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9 July 2013

Chairman Mark Carney
Financial Stability Board
Bank for International Settlements
CH-4002
Basel, Switzerland

Secretary General David Wright
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

Re: Implementation of Market Regulations

Dear Chairman Carney and Secretary General Wright:

The Global Financial Markets Association ("GFMA")[1] commends the G20 Finance Ministers, the Financial Stability Board ("FSB"), and the International Organization of Securities Commissions ("IOSCO") for their role in encouraging jurisdictions to adopt national regulatory frameworks that are largely comparable. Your efforts have helped to avoid or mitigate cross-border conflicts, inconsistencies, gaps and duplicative requirements arising from regulatory reform initiatives adopted by jurisdictions in response to the global financial crisis. Despite these efforts, market participants face an increasingly complex regulatory web as national and regional jurisdictions fail to pursue the objective set forth by the G20 to promote "...standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage."[2]

As we noted in our earlier companion letter,[3] inconsistent implementation of prudential standards risks undermining the work you have done. Similarly, the fundamentally global nature of financial markets makes consistency of their regulation at least as important, if not more so, than prudential standards for market participants. Without careful coordination, market regulation by one jurisdiction can have extraterritorial implications. In addition, inconsistent market regulation can create opportunities for regulatory arbitrage and risks fragmentation of global markets, resulting in risk

[1] The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. For more information on GFMA, please visit http://gfma.org/about/.
[2] See G20 Leaders' Statement, Pittsburgh Summit (24-25 September 2009), available at http://www.g20.utoronto.ca/2009/2009communique0925.html.
[3] See GMFA letter to the FSB and the Basel Committee on Banking Supervision regarding implementation of prudential standards (24 June 2013), available at http://www.gfma.org/correspondence/item.aspx?id=491.

migrating to less-regulated jurisdictions. Ultimately, inconsistencies can impede growth within jurisdictions and around the world.

To address these risks, we urge the FSB and IOSCO to promote a shared understanding of mutual recognition and substituted compliance principles, use the FSB peer review process to assess and encourage progress in reducing reliance on credit ratings, and alert G20 Finance Ministers to the risks of cross-border financial transaction tax proposals.

There are a number of current initiatives that call into question the consistency of market regulation, which we describe below along with our recommendations for constructive action.

I. The FSB and IOSCO should promote the goal of mutual recognition and substituted compliance between jurisdictions, particularly in the area of cross-border over-the-counter (OTC) derivatives, through development and promulgation of a common understanding of what these principles mean in practice, and their efficacy.

In 2009, G20 Leaders agreed on a general framework for the regulation of OTC derivatives. Since that time, the FSB has issued several progress reports tracking the significant efforts made toward that goal. Most recently, IOSCO created a "Task Force on Cross Border Regulation" to develop a "tool box" of measures to address the challenges involved in regulating cross-border activity, and principles to guide the use of these tools including substituted compliance, mutual recognition and supervisory cooperation. We applaud the active engagement of both organizations in seeing this mandate through to implementation. However, the adoption of final cross-border guidance by the Commodity Futures Trading Commission (the "CFTC") while these productive discussions remain ongoing could threaten their continued progress.

Financial authorities and regulators from around the globe continue to stress the need for international coordination and consistency in implementing OTC derivatives reforms. The FSB itself has recently issued a progress report supporting the consistent implementation of G20 commitments through the development of international standards, highlighting continued progress to this end.[4] Officials and market participants continue to express concern that if the CFTC were to allow its cross-border exemptive relief to expire on 12 July 2013 without an extension, or prematurely finalize cross-border guidance, it would hinder such efforts. On 28 May 2013, representatives of the European Commission sent a letter to the CFTC expressing such concerns, noting that such actions could jeopardize the productive and cooperative efforts underway towards meeting G20 commitments on OTC derivatives reform.[5] Even within the CFTC such concerns have been expressed, as evidenced by a 6 June 2013 statement from Commissioner Scott O'Malia supporting an extension of the CFTC's

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[4] See "OTC Derivatives Market Reforms: Fifth Progress Report on Implementation (15 April 2013), available at http://www.financialstabilityboard.org/publications/r_130415.pdf.

[5] See "Invitation to extend the Exemptive Order on cross-border swap" (28 May 2013), available at http://www.davispolk.com/files/uploads/FIG/EC.Letter.Cross.Border.Swaps.052813.pdf.

exemptive relief, given the need to harmonize cross-border regulatory framework with fellow regulators and draft workable final guidance.[6] The Securities Industry and Financial Markets Association ("SIFMA"), the U.S. regional member of GFMA, along with several other associations, requested an extension of the CFTC's exemptive relief on 6 June 2013, citing similar concerns to those raised by the European Commission and Commissioner O'Malia, stressing the need for the CFTC to take time to harmonize its rules with domestic and foreign regulators prior to finalizing any cross-border guidance.[7]

In addition, there are a number of specific areas requiring more active engagement of the FSB and IOSCO to ensure global consistency. For example, the European Market Infrastructure Regulation prohibits EU based entities from clearing through non-EU central counterparties not recognized by the European Securities and Markets Authority. As a result, non-EU counterparties may be subject to local clearing requirements that are incompatible.

Implementation of derivatives regulation in the United States has already created cross-border complications. The CFTC has required many non-US entities, regardless of their home country regulatory framework, to register with the CFTC as swap dealers, thereby subjecting them to capital requirements, inspection and supervision by US regulators, as well as other requirements (such as margin rules for uncleared transactions). Compounding this problem, in proposals to date the CFTC has taken a very narrow view of substituted compliance for purposes of the Dodd-Frank Act's transaction- and entity-level requirements. Its rule-by-rule and equivalence approach to substituted compliance will likely create a regime of conflicting, confusing and unnecessarily complex regulations.

In contrast, we believe a more principles-based or holistic approach, akin to that proposed by the Securities and Exchange Commission, could avoid these outcomes and be particularly appropriate given the G20's detailed agreement on the goals and objectives for regulation of the global swaps market. With the support of the FSB, we believe IOSCO's task force is ideally positioned to develop a common understanding of mutual recognition and substituted compliance for use by jurisdictions, thereby avoiding these and other similar problems.

II. The FSB should ensure its peer review provides a rigorous assessment of jurisdictions' progress in reducing reliance on credit ratings and continue to promote tangible progress towards that goal.

Following its 2010 *Principles for Reducing Reliance on CRA Ratings*, the FSB issued a roadmap accelerating the development of alternative approaches to the mechanistic reliance on credit ratings by mid-2014. In March 2013, the FSB launched a thematic peer review on progress towards the *Principles*.

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[6] See "Statement by Commissioner Scott D. O'Malia on Ensuring a Backup Plan on Cross-Border Guidance to Give Markets Certainty" (6 June 2013), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement060613.

[7] See SIFMA, American Bankers Association, ABA Securities Association, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association letter (6 Jun 2013), available at http://www.sifma.org/issues/item.aspx?id=8589943947.

However, major jurisdictions have taken different approaches to reducing reliance on credit ratings. US legislators took the radical approach of eliminating all statutory references to credit ratings and directing US regulators to do the same in their regulations. In contrast, the EU has focused on the more measured mandate of the *Principles* – namely, finding ways to reduce reliance on credit ratings as viable alternatives are developed. Inconsistent regulatory objectives between these major jurisdictions may produce conflicting requirements as well as inconsistent regulation of the credit rating agencies themselves.

We encourage the FSB to ensure that its peer review provides a rigorous assessment of jurisdictions' progress in reducing reliance on credit ratings, and continue to promote tangible progress consistent with its accelerated timetable, without the assumption that any of the particular approaches applied to date should be adhered to.

III. FSB and IOSCO should alert G20 Finance Ministers to risks FTTs pose.

Several jurisdictions are considering, or have imposed, a financial transactions tax ("FTT"). However, the interconnected nature of financial markets makes it very difficult to limit the impact of these local taxes on foreign investors and markets. In fact, the proposed FTTs under consideration – whether motivated by a desire to minimize avoidance or otherwise – have clear extraterritorial effects. This is inconsistent with repeated calls by the G20 to avoid measures exhibiting such effects. GFMA, along with a number of other associations, recently delivered a letter to G20 Finance Ministers expressing strong opposition to the EU's proposed FTT.[8]

Beyond extraterritorial concerns, FTTs increase the cost of equity and debt financing for governments and corporate entities as well as the cost of risk-mitigating hedging transactions. These increased costs have a demonstrably negative impact on national economies.

We are particularly concerned about the European Commission's proposed FTT. It would apply to every purchase and sale of a financial instrument that: (1) is issued in one of the eleven EU member states that have agreed to adopt the FTT ("EU11"); (2) involves a buyer or seller resident in an EU11 country; or (3) involves an EU11 financial institution in the transaction. No exemptions are permitted for intermediary transactions. Thus, for example, the FTT would apply to the sale of corporate bonds of a French company by a Japanese bank to a Canadian bank through a US broker-dealer.

The impact of the EU's proposed FTT would be severe. The increased costs of hedging, repo and other basic market transactions caused by the FTT could outweigh the margins on these transactions, resulting in a less efficient and less stable financial system. Studies have further indicated the proposed

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[8] See GFMA, Australian Financial Markets Association, Investment Industry Association of Canada, Japan Securities Dealers Association, and Korea Financial Investment Association letter to G20 Finance Ministers regarding opposition to the European Commission's proposed FTT (16 April 2013), available at http://www.gfma.org/correspondence/item.aspx?id=464.

EU FTT will cause the European repo market to shrink to one-third of its current size[9] and reduce business investment and participating member states' GDPs by 1.8 percent and 50 basis points, respectively.[10]

FSB and IOSCO, as the preeminent international bodies tasked with monitoring global financial markets, should alert G20 Finance Ministers to the risks which cross-border FTTs pose to the efficient functioning of global financial markets and to their capacity to provide financing for economic growth.

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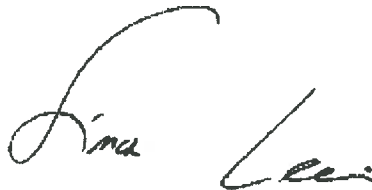
The GFMA appreciates your consideration of these important issues. If you have any questions or we can be of assistance in resolving these issues, we would be pleased to meet with you to discuss these issues in more detail.

Sincerely,



Simon Lewis
CEO
GFMA

cc: G-20 Finance Ministers

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[9] See "Collateral damage: the impact of the Financial Transaction Tax on the European repo market and its consequences for the financial markets and the real economy," International Capital Market Association (April 2013), available at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/the-impact-of-the-financial-transaction-tax-on-the-european-repo-market.

[10] See "The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt," City of London Economic Development (April 2013), available at http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2013/Impact-of-FTT-on-corporate-and-sovereign-debt-Final-PDF.pdf.