WORLD FEDERATION OF EXCHANGES

November 2017

Financial Markets and International Regulatory Dissonance:

A WFE Position Paper

Visit us at:
www.world-exchanges.org

Background

The World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses. We represent more than 200 market infrastructure providers, of which more than 100 are Central Counterparties (CCPs) and Securities Depositories (CSDs). Our members include exchange groups and standalone CCPs[1].

Our members are both local and global, operating the full continuum of market infrastructure operators in both developed and emerging markets. Of our members, 41 percent are in the Asia-Pacific region, 40 percent in EMEA and 19 percent in the Americas. WFE exchanges are home to nearly 45,000 listed companies, and the market capitalisation of these entities is over $67.9 trillion; furthermore, around $84.18 trillion in trading annually passes through the infrastructures our members safeguard[2].

The WFE works with global standard setters, policy makers, regulators and government organisations to support and promote the development of fair, transparent, stable and efficient markets. We share their goals of ensuring the safety and soundness of the global financial system.

Furthermore, we believe there are significant benefits to the wider population of integrated financial markets, and we think it important to have strong common principles, approaches and supervisory coordination to promote financial integration and market integrity, whilst safeguarding supervisory coordination. This is fundamental to well-functioning and safe markets in which investors can have confidence.

Introduction

Post-crisis financial regulatory reforms have significantly improved financial stability, promoting confidence in financial markets and bringing benefits to market participants and the end-users of financial services.

Market infrastructure providers such as exchanges and clearing houses have engaged with regulators to design and implement these reforms, and have undertaken significant change programmes to meet the challenges of implementation.

The Financial Stability Board (FSB), IOSCO and other international standard setting bodies have done commendable work in designing global frameworks that meet the needs of different jurisdictions whilst upholding robust, politically agreed norms.

Nevertheless, we observe a lack of coherence in the implementation of internationally agreed policy at the national level. This has led to unintended consequences, including market fragmentation, unduly burdensome implementation challenges and an overarching policy framework that is, at times, contradictory.

We acknowledge the significant efforts currently underway by regional and international authorities to assess the cumulative impact of post-crisis regulation – including identifying and addressing any unintended consequences arising from the interaction of different pieces of regulation with each other – and this document doesn't attempt to pre-empt nor address those particular workstreams.

Rather, we seek to highlight common challenges overarching the assessment and interaction of individual pieces of regulation and legislation. We discuss the benefits to financial markets of the principles of mutual recognition / deference, and we identify the implications of international regulatory dissonance. In order to illustrate the high level and globally focused concerns we raise, we highlight - as case studies - recent salient examples that have been front and centre of the cross-border concerns of the WFE's membership. These are designed to make clear the wider point in question and not to criticise any specific authority in any particular jurisdiction.

[1] The WFE membership list can be found here
[2] As at end 2016

The paper highlights the following five key areas of concern:

1) Disproportionate expense;
2) Implementation timelines;
3) Legal uncertainty;
4) Policy incoherence; and
5) Economic (in)efficiency.

It also seeks to demonstrate the cumulative adverse effects – including on entities located in Emerging Market regions and the general public at large – these concerns will lead to.

Finally, we set out policy recommendations pointing to how international regulatory coherence can best be promoted by interested stakeholders and institutions.

Overview

Achieving international regulatory coherence is important because financial markets are critical for economic growth and sustainable development. Dissonance adds costs, slows innovation, threatens stability, impedes competition and reduces choice for end-users.

Financial markets in different parts of the world are closely connected and responsive to each other, and investors are not necessarily limited by geographical borders. These increasingly international markets require regulatory cooperation based on commonly agreed principles rather than prescriptive cross-border supervision. For this very reason, the G20 Leaders have called on national regulatory authorities to defer to their fellow regulators in the context of internationally agreed frameworks and cooperation on cross-border supervision.

Our view is that to do otherwise would create conflictual and extraterritorial laws, giving rise to overlaps and underlaps in the supervision of markets and financial institutions. Such dissonance undermines the ability of firms to manage risk and makes for higher financing costs for the real economy. This affects the real economy through higher food and energy costs, and greater difficulty in managing retirement funds. Dissonance ultimately undermines investment, employment and living standards.

This is also a sound financial stability rationale for promoting international regulation coherence. Whilst Authorities at their core have responsibilities to ensure financial and market stability, we highlight the risks of dissonance not only in making the use of financial markets costlier, but also the effect of the resulting fragmentation in making it more difficult for regulators to monitor the build-up of risk.

The WFE concludes that the optimal system is one of mutual recognition based on global standards and principles of regulatory deference, implemented and overseen by national authorities; isolationist, protectionist and autarkic impulses should be avoided.

International Efforts at Achieving Regulatory Coherence

G20 & Financial Stability Board

The G20 leaders - through their 2009 Pittsburgh communique - introduced the concept of regulatory deference in the context of ensuring the practical cross-border implementation of the OTC derivative clearing obligation, stating:

> "*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 regulation regimes*."

The FSB subsequently surveyed G20 members to determine progress on achieving this principle. Whilst some jurisdictions had well-developed capability and authority to defer, others did not. A more limited cohort, the 'OTC Derivatives Regulators Group', representing the major markets for derivatives trading, as a result was formed to address coordination problems arising from the implementation of derivatives reform.

The FSB came together with the BCBS, CPMI and IOSCO to agree a workplan on the recovery and resolution regime for CCPs. Part of this programme involved a study group to look at the systemic effects of a CCP failure; the study group called upon authorities to:

> "…*consider the nature and scope of their cross-border cooperation arrangements, including the composition of their [Crisis Management Groups], in light of the cross-border cooperation that will be required in a resolution and the resolution actions that may need to be given effect in a cross-border context*."

IOSCO Task Force on Cross-Border Regulation

IOSCO has adopted memoranda between its members on international regulatory standards for securities markets and practices to facilitate cross-border enforcement and exchange of information among international securities regulators. These are within the realm of 'soft law' in that they are not agreed by international treaty nor subject to binding enforcement mechanisms.

In 2013, IOSCO initiated a Task Force on Cross-Border Regulation to develop an overall understanding of various approaches to cross-border regulation. It identified three main approaches, namely:

1) National treatment;
2) Recognition; and
3) Passporting.

Industry respondents to the associated consultation cited examples of divergences in exchange trading and clearing rules that gave rise to distortions. Some of the examples publicly provided included:

- U.S. CFTC requirements on Swap Execution Facilities;
- Differences in OTC clearing obligations between Dodd-Frank and EMIR;
- Differences in the parameters of reporting between Dodd-Frank and EMIR; and
- Delays in EMIR equivalence assessments.

Proposals to remedy such divergence include[3][4][5]:

- Political and legal changes - such as treaty arrangements - to overcome divergence;
- Detailed standards for comparability assessments;
- Increased transparency in the process for identifying and resolving substantial differences;
- Improved mechanisms for the ongoing assessment of regimes as rulemaking and implementation progress, e.g. more frequent and timely peer reviews and implementation assessments;
- Fora for ex-ante coordination of rules; and
- Improvements to the system of transitional reliefs.

The output from the Task Force was a detailed toolkit for regulators to refer to when looking at cross-border financial activity and a decision to incorporate cross-border considerations such as timing mismatches into IOSCO's standard-setting work.

The Task Force also concluded that IOSCO should engage more with the G20 and FSB to raise greater awareness of the key issues and challenges faced by IOSCO members on cross-border regulation, including the need for more refined thinking on the concept of deference.[6]

Notwithstanding these advances, the Task Force injected significant realism into the debate over harmonisation or coordination of international standards, recognising the complexity of securities law, the national interests at stake, and the lack of a treaty basis for international policy fora.

The final report of the Task Force summarises by saying[7]:

> "*The emphasis is towards more engagement via recognition to solve cross-border overlaps, gaps and inconsistencies through a combination of more granular international standards (where appropriate) in specific areas implemented at a jurisdictional level, and an increasing emphasis on determining when, and under what circumstances, it may be appropriate to recognize foreign laws and regulations as a sufficient substitute or equivalent for domestic laws and regulations. The Task Force recognizes that at this stage, increased engagement on recognition is mostly bilateral, though occasionally multilateral. Multilateral engagement may develop further as major markets grow around the world.*"

[3] Deutsche Bank, "DB response to IOSCO Task Force on Cross-Border Regulation's consultative report", 12 February 2013,
[4] Atlantic Council, "The Danger of Divergence: Transatlantic Financial Reform & the G20 Agenda" December 2013,
[5] US Chamber of Commerce, "Restarting the Growth Engine: A Plan to Reform America's Capital Markets", September 2016,
[6] Ashley Alder, "Regulation Remains Local, Finance Remains Global: Will this change?" 2 December 2015
[7] IOSCO, "IOSCO Task Force on Cross-Border Regulation"

Challenges Associated with Dissonance

The volume and complexity of financial market regulation means that unintended consequences are not always obvious or easy to identify. Once identified, the process of compliance is often complicated by differing philosophies and implementation approaches in differing regions. The challenges WFE members have identified with a lack of convergence can be summarised as follows:

Disproportionate Expense

One of the key principles of better regulation is a rigorous approach to the costs and benefits of public policy solutions. Avoiding disproportionate costs will benefit markets and end-users of financial services. Regulatory barriers to entry due to high costs have an adverse impact on competition – particularly in the event the "cost-benefit analysis" concludes the additional compliance cost does not correspond to the benefit of incurring the cost in the first place, resulting in a business decision to withdraw the cross-border service.

Such costs – whilst often resulting from well-intentioned policies designed to maintain financial market stability/integrity and/or safeguard against future shocks - can nevertheless also impede the ability of SMEs and emerging market institutions from participating in global capital markets.

Furthermore, a withdrawal of international cross-border business reduces the vibrancy, competitiveness and international orientation of regional and local capital markets These types of effects should be carefully considered when designing local requirements in the light of the potential increased costs involved and the international nature of markets.

Case Study: Disproportionate Expense Related to the EU Benchmarks Regulation

One example of disproportionate costs related to extraterritorial regulation relates to the requirement within the EU Benchmark Regulation for a legal representative in the EU under the "recognition" regime (i.e. in the absence of a full equivalence determination). The only alternative to having such a legal representative in such a circumstance is having a third-party endorser, again within the EU.

Both these routes entail expenses that may be very significant in proportion to the economic activity derived from the benchmark(s) in question. Furthermore, it is unclear to benchmark providers whether these routes are practically viable. For instance, there is a lack of guidance about whether a non-regulated representative office could take legal responsibility for benchmarks, or whether third parties could represent multiple benchmark providers. The discussions WFE members have had with law firms suggest that these third parties may not wish to assume the risks associated with such representation.

The risk of entities concluding that the costs outweigh the benefits are that administrators pare back on, or withdraw, their benchmark activity in the EU. We believe that the imposition of such legal and administrative expense, and the resultant withdrawal of IOSCO compliant benchmarks from the EU, is an unnecessary and unfortunate outcome that could easily be avoided through the application of mutual recognition and recourse to globally accepted principles.

Implementation Timelines

The implementation timelines associated with different pieces of local regulation (many of which seek to implement global initiatives as requested by the G20) have put a severe strain on third country market infrastructure providers.

This relates not only to uncertain timelines in individual jurisdictions or regions, but also to inconsistent timelines for the implementation of similar requirements in different parts of the world.

Regarding uncertainty, even where relatively generous transition and implementation periods exist, delays in the agreement of technical requirements and equivalence decisions significantly compress timelines for international exchanges. Furthermore, the dual structure of jurisdictional equivalence and entity-level licencing in some jurisdictions, and the ability for equivalence to be revoked or revisited at short notice, creates legal uncertainty and can impede business planning. It also poses significant implementation challenges. Regulatory requirements often necessitate major system changes for third country institutions; attempting to compress such change into very short timescales poses risks to system stability and the ability of institutions to focus on managing their markets and serving customers effectively.

Regarding inconsistency, differing cross-jurisdictional timelines for requirements that seek to achieve the same objective or outcome can create misalignments for market operators and participants, as well as introduce additional systems implementation challenges (for example, where roll-outs may differ in technical detail, or timeframe). We additionally note an unhelpful impulse to achieve extraterritorial rule promulgation through “first mover advantage”, i.e. bypassing international coordinating mechanisms and coercing other jurisdictions to replicate the first mover despite rules not being optimal given the nuances of the national legal, regulatory or market environment.

It is therefore important that implementation timelines and guidance are provided in a coordinated and unambiguous manner, with a view to providing markets with certainty about the standards which they must apply whilst also accounting for practical implementation challenges. In particular, third country-related requirements and enforcement guidance should be proportionate and include forbearance, where appropriate, to account for the particular challenges facing emerging market venues that are not able to apply the same level of resource to the monitoring and implementation of regulatory change that impacts them from outside of their own region.

Case Study: Risks and Challenges of Unpredictable Implementation Timelines

EU equivalence decisions usually involve an assessment by the European Commission based on technical advice from one of the European Supervisory Authorities (ESAs). The assessment is determined according to a range of usually undocumented factors (although there may be some high-level guidance contained within the relevant legislative text on factors that may be considered), leaving the Commission broad discretion in making a determination, resulting in considerable opacity for the jurisdiction being assessed. Once the determination process has begun, there is little guidance on timeframes the Commission will work to in reaching a decision, that depending on a number of factors including whether there is the need for technical input from the ESAs, and how granular the assessment becomes. Whilst in theory the assessment should follow an objective-based approach, the assessment can often in practice involve a line-by-line analysis. This – and the inevitable politicisation of determinations – adds to the uncertainty around how long an equivalence process can take.

The WFE’s separate document relating to CCP authorisation and recognition in the EU under the EMIR review highlights some examples of the effects of the complex and time-consuming equivalence processes globally – including market uncertainty due to processes that in some cases have taken more than four years. We also note, by way of example, the significant uncertainty as to the process for determining whether third countries will be eligible to be relied upon by EU institutions for MiFIDII transaction reporting purposes (due to come into effect in January 2018). This ambiguity has created uncertainty for third country exchanges and their EU market participants, with the need to adapt systems, compliance and business processes by the January deadline in accordance with the eventual decision (or, indeed, in the absence of a decision by that date).

Finally, and as discussed above, relating to differing cross-jurisdictional timelines, it has been observed that the rapid implementation of certain elements of the US regulatory reform agenda within Dodd-Frank have forced other jurisdictions – in the interests of ensuring global harmony – to implement locally in a way that might not have been optimal for the local market structure, or the legal/regulatory environment.

Legal Certainty

Related to the concern over implementation timelines is a lack of legal certainty that often characterises incoming rules - particularly those for third country venues. The issue typically arises where the criteria against which equivalence is evaluated, and the conditions attached to equivalence, do not sufficiently converge, leaving room for a subjective interpretation by the implementing authority (and a resulting inability for market participants to determine adherence standards). Without legal certainty, firms must rely on subjective opinions, increasing costs and risks associated with business planning and process development. A lack of legal certainty can make enforcement appear arbitrary, reducing confidence of market participants and end-users.

As such, we consider it important that local and regional authorities are clear and consistent in detailing their expectations, ensuring decisions are made in a non-political way, following as closely as possible global rules, guidelines and principles to encourage legal certainty whilst appreciating the nuances of the local market environment.

Additionally, we consider streamlining and clarifying the process for third-country equivalence determinations would help to reduce legal (and process) uncertainty for third country venues. There is a lack of consistency globally, and indeed even within regions, as to how these processes function and therefore how the desires of the G20 are implemented. For example, in the EU there is no single “equivalence” framework, but the framework and processes are governed by the specific provisions of the relevant sectoral legislation. As of end-2016, there were 39 separate equivalence processes across different aspects of the EU’s financial regulatory framework and the process, actors and timeframes differ for each.

Consequently, thought should be given to standardising and centralising a firm-level application and recognition process – for example, in the EU, through the ESAs (triggering a jurisdiction-level equivalence decision by the European Commission).

Case Study: Legal Certainty in European Legislation

Prominent examples include the legal regimes for anti-money laundering and data protection, which conflict within the EU’s *acquis communautaire**, and which also conflict with US laws. On the one hand, there are requirements for data localisation and protection, on the other there are requirements for international information sharing to prevent and/or identify illicit activity. Whilst this tension is to a certain extent inherent in the competing policy priorities, it is important that policymakers resolve such tension ex-ante, rather than creating a regime that threatens firms with legal uncertainty and which may undermine the policy ambitions it seeks to address.

As such, we consider the EU’s smart regulation programme should have a renewed focus on ensuring quality legal drafting that is both certain and practicable. Such an effort would help increase the confidence of European citizens in the EU’s policymaking process and outcomes.

The EU is a global leader in regulatory policy; policymakers can entrench and build on this status by ensuring that European laws are unambiguous and do not conflict amongst themselves, with other major jurisdictions, nor with international standards.

* the accumulated legislation, legal acts, and court decisions which constitute the body of EU law.

Policy Incoherence

We believe financial regulations should be coherent amongst themselves, as well as with wider public policy goals including employment growth, sustainable development and international comity. We note and appreciate that many regulatory initiatives specifically seek to address this – for example the FSB's review[8] into the effects of G20 regulatory reform, the European Commission's efforts[9] within the Capital Markets Union call for evidence, and the CFTC's Project KISS initiative[10] to name but a few. Nevertheless, we still observe a lack of policy coherence in several areas of financial regulation – albeit in many cases as an unfortunate unintended consequence as opposed to by design.

Fragmentation of financial markets due to regulation which acts to siphon activity from third country venues reduces the viability of those venues and has the potential to slow financial sector deepening in countries, potentially slowing the development of emerging market economies. This comes into conflict with the EU and World Bank development programmes aimed at poverty reduction in emerging markets; stock market liquidity has been shown to be predictive of "long-run growth, capital accumulation and productivity improvements".[11] The risk of fragmentation on third country venues is that market liquidity could suffer, and price volatility increase, making price discovery more difficult[12]. Fragmentation across markets may also make meeting best execution obligations more challenging to achieve. Finally, because of lower liquidity, issuers in the home market would face a higher cost of capital[13]. Ultimately, in this regard, a lack of regulatory coherence would have the effect of lowering the future pension incomes, or increasing food, energy and mortgage costs, of citizens.

International regulatory dissonance and fragmentation also poses practical challenges for the supervisors of financial markets – including, for example, making it more challenging to monitor and survey the whole of a market that has fragmented across jurisdictions.

As such we suggest it pragmatic to take a flexible approach to third country venues where possible to ensure fairness and non-discrimination is assured. When regulation may fragment markets, we advocate that discretion be applied to ensure that third country primary markets do not suffer undue detriment and over burdensome extraterritoriality effects. Market infrastructure licensing and regulatory requirements should be focused on ensuring sound and efficient market functioning rather than advancing the competitive interests of particular firms.

Case Study: Policy Incoherence Related to Development and Financial Market Deepening

One example of third country market uncertainty and concern around fragmentation has been seen through the share trading obligation in MiFIR. Within the Regulation is the fact that, for shares made available for trading on both EEA and non-EEA platforms, EEA investment firms will be required to trade on the EEA trading venue in the absence of an equivalence decision – even if the non-EEA venue is the primary and most liquid market in such trading. Notwithstanding the significant efforts of the European Commission and various European competent authorities to process a number of jurisdictional equivalence decisions ahead of the impending deadline - and including the recent clarifications and assurance in ESMA's Q&A* - there has until now been concern around the effect of obliging EEA investment firms to trade on less liquid EEA venues – that being to effectively siphon trading activity from third country venues at potentially worse outcomes for investors (specifically not achieving best execution), meaning that EEA investors will transact at a higher cost. This has also led to material regulatory and business uncertainty for third country exchanges.

* ESMA Clarifies Trading Obligation for Shares Under MiFIDII - 13 November 2017

[8] FSB – "Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms" – July 2017, and 2018 Workplan – October 2017
[9] European Commission – "Call for Evidence on EU Financial Services" – feedback of November 2016
[10] CFTC – "Project KISS" – May 2017
[11] Ross Levine and Sara Zevros, "Stock Markets, Banks and Economic Growth," American Economic Review, 1998.
[12] Ian Domowitz et al., "Cul de Sacs and Highways: An Optical Tour of Dark Pool Trading Performance," The Journal of Trading, Winter 2009.
[13] Gunther Wuyts, "Stock market liquidity: determinants and implications," Tijdschrift voor economie en management, 2007.

Market Efficiency

As described above, where international regulatory dissonance unduly fragments liquidity and pools of capital, the economic benefits of these markets are curtailed through higher costs for investors and issuers. Policymakers should avoid jurisdictional market fragmentation and actively cooperate to reduce it, bearing in mind the objectives of ensuring financial markets integrity and stability and avoiding unintended consequences (especially for developing markets).

The positive role of efficient financial markets in fostering development is well established.[14] Efficient markets engender greater rigour in the allocation of capital, increased availability of capital, and spur competitive forces among financial institutions. Whilst market efficiency must be weighed against other policy aims - including systemic risk - introducing inefficiencies through a simple lack of coordination is undesirable for financial markets and the citizens who benefit from them.

Case Study: Market Efficiency

One recent example of this fragmentation comes from the OTC derivatives market. When elements of the US Dodd-Frank legislation were implemented ahead of the European OTC derivatives reform, the market for OTC derivatives became increasingly bifurcated between US entities subject to Dodd-Frank rules, and non-US entities choosing to trade EUR IRS on venues outside of the US with non-US counterparties. This has been shown to result in a "*slowdown in market activity as captured by the raw volume, number of trades and number of participants active*." (Bank of England Staff Working Paper No. 580, July 2016.)

The political brinksmanship associated with the EU/US dispute over the calculation of initial margin is another example of avoidable regulatory risk associated with suboptimal international regulatory coordination. One practical impact of this was the EU equivalence and recognition process for US CCPs, which was a lengthy, detailed negotiation involving a line-by-line technical analysis of the differences/similarities of the two regulatory frameworks and resulted in the direct application of some EU requirements to US CCPs.

[14] Thorsten Beck, "Creating an Efficient Financial System: Challenges in a Global Economy," World Bank, February 2006.

The Emerging Markets Conundrum

The WFE's diverse membership represents both established and emerging markets. Whilst the concerns we raise are relevant to all WFE member markets, they are felt particularly acutely in emerging markets. Capital markets are at varying stages of growth and development and their dependency upon external capital flows varies. International financial institutions and international capital flows often play important roles in emerging economies' capital markets. As a result, certainty of access to large overseas financial institutions carries unique risks and costs to emerging market exchanges and CCPs.

Relatively low levels of liquidity are amongst the biggest challenges emerging market exchanges face. Furthermore, these markets often rely heavily on foreign participants to provide liquidity. Therefore, any policy that acts to shift international activity away from these exchanges will have a detrimental impact on their development and the local economy.

Whilst it may seem that attaining equivalence is a readily available remedy to this issue, in reality the process poses several challenges:

- Third country exchanges may have the task of convincing their local regulatory authority to engage in a dialogue with an overseas securities regulator, who in turn may act as a "sponsor" for that exchange through the process.

- Political factors as well as practical ones (e.g. the inevitable prioritisation of larger markets) may place emerging markets and smaller countries' exchanges at a disadvantage compared to larger, more globally integrated trading venues.

- In the context of compressed timescales for determining equivalence, certain exchanges may not have an opportunity to be assessed in advance of relevant legislation coming into effect.

- On a practical level, managing equivalence and recognition processes inevitably require entities to set aside internal resources for an undefined period, whilst also setting aside resources to cover the fees that may be required to assist in the attainment of these. These resources – which are often in scarce demand in emerging market economies - will not be available for other activities such as business development. This will represent an unjustified and harmful diversion of funds and human capital.

Case Study: Legal Uncertainty on Emerging Markets due to Cumbersome Equivalence Processes

In many jurisdictions, the process of obtaining third country licences can be burdensome and time consuming. This has been the case for many of WFE's members – including those from Emerging Economies – going through the process of obtaining ESMA recognition as a TC-CCP under EMIR. This includes CCPs based in jurisdictions that have substantially similar requirements compared to other jurisdictions that have been granted equivalence to date.

Ambiguities and extended timescales in the process have created uncertainty and undermined the ability of these CCPs to provide clearing services to EU clients on reasonable and certain terms. This is important to EU banks and investment firms given capital treatment is tied to their use of recognised TC-CCPs. These capital implications take on even more importance for emerging economies' financial markets, which are most reliant on the participation of large EU banks and investment firms to provide liquidity.

On a practical level, in light of uncertainty, the proposals would require TC-CCPs to set aside internal resources for an undefined period to account for new processes and obligations. These resources – especially precious in Emerging Market economies – may not be available for other activities such as business development.

The risks of uncertainty may cause some non-EU CCPs to reassess whether the burdens of applying for, or maintaining, recognition outweigh the benefits. It is possible – in the light of proposed amendments to the EMIR legislation - that CCPs currently in a recognition process would pause, pending further clarity about the regime. Furthermore, there is a risk that the proposed direct application of EU rules, supervision and enforcement may result in some TC-CCPs from these jurisdictions deciding to vacate their EMIR recognition altogether.

Conclusion

Financial markets in different parts of the world are closely connected; indeed, global authorities have already admitted that increasingly international markets require commonly agreed standards and cross-border supervision.

There are significant benefits to the wider population of integrated financial markets. Strong common principles, approaches and supervisory coordination to promote financial integration and market integrity are fundamental to well-functioning and safe markets in which investors can have confidence.

To not follow such an approach would undermine the ability of firms to manage risk. This makes for higher financing costs for the real economy, manifesting itself in higher food and energy costs and greater difficulty in managing retirement funds. This in turn will undermine investment, employment and living standards.

It is not possible for every country to assess every other country to ensure line-by-line replication of rules and procedures. As such, we conclude that the optimal system is one of mutual recognition based on global standards and principles of regulatory deference, implemented and overseen by national authorities; isolationist, protectionist and autarkic impulses should be avoided.

Policy Recommendations and the Way Forward

To help achieve the above, the WFE and its members call on policy makers and authorities to take into account the following high-level principles when considering policies that have a cross-border effect.

Disproportionate Expense

- Consideration should be given to streamlining, standardising, centralising and clarifying the process for third country equivalence determinations to help reduce legal and process uncertainty for third country venues.

Implementation Timelines

- Implementation timelines and guidance should be provided that are clear and consistent and that have a view to providing markets and their participants with certainty about the standards which they must apply.

- Third country-related requirements and enforcement guidelines should be proportionate and include forbearance - where appropriate - to account for the particular challenges facing emerging market venues that are not able to apply the same level of resource to the monitoring and implementation of regulatory change that impacts them from outside of their own region.

Legal Certainty

- Local and regional authorities should be clear and consistent in detailing their expectations, ensuring decisions are made in a non-political way, following as closely as possible global rules, guidelines and principles to encourage legal certainty whilst appreciating the nuances of the local market environment

Policy Incoherence

- A flexible approach towards third country venues should be taken - where possible - particularly for those from emerging market jurisdictions.

- Where regulation may act to fragment markets, discretion should be applied to ensure third country primary markets are not cannibalised due to the unintended consequences of local regulation, and to ensure fair and non-discriminatory treatment between large and small venues.

Market Efficiency

- Except in those few instances where localisation is justified through overriding prudential considerations, policymakers should avoid such fragmentation and actively cooperate to reduce it.