Deference in ODRG Jurisdictions with Respect to Central Counterparties

1. At the St. Petersburg Summit in September 2013, the G20 Leaders agreed that “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.”¹
2. Since the St. Petersburg Summit, the OTC Derivatives Regulators Group (ODRG) members² have continued to engage with the issues of regulatory and supervisory deference in OTC derivatives reform, particularly in light of the G20 November 2014 Declaration calling on regulatory authorities to make “further concrete progress in swiftly implementing the agreed G20 derivatives reforms.”³ In the context of its work to implement understandings in the area of equivalence and substituted compliance, the ODRG has been considering how deference to foreign regimes may work in practice.
3. The ODRG members have committed to avoid, to the extent possible, the application of conflicting rules to the same entities and transactions. The members also have acknowledged, in implementing their individual requirements, the desire to eliminate the application of inconsistent and duplicative requirements.⁴ 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.⁵

¹ 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.

² The ODRG includes Principals of the following regulatory authorities with responsibility for regulation of over-the-counter (OTC) derivatives markets: 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 (OSC), the Autorité des marchés financiers du Québec, the Monetary Authority of Singapore, the Swiss Financial Market Supervisory Authority, the U.S. Commodity Futures Trading Commission (CFTC), and the U.S. Securities and Exchange Commission. For the OSC, SEC and CFTC, references to “Principals” refers to the Chairs of their respective agencies, and not to the full bodies.

³ 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 Communiqué, November 2014, Brisbane, available at https://g20.org/wp-content/uploads/2014/12/brisbane_g20_leaders_summit_communique1.pdf.

⁴ See, ODRG Report on Agreed Understandings to Resolving Cross-Border Conflicts, Inconsistencies, Gaps and Duplicative Requirements, August 2013, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf>.

⁵ G20 Leaders’ Declaration, September 2013, St. Petersburg *supra*, note 1.

4. The ODRG members have been working on practical aspects of deference, building on the survey work of the FSB, by drawing out themes and identifying potential common approaches. The ODRG has focused on delineating and describing forms of deference in the context of central counterparties (CCPs) in view of the importance of CCPs in the global OTC derivatives markets.
5. ODRG members have developed a greater appreciation of, and respect for, differences in legal authority, policy objectives, and approaches to the application of deference. The ODRG members have a fuller understanding and acceptance of the forms of deference that could be applied; nevertheless, these differences limit the ability to agree on a common approach regarding whether and how deference should be used. Therefore, this paper does not prescribe or endorse a particular model or framework.

Approaches to Deference

6. Deference in some jurisdictions is understood to be the full or partial reliance on another jurisdiction's regulatory and/or supervisory framework. In other jurisdictions, deference is understood to mean that an entity may comply with home jurisdiction⁶ requirements that are comparable and comprehensive as a substitute for compliance with host jurisdiction requirements. However, deference must also be consistent with an authority's objectives and legal responsibilities. In some jurisdictions, for example, it may not be legally permissible under national requirements to provide for deference in certain situations. While some authorities may choose to defer to the home authority, this should not mean that all authorities must do so. Some members noted that the application of some forms of deference may not be consistent with all the objectives of the OTC derivatives reforms. Each authority's duty to carry out its own objectives and legal responsibilities comes first.
7. Differences in approaches to deference among jurisdictions can be understood on a spectrum. At one end of the spectrum, the host jurisdiction may grant full deference to all relevant aspects of the home jurisdiction's regime including relying on the home jurisdiction's licensing and registration, disapplication of host jurisdiction rules in favor of home jurisdiction rules, and reliance on home jurisdiction day-to-day oversight, general supervisory oversight, and reporting requirements. At the other end of the spectrum, the host jurisdiction may grant no deference, requiring direct compliance with its rules and conducting its own comprehensive oversight of CCPs operating across multiple jurisdictions. In between, there is a range of deference arrangements in which

⁶ This paper discusses deference from the perspective of a "host" authority of a cross-border entity that is considering whether, and if so, to what extent, to exercise deference to the authority in the entity's "home" jurisdiction.

host jurisdictions may grant partial deference with respect to a full or limited set of rules and requirements using a range of processes and/or retain certain direct supervisory oversight practices. Within the ODRG, with respect to supervision of CCPs, most host authorities retain supervisory authority; however, some host authorities may not be able to monitor or oversee foreign CCPs as closely as domestic CCPs and may choose to rely on the home authority in practice for day-to-day supervision. Two ODRG jurisdiction regimes permit or will permit complete disapplication of their supervisory authority in favor of a CCP's home supervisory authority.

8. Common features of deference frameworks include the following:

- Strong safeguards to protect the ability of the home and host authorities to carry out their legal and/or supervisory responsibilities and ensure that the home authority is carrying out its responsibilities appropriately.
- Cooperation among authorities (including between home and host authorities).⁷
- Flexibility, so that the model appropriate for a jurisdiction may be applied with respect to (a) different jurisdictions' legal frameworks and (b) different CCPs (e.g. an authority may determine that a specific CCP may have a distinct systemic, market or other importance compared to other CCPs in its jurisdiction).
- Comparable rules with similar regulatory outcomes will often need to be in place.

9. While the group recognizes that some members of the ODRG may choose to exercise deference in certain contexts, it is understood that all members must decide such issues depending on the context of application and their respective domestic market conditions, regulatory and supervisory framework for CCPs, legal constraints and policy preferences. Of those jurisdictions that choose to exercise deference, some apply broad deference of substantive regulations, supervisory practices and supervisory authority and some apply a deference model that involves deference with respect to certain substantive regulations and/or some supervisory practices and/or supervisory authority. One member does not currently have available means or authority to exercise deference with respect to CCPs at all. As agreed previously by the ODRG, “[a]n equivalence and 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.”⁸

⁷ The group recognizes that Responsibility E of the CPMI-IOSCO Principles for Financial Market Infrastructures sets out the international standards for cooperation of authorities with respect to financial market infrastructures, including CCPs.

⁸ See Report of the OTC Derivatives Regulators Group (ODRG) to G20 Leaders on Cross-Border Implementation Issues, November 2014, available at http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/oia_odrgreportg20_1114.pdf

Forms of Deference

10. The following forms of deference, which memorialize some existing practices of ODRG members, is designed to be neither exhaustive nor prescriptive and is premised on a jurisdiction having the means or authority to do so.

Registration and Recognition Processes

11. In some circumstances, an authority may use a registration/authorization framework, and may offer the possibility of substituted compliance in connection with certain requirements applicable to the registered/authorized entity. In some other circumstances, an equivalence and recognition framework may be used or a combination thereof. Authorities also may defer through the use of registration categories or exemptions. In a registration and substituted compliance situation, the host authority's substantive requirements would still apply, but a CCP may comply with such requirements through the requirements of the home authority.⁹

Consideration of the Significance of the CCP and/or the Market, and Other Considerations

12. When determining whether deference should be exercised, host authorities may consider the context and circumstances of the particular CCP. In deciding whether and to what extent to defer, authorities may choose to take into consideration, among other things, the significance of the CCP to the market or conversely, the significance of the market to the CCP (i.e., if a CCP does a large portion of its business in a host jurisdiction), or some combination of these considerations.
13. Some authorities may choose to apply a higher level of deference where the relevant entity has a lower impact in, or nexus to, the host country's market. For example, some authorities may apply a *de minimis* threshold, whereby full or partial deference is provided for an entity that is below a certain level of systemic, market or counterparty risk significance. Alternatively, some authorities may take a more graduated approach with multiple thresholds, where the level of deference increases as the level of significance decreases, which could reduce reliance on the supervisory resources in the host country without endangering its financial stability or its market or counterparty protections. Where the host jurisdiction is less exposed to such risks, the host authority could determine that the level and scope of oversight may be correspondingly different or less than for a CCP which poses a higher level of risk to the host jurisdiction.

⁹ Definitions of substituted compliance may vary with respect to how the compliance is measured and the allocation of responsibility for enforcement if compliance is not achieved.

14. In addition, some members noted that supervisory and regulatory resources and the practical difficulties of regulating a foreign entity are also contributing factors in determining whether, and if so, to what extent, to defer to a foreign CCP's home regulatory or supervisory regime to regulate or supervise the foreign CCP. Moreover, in a highly mobile, global market, determination of the risk that activity in a particular jurisdiction poses can quickly become outdated.

Information Requirements

(a) Regulatory Reporting Requirements

15. All regulators require reports from CCPs that are registered, recognized or authorized with them. These reports may concern information on arrangements, strategies, processes and mechanisms implemented by CCPs to verify compliance and to evaluate the risks to which CCPs are exposed. Different jurisdictions have varying requirements for information. Some host jurisdictions may accept reports in compliance with home country requirements while other host jurisdictions will require reports that differ from the home jurisdiction's requirements. Moreover, authorities may prefer to retain their rights to request and receive information directly from CCPs rather than through another regulator, even in situations where they may be willing to consider some deference to another regulator's rules.

(b) Receipt or Exchange of Information

16. Regulators may also consider their ability to receive information from CCPs or exchange information with other authorities. This may include how reporting between authorities and CCPs they supervise will occur, and exchange of "business as usual" regulatory information between home and host authorities. This may also include deciding on the proper means for receiving or exchanging information about unanticipated business and market developments, including during times of market stress. The mechanism for this may be set out in a memorandum of understanding, a college's terms of reference, or the regulatory conditions for the CCP in individual jurisdictions. The outcome of these procedures should be that all regulators are fully apprised of information that impacts their ability to fulfil their statutory duties. For example, if moments of stress trigger enhanced reporting obligations on the part of the CCP, regulators should consider how they would expect to receive and/or share this information in contemplating a deference arrangement. The flow of information should be such that there is no significant risk of important market or financial data or information affecting the resilience of a CCP not being provided to both authorities in a timely manner. Measures to communicate early warning signs of systemic, market or counterparty risk should be considered prior to a

deference determination to allow host authorities to attempt to control or limit the impact of the risk.

Surveillance and Monitoring

17. A host authority may make different choices as to how to ensure that a CCP is compliant with all applicable rules. A host authority may not wish to defer unless it can ensure that activities within the host jurisdiction are appropriately supervised by the home authority. It may be more difficult for the host authority to be comfortable that the home authority is properly supervising the entity's presence in the host jurisdiction, partly because the home authority may not have sufficient knowledge of the host market. A host authority may determine that the disapplication of its requirements can be monitored and assessed through the equivalence process (if applicable) through which the host authority can evaluate the quality of supervision of the home authority. This may be done, for example, by using questionnaires to authorities or publicly available sources on the quality of supervision (including dedicated supervisory resources) of the home authority. Additionally, a host jurisdiction may choose not to defer monitoring and inspection of the CCP to the home jurisdiction but will conduct its own on-site inspections to evaluate compliance with the host jurisdiction's requirements on terms to be determined between the home and host jurisdictions and possibly the relevant CCP.

Registration Applications and Changes to Service or Product Offerings, Rules and Risk Management

18. Regulators whose regimes require registration/recognition will typically require the relevant CCP that is applying for registration/recognition to provide to the host authority information that would substantiate that the CCP is in compliance with the host authority's requirements. In doing so, some host authorities may rely on information already provided to the home authority.
19. When a CCP makes changes to its service offering, product offering, rules or risk management, an authority that has extended some form of deference must determine the extent to which it will evaluate such changes and, if applicable, the proper process to evaluate and, if appropriate, to recognize such changes. The host authority may decide to not undertake the full registration/recognition process, provided that the change sought stays within the bounds set by the host authority's initial authorisation. Some authorities may wish to retain a more comprehensive independent right of review. Other authorities may require the CCP to go through the registration/recognition process again when significant modifications are made to its service offering, product offering, rules, and risk management. Most authorities require specific reporting on business developments, for

example when significant changes are made to risk management models and parameters. If a change goes outside the scope of initial registration/recognition by the host authority, most host authorities would require their approval of the change. In other cases, some host authorities may defer entirely to the home jurisdiction or require only notice of the change.

College Arrangements

20. Some CCPs have global college arrangements and some other CCPs may have college arrangements established at a future point in time. Membership in a global college may help a host authority to be more willing to consider deference. Mechanisms, such as licencing conditions, and direct access to the CCP's books and records, may need to be in place to ensure adequate supervision by the host authority. This need may be more or less pronounced depending on the nature of the global college and whether the authority is outside the college structure.

Memoranda of Understanding (MoUs)

21. There are currently a significant number of supervisory MoUs in existence between ODRG members relating to consultation and cooperation in the oversight of globally active CCPs. Many of these MoUs commonly include provisions such as those on exchange of information, notification of regulatory actions or sanctions and enforcement actions, cooperation with on-site inspections, confidential safeguards on use of information, and consultation and meetings or calls between the regulators.