

**CONFIDENTIAL**

**EU-US COALITION ON FINANCIAL REGULATION**

**MUTUAL RECOGNITION, EXEMPTIVE RELIEF AND “TARGETED”  
RULES’ STANDARDISATION: THE BASIS FOR REGULATORY  
MODERNISATION**

American Bankers Association Securities Association (ABASA)

Bankers' Association for Finance and Trade (BAFT)

British Bankers' Association (BBA)

Futures Industry Association (FIA)

Futures and Options Association (FOA)

International Capital Markets Association (ICMA)

Investment Industry Association of Canada (IIAC)

London Investment Banking Association (LIBA)

Securities Industry and Financial Markets Association (SIFMA)

Swiss Bankers Association (SBA)

**FEBRUARY 2008**

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## MUTUAL RECOGNITION, EXEMPTIVE RELIEF AND “TARGETTED” RULES’ STANDARDISATION: THE BASIS FOR REGULATORY MODERNISATION

### 1 INTRODUCTION

- 1.1 The EU-US Coalition on Financial Regulation (the “Coalition”) was established in July 2005 and currently comprises the financial industry associations listed on the cover of this Report.
- 1.2 The objectives of the Coalition are to promote and encourage the establishment of a seamless set of consensual high-level standards in effective regulation and to deliver commercial, cost and regulatory efficiencies when carrying on transatlantic business, particularly wholesale business (i.e. business undertaken with institutional and other sophisticated investors and customers), in financial services.
- 1.3 This Report updates and expands on the Coalition’s first Report<sup>1</sup> by:
- (a) supporting, for the reasons set out in paras 4.2 to 4.5, the case for “fast track” *exemptive relief* for foreign intermediaries in respect of defined levels of wholesale business on the basis that it is likely to be more readily deliverable and will provide a foundation for establishing regulatory recognition under (b);
  - (b) encouraging wider acceptance of *regulatory recognition* (whether unilateral, bilateral or multilateral) as accepted international regulatory policy based on a common set of regulatory values and shared outputs (see paras 4.6 to 4.9);
  - (c) identifying and promoting the need for “*targetted*” *rules’ standardisation* where there is either (i) insufficient approximation in rules’ outputs to facilitate recognition; or (ii) where standardisation would deliver tangible benefits for the providers and consumers of financial services, including increased business and compliance efficiencies, cost effectiveness, improved customer choice or understanding or simplified market access (see paras 4.10 and 4.11);
  - (d) encouraging the establishment of a framework and process for (i) taking forward the regulatory dialogue on a regulator-to-regulator basis; and (ii) accommodating

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<sup>1</sup> In September 2005, the Coalition, working with its appointed external counsel, Clifford Chance LLP, published its first report “The Transatlantic Dialogue in Financial Services: The Case for Regulatory Simplification and Trading Efficiency” (Volume 1: [http://www.foa.co.uk/publications/euus\\_regulationreportol\\_v1\\_sept05.pdf](http://www.foa.co.uk/publications/euus_regulationreportol_v1_sept05.pdf); Volume 2: <http://www.foa.co.uk/publications/eu-us%20report-%20vII-sept05.pdf>).

regular and consistent *industry input* into that framework and process (see paras 5.1 to 5.3); and

- (e) providing an updated set of priorities for regulatory action which reflect the needs and priorities of today's transatlantic financial services industry for increased business efficiency and efficient and effective regulation (see Appendix 1).

1.4 The Coalition's first Report set out a consensual transatlantic industry manifesto for working towards greater regulatory convergence in order to facilitate mutual recognition; identified a number of priority areas which the industry felt needed to be addressed; and included a comparative analysis of US and EU licensing and business conduct rules governing various aspects of the wholesale equity and equity derivatives markets in the US and in four states of the European Economic Area, namely, France, Germany, Spain and the UK. In 2006, when the Swiss Bankers Association joined the Coalition a "Swiss chapter" was added to the analysis demonstrating a high degree of comparability between Swiss, EU and US regulatory standards.

More particularly, Volume 1 of the Coalition's report contained a summary of eleven priority areas for regulatory action which have since been updated and enlarged to reflect current thinking and shifts in regulatory policy, as set out in Appendix 1 to this Paper. *While these updated priority areas comprise an ambitious work agenda, they are, nevertheless, critically important to delivering the benefits listed in para 2.3.*

1.5 Noting the positive reaction to its first report, the Coalition is now publishing this second paper which sets out the three "gateways" for modernising the regulation of transatlantic financial services business, namely, *regulatory recognition, exemptive relief* and *rules' standardisation* (see para 4). The Coalition believes that adoption of these three approaches to regulatory modernisation will lead to greater regulatory efficiency, effectiveness and coherence as regards the carrying on of transatlantic financial services business, enable banks and investment firms to develop common internal compliance and business processes and procedures and customer-facing documentation, improve customer choice and understanding and enhance and simplify market access (see para 2.3).

1.6 The Coalition recognises that there will be a need for cross-border retail dealings to be progressively liberalised through a coherent framework of regulation, but this is likely to be a protracted and difficult process because it touches on sensitive areas of public policy and investor protection priorities. For this reason, the Coalition believes that the first and most essential step should be directed towards opening up the wholesale markets and accommodating wholesale business between licensed institutions and between them and institutional and other sophisticated customers and investors agreeing on a basis for exemptive relief for transatlantic wholesale business.

1.7 The Coalition recognises that regulatory authorities must be able to engage in a confidential regulator-to-regulator dialogue<sup>2</sup>, but believes that they should also facilitate

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<sup>2</sup> The Coalition notes the observation in the SEC-CESR Terms of Reference for future collaboration that CESR and the SEC will inform the institutions involved in the EU/US Financial Market Dialogue of the substance of their

a regular, structured series of meetings with industry participants and their representative bodies in order to secure delivery of the commercial benefits, stability objectives and market efficiency targets that are among the key drivers behind modernising the regulation of cross-border transatlantic business<sup>3</sup>.

1.8 While this paper addresses the cross-border priority needs for broker-dealers and their institutional and other sophisticated customers and investors, the Coalition supports strongly the need for foreign markets and exchanges to be able to offer execution services regardless of methodology (e.g. location of trading screens in host states, cross-border or via order-routing systems) without being required to meet local licensing and regulatory requirements. Improved exchange access will enhance and deepen liquidity of European and US markets and provide greater choice in global investment and sources of capital for issuers, investors and other consumers of financial services. In this context, the Coalition notes the “no action” processes of the CFTC in recognising and affording rights of access to non-US futures exchanges (which, despite an in-depth review earlier this year, has been approved by the CFTC and continue largely unchanged).

1.9 *The conclusions reached in this paper are the result of extensive consultation with those member firms of the Coalition industry associations which are particularly engaged in transatlantic financial services business; and, in the view of the Coalition, they are consistent with the commonly-held regulatory objectives of maintaining financial stability, enhancing market integrity and delivering proportionate levels of investor protection.*

## 2 WHY ENCOURAGE EU-US REGULATORY MODERNISATION?

2.1 The EU and the US are, between them, the world's two largest trading areas and, as such, should be engaging constructively to develop consensual positive outcomes that will benefit their investors and shared financial services industry in terms of establishing a modern framework of regulation and a commercially efficient transatlantic marketplace. This is an industry which supports nearly 7 million US and EU jobs, nearly \$4.1 trillion / €2.8 trillion in direct investment and stock and bond flows in excess of US\$51.3 trillion / €35 trillion; and accounts for 70% of global financial services business. With a collective consumer base of 800 million, the US and the EU

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cooperative and collaborative discussions, unless bound by confidentiality requirements (Term 4 of the terms of reference: SEC Press Release 2004-75 dated 4 June 2004).

<sup>3</sup> The Coalition notes the remarks of Andrea Corcoran and Robert Rosenfield of the CFTC, writing in a personal capacity in relation to the CFTC-CESR Trans-Atlantic Cooperation Initiative, that the CFTC-CESR Task Force welcomed ideas on mechanisms whereby the private sector could best assist in carrying forward some aspects of the work program described in the CFTC-CESR Communiqué and "each understand...that the industry and end-users desire to be involved...as ongoing participants who would in the first instance articulate issues and develop solutions". (Futures & Derivatives Law Report, September 2005, Vol. 25 No.6 p.3)

are each others' most important economic partner. The current financial market turmoil demonstrates the depth of these trading links.

- 2.2 The EU and US financial services sectors have greatly benefited from the informal transatlantic Financial Markets Regulatory Dialogue (FMRD). This has allowed US and EU regulators to discuss proposed regulations on a collective basis, minimise regulatory differences and foster a more coherent regulatory approach to an increasingly transatlantic business environment. These objectives have been further enhanced by the work of IOSCO in developing common standards and principles. However, the rules of regulatory authorities continue to be geographically based and governed by differentiated national laws. The result is a complex and costly meld of duplicative and sometimes conflicting regulations and processes, which sits uneasily with the increasingly global nature of financial markets and services. More particularly, this compromises regulatory efficiency and effectiveness, exacerbates the risk of non-compliance, creates unnecessary customer confusion, generates needless trading, investment and business costs and restricts access for both the providers and consumers of financial services. The Coalition believes, therefore, that EU and US regulatory authorities should become actively engaged in establishing the new approach set out in para 4 of this Report and Appendix 1.
- 2.3 In an international marketplace made up of investors, issuers, borrowers and other consumers of financial services, whose trading and investment needs are increasingly being met by non-domestic providers and through non-domestic products, simplification of cross-border financial services business along the lines set out in this report will:
- (a) deliver substantial benefits for all *consumers of financial services*:
    - by enabling them to access global investment opportunities and a wider range of services, products, sources of capital and providers of financial services;
    - by materially improving customer understanding of regulatory protections, financial products and transactional risk and so reducing investor confusion;
  - (b) deliver greater business and cost efficiencies for *providers of financial services*, in terms of facilitating common internal processes and customer-facing procedures and documentation across their operational units in EU member states and the US;
  - (c) enable *market infrastructure providers*, particularly exchanges and other platform operators, to offer more efficient investment and capital raising services and generate deeper pools of liquidity through enhanced and more cost-efficient cross-border dealings, particularly if foreign exchanges are permitted to offer their execution services and provide trading and investment opportunities under a similar framework;
  - (d) enable *regulatory authorities* in different countries (and we recognise that much good work is already being carried out in this area through existing MOUs with

cooperation arrangements) to deepen common understandings and develop greater trust and deeper working relationships, so enhancing their ability to better cooperate in terms of the exercise of supervisory and enforcement functions and discretions and manage issues of extraterritoriality in the interests of investor protection and financial stability;

- (e) reduce regulatory conflict and duplication of cost and simplify compliance to the benefit of all “stakeholders”.

### 3 WHY ACT NOW?

- 3.1 The Coalition is very conscious of the changes in regulatory priorities generated by the current market turmoil and the need for regulatory authorities to promptly manage and respond to its impact on market liquidity and confidence. It remains convinced, however, of the importance of regulatory authorities on both sides of the Atlantic continuing their efforts to reduce and eliminate conflicting and unnecessarily duplicative regulations through increased dialogue and greater coordination. The increasing globalisation of financial markets and the increasing speed of change means that national regimes must be assessed and re-evaluated to ensure that they are globally “fit for purpose” and capable of regulating cross-border business efficiently and cost-effectively – and the current market turmoil is a graphic example of why there is a need for such a re-evaluation to take place. As Christopher Cox, Chairman of the SEC, in his address at the 2007 US-EU Corporate Governance Conference on 9<sup>th</sup> October, said “*At the same time, as our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more significant*”.

Subjecting a firm that operates in many different countries to needlessly differentiated rules developed independently for local markets imposes disproportionate costs and regulatory conflict or duplication, generates customer confusion and undermines the efficiency of cross-border transactions and impairs market access. Such regulatory differentiation was less of a problem when institutional investors and broker-dealers were mainly focused on domestic investment and trading opportunities. However, the momentum towards transatlantic exchange and clearing consolidation and increasing levels of trade, investment and capital flows between the two economic areas and beyond demonstrate that rationalising and modernising the current confused regulatory framework would benefit all public and private stakeholders in the transatlantic marketplace.

- 3.2 The Coalition believes it is in the best interests of both the US and the EU to accelerate the dialogue and, in this context, strongly supports the general view in both the EU and the US that 2008 will be a “pivotal year” in which swift progress must be made. We are encouraged by the 3<sup>rd</sup> January 2008 joint statement of the EU Commission and the US SEC on Mutual Recognition in Securities Markets (the January 08 Joint Statement) , in which Chairman Cox and Commissioner McCreevy mandated their respective staffs to

*“intensify work on a possible framework for EU-US mutual recognition for securities in 2008”.*

This timeline should be achievable, bearing in mind that the US/EU relationship is founded on common commercial and political goals and values and upon the free-flow exchange of ideas, persons, products, services and technology. In financial services, these linkages are evidenced by market statistics (a few of which are identified in para 2.1), the increasingly transatlantic nature of capital and derivative markets and of the financial services industry generally and by a shared regulatory culture founded on common objectives, standards and outputs. In this context, it should be born in mind that a large part of the prevailing framework of regulation and financial services in Europe and Canada (and a number of other jurisdictions) was drawn from the regulatory approach of the US authorities.

- 3.3 The Coalition believes that the case for accelerating and delivering improved market access and regulatory simplification of cross-border business is now overwhelming from a regulatory, commercial and market standpoint. Indeed, transatlantic regulation is looking increasingly “out of step” with the commercial reality and impact of an increasingly global marketplace. Not surprisingly, there has been a sharp rise in the number of high-level statements supporting the need for prompt action to reduce the complexity, duplication and conflict of jurisdictionally-based rulebooks.
- 3.4 More particularly, the SEC has expressed its intent to engage more closely with overseas regulators by (a) reviewing its approach to exemptive relief for foreign broker-dealers; and (b) accommodating regulatory recognition as an internationally-recognised approach to regulating cross-border business. An early possible approach for exempting foreign broker-dealers from full SEC registration in respect of business dealings with US customers was signalled in an article in the Harvard International Law Journal by Ethiopis Tafara and Robert J. Peterson<sup>4</sup>. Against the background of that

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<sup>4</sup> On 3<sup>rd</sup> January 2007, the Harvard International Law Journal published an article by Ethiopis Tafara and Robert J. Peterson in which they opined that relief from compliance with US rules would be dependent on broker-dealer compliance with a comparable (to the US) home state licensing and regulatory regime (“substituted compliance”), subject to the following conditions:

- formal registration with the SEC and submission to its jurisdiction to pursue violations of anti-fraud provisions of US federal securities laws
- the SEC retaining jurisdiction to pursue violations of anti-fraud provisions of US federal securities laws
- appropriate arrangements being put in place, and maintained, between the SEC and the relevant overseas authority to share enforcement-related and supervisory-related information
- the relevant broker-dealer being regulated by an authority that applies comparable regulatory standards and oversight
- the US activity being restricted to non-US listed securities/investment products (i.e. if the foreign entity wants to offer US-registered investment products, it would have to register with the SEC in the usual way).



article, the Coalition would observe that (i) if “substituted compliance” is to be the basis of regulatory recognition, it should be founded on the quality of approximation of the rules’ “outputs” and not on harmonisation of the rules themselves; and (ii) any requirement for SEC registration (which, it is currently understood, will be for notification and other formal purposes) should be such as to give full and fair effect to that concept and to the need for a fast-track simplified process of application.

It is recognised that this original proposed basis for recognition may change when the SEC publishes its anticipated concept release for affording exemptive relief for foreign broker-dealers (and, as may be appropriate, regulatory recognition for both foreign exchanges and broker-dealers) doing business with US customers.

- 3.5 The April 2007 EU-US Summit in Washington adopted a framework on transatlantic economic integration and urged the development of an accelerated work programme on certain “lighthouse projects”, one of which focused on financial markets and which is to be overseen by the Transatlantic Economic Council (TEC). The resolutions that stand behind this particular project are “*to take steps, towards the convergence, equivalence or mutual recognition, where appropriate, of regulatory standards based on high-quality principles*” and to “*increase cooperation between EU and US financial regulators*”. In a recent statement issued by the TEC on 9<sup>th</sup> November, it welcomed the FMRD approach to consider “*how and in which areas to establish mutual recognition in the field of securities and identification of other approaches to facilitate cross-border trade in financial services*”. This emphasis on other alternatives to facilitating cross-border activity in financial services is particularly relevant to the case for exemptive relief set out in this paper (see para 4.2 *et seq.*).
- 3.6 The EU Commission and US SEC, in their January 08 Joint Statement agreed that “*the concept of mutual recognition offers significant promise as a means of better protecting investors, fostering capital formation and maintaining fair, orderly and efficient transatlantic securities markets*”. To this end, Commissioner McCreevy and Chairman Cox, in the same Statement, not only mandated their respective staffs to work towards establishing a possible framework for mutual recognition in 2008, but further agreed to work closely together to review progress through the year.
- 3.7 The US and the EU are well-placed to and should play a leadership role in developing common global approaches to regulation, as they are home to some of the most experienced regulatory authorities in the world, with a long track record of supervising a broad mix of domestic, international, retail and wholesale financial services and markets and suppliers of varying size and complexity. This is particularly important as other markets are developing and strengthening their own individual regulatory frameworks to reflect the growing importance of their domestic capital markets. As it was put in 2005 by the then US Treasury Secretary John Snow “*The gains from US-European*

*cooperation on growth and financial markets are potentially enormous. The US and Europe, as the world's two largest economies, must seize this opportunity and lead".*

If such a lead is not taken promptly by the EU and the US, there is a real risk that other jurisdictions will adopt individual approaches to recognition / access based on out-of-date models that will not achieve the regulatory and commercial benefits set out in this paper. It is important that the EU and US develop a regulatory approach, such as exemptive relief, for foreign broker-dealers that will:

- (a) enable wholesale business to be conducted cross-border on a basis which can be readily adapted for implementation across a range of different markets and jurisdictions; and
- (b) promote the global integration of wholesale markets, without being dependent on a complex and differentiated set of individual frameworks of mutual recognition across a larger number of disparate jurisdictions (which would take a considerable time to standardise because of different regulatory cultures and approaches); and
- (c) lead to the development of a broader and more common basis for unilateral or mutual recognition as regulatory relationships develop and strengthen.

#### **4 KEY METHODOLOGIES FOR REGULATORY MODERNISATION**

4.1 The Coalition believes that there are three ways (none of which are exclusive) to reform the regulation of cross-border transatlantic business and alleviate the complexities, costs and burdens on cross-border business resulting from the need to comply with differing national rules:

- A. *Exemptive relief*: i.e. relief from compliance with host state rules in the case of foreign firms or issuers engaged in wholesale business where the imposition of those rules would be unnecessarily duplicative or inappropriate, bearing in mind the nature of the counterparties and the business being undertaken;
- B. *Regulatory recognition*: i.e. acceptance by a host state regulatory authority of compliance by a foreign firm, issuer or exchange with its home country licensing, prudential and business conduct rules through a process of unilateral, bilateral or multilateral regulatory recognition based on shared regulatory policy, principles and rules' outputs;
- C. *Rules' standardisation*: i.e. the development of common approaches, international standards and/or converged rules "targeted" to deliver simplified market/customer /provider access and incremental business efficiencies, or where there is insufficient approximation in the output of rules to facilitate regulatory recognition.

**A “Fast track” exemptive relief for providing direct cross-border access by and to institutional and other sophisticated customers and investors**

4.2 The accelerated pace in the globalisation of wholesale financial services and investor demand for global choice calls for prompt action on market liberalisation. However, regulatory recognition and “targeted” standardisation of rules, while critically important, are likely to involve protracted negotiation and extensive regulatory analysis. This is evident from the earlier long-running discussions on international recognition of accounting standards and the multilateral internal EU negotiations which preceded adoption of the Markets in Financial Instruments Directive (MiFID), its predecessor Directive, the Investment Services Directive, and of other EU “passporting” directives in other financial service sectors. The Coalition appreciates that, if recognition is to be credible and durable, that process of analysis must be thorough. On the other hand, exemptive relief can be delivered on an expedited basis; will accommodate early delivery in meeting the investment, hedging and capital-raising needs of an increasingly globally-aware investor and borrower base; and will avoid the possibility of a protracted regulatory “standstill”, which would result in regulation falling further behind the pace of market globalisation. Early focus on exemptive relief would also generate momentum for taking forward the dialogue for regulatory recognition.

The position regarding exchange access is understood by the Coalition to be different insofar as the exchanges have indicated their preference for regulatory recognition. On this basis and taking into account the fact that recognition in their case should be a more straightforward exercise, the basis of recognition of EU exchanges should be capable of being addressed, even though it is a separate issue, while work is also undertaken to finalise the grounds for exemptive relief for foreign broker dealers.

4.3 The Coalition believes that the concerns set out in para 4.2 and the fact that there is an “equivalence in arms” between institutional and other sophisticated customers and investors (classified in the EU under MiFID as “Eligible Counterparties”) in the conduct of financial services business make it appropriate to afford such business exemptive regulatory relief. Such customers and investors are of a size and have the knowledge and understanding of financial services and markets to choose their own brokers, counterparties, products and services and to run the risk and accept the consequences of their decisions.

4.4 In essence, the liberalisation of cross-border access to and by institutional and other sophisticated investors and customers could be delivered through a phased and tiered approach (which may, at some point, need to be reviewed for the purpose of establishing similar rights of cross-border access for appropriate retail business), supplemented by a process of reviewing and strengthening cooperative relationships and actions between regulators to better coordinate regulatory oversight of global business. This approach should start by providing exemptions from local licensing requirements for cross-border business conducted with institutional and other sophisticated customers and investors. This model of supporting direct cross-border institutional access is a better fit with a more globalised marketplace as it allows those customers and investors to deal directly with the

firms that provide the services and products they wish to obtain. Even if the foreign firm is exempt from host licensing requirements for transactions with institutional and sophisticated investors, it may still be subject to host notification requirements (or requirements to consent to the host jurisdiction) or business conduct or market rules. However, the scope of such rules should be very limited as they will either replicate home-state rules required to be observed by the foreign firm or may involve the delivery of protections that, by mutual regulatory agreement, are recognised as neither needed nor necessary in the context of business conducted with institutional or sophisticated investors. In these circumstances, it may be appropriate for such rules to be disapplied. The Coalition notes the impact of the US Antifraud Rule under the Investment Advisers Act and the EU's Market Abuse Directive and, while it recognises that some elements of extraterritoriality are inevitable, it is important that, in the interests of fair and proportionate enforcement, they are kept to a necessary minimum. Where they do exist, the regulatory authorities in the US and Europe should enter into an appropriate set of arrangements for cooperative processes and actions (and the Coalition notes the increasing readiness of the SEC to recognise non-US judicial and disciplinary processes).

4.5 The basis and conditions for “fast track” exemptive relief will provide a practical foundation for taking forward the dialogue on regulatory recognition and, as indicated earlier, should:

- (a) lead to the establishment of a broader framework of market and customer access;
- (b) lead to the disapplication of duplicative business conduct rules; and
- (c) be capable of being rolled out for consideration by a wider spread of key jurisdictions.

One example of how this can be achieved is provided by the CFTC's approach under its Part 30 rules (see Appendix 3). It is worth noting that these rules have been in place between the CFTC and a significant number of non-US jurisdictions since the early 1990s and are generally agreed to have worked well in terms of establishing an effective degree of cooperative regulatory oversight and a simplified and more open framework of market, provider and customer access, without undermining acceptable regulatory standards. However, this approach is dependent on comparability in regulatory standards (and is, arguably, more a process of regulatory recognition). Further, US access under Part 30 is generally limited to dealings in non-US exchange-traded futures and options products – it will be difficult to observe this distinction between foreign / domestic and OTC / listed business in the context of business in securities and over-the-counter derivatives with institutional and other sophisticated customers and investors.

***B: Criteria for accommodating regulatory recognition***

4.6 The Coalition believes strongly that the basis of regulatory recognition and the focus of any preceding comparative regulatory analysis should be a “top down” approach based on approximation in regulatory outputs, principles and objectives and not “bottom up” measures such as assessing and requiring rules to be identical. In his speech to the 2007

US-EU Corporate Governance Conference on 8<sup>th</sup>-9<sup>th</sup> October, Christopher Cox, Chairman of the SEC, rejected the concept of a “one-size-fits-all” approach to securities regulation on the basis that “*we’ve got to respect our differences as we build on common ground*” and by acknowledging that “*our regulations shouldn’t all be the same. There is fools’ gold here*”.

4.7 The Coalition has set out below a number of criteria and factors which it believes should form a key part of the technical discussions for facilitating durable regulatory recognition:

- (a) early agreement on a set of shared public policy objectives / principles for wholesale financial services regulation (see paras 4.8 and 4.9) which could:
  - (i) serve as an agreed “executive summary” of the desired rules’ outputs of EU and US regulatory authorities (and which could also, as and where appropriate, provide a common foundation for establishing shared “Principles for Business”);
  - (ii) establish a policy perimeter around rules’ convergence and onward rules’ development;
  - (iii) facilitate mutual regulatory recognition in a way which allows for the continuation of rules’ differences (where they deliver the same outputs) and avoids regulatory “harmonisation for harmonisation’s sake”;
- (b) early agreement on a set of consensual “Principles for Better Regulation” which would establish high-level criteria for adopting a common approach towards the onward development of rules (e.g. facilitating competitiveness and innovation, public consultation, cost benefit analyses, market failure justification for new or changed rules);
- (c) a shared objective of avoiding imposing a significant regulatory cost and resource burden through the imposition of unnecessary rule(s) changes (i.e. “harmonisation for harmonisation’s sake”) on regulated firms, particularly the large numbers of small or purely domestic European and US businesses which do not undertake transatlantic business and for whom the process of transatlantic regulatory convergence offers no direct tangible commercial benefit;
- (d) early commencement of a comparative regulatory analysis on the basis that such analysis will:
  - (i) expedite delivery of regulatory recognition;
  - (ii) identify where are public policy conflicts or significant differentiation in rules’ outputs or in the observance of principles which obstruct the delivery of recognition;

(iii) determine where there are unnecessary overlapping, duplicative and/or inconsistent rules not otherwise identified in Appendix 1 and how they should be addressed (e.g. recognition, exemption or standardisation ).

(e) a review of the existing Memoranda of Understanding and mutual cooperation arrangements (particularly as regards inspection and supervision) to strengthen relationships, deepen inter-reliability between regulators and enhance coordinated regulatory oversight of global business.

4.8 In 1998, IOSCO published its report “Objectives and Principles of Securities Regulation” which established thirty principles of securities regulation – principles which, in general, are relevant to other forms of financial services and market activity – with the specific purpose of fulfilling the three core objectives of (i) protecting investors; (ii) ensuring market integrity and transparency; and (iii) reducing systemic risk.

*In its Introduction to the Principles, IOSCO stated: “An increasingly global marketplace also brings with it the increasing interdependence of regulators. There must be strong links between regulators and a capacity to give effect to those links. Regulators must also have confidence in one another. The development of these linkages and this confidence will be assisted by the development of a common set of guiding principles and shared regulatory objectives.”*

4.9 The Coalition believes that these thirty IOSCO Principles (see Appendix 2) could provide a sound basis for measuring rules’ outputs and establishing a common set of regulatory values sufficient to deliver regulatory recognition for the following reasons:

- the three IOSCO objectives listed in para 4.8 are in accord with the objectives of most well-regulated jurisdictions (irrespective of whether or not their regulatory authorities are members of IOSCO);
- the eight categories of Principles (summarised in Appendix 2) emphasise the importance of high standards of regulation in terms of fairness, accountability, resources, enforcement, information-sharing and cooperative arrangements; set out the duties and obligations of issuers; set out the business conduct priorities and standards expected of intermediaries; and address the need for exchanges to maintain high standards in terms of transparency, market integrity and monitoring, managing and supervising market activities;
- the members of IOSCO, which, between them, are responsible for the regulation of over 100 jurisdictions and 90% of the world’s securities and other financial markets, have already endorsed these Principles;
- through their endorsement of the IOSCO Principles, the members of IOSCO have committed to use “their best endeavours” to ensure compliance with them and, while it is recognised that they will have to apply within their overall (and often differentiated) domestic legal and market frameworks, the members subscribed to the statement that “to the extent that current legislation, policy or

regulatory arrangements may impede adherence to these principles, they intend that changes should be sought”;

- the intensive programme of assessing compliance with the principles carried out by IOSCO and the IMF since 1998 has shown high levels of compliance by members of the EU/EEA and Switzerland (all but a handful of which have been assessed) as demonstrated by the published assessment for each jurisdiction and a recent IMF Working Paper [footnote: IMF Working Paper: Strengths and Weaknesses in Securities Market Regulation: a Global Analysis; Ana Carvajal and Jennifer Elliott, October 2007]. It appears likely that completion of the EU’s FSAP programme will have contributed to enhanced compliance in some Member States, thereby pulling up the average. Testing of this should be relatively straightforward;
- by using IOSCO’s globally-accepted Principles, the European and US authorities would be basing their framework of regulatory recognition on a set of internationally accepted criteria for measuring the regulatory quality and, by adopting a more global and inclusive approach to recognition, would enable other jurisdictions to negotiate recognition on a similar basis.

The Coalition strongly supports adherence by regulatory authorities to the IOSCO Principles and believes that this is a critical step to modernising the regulation of cross-border financial services activities and meeting the commercial objectives of delivering a more open transatlantic marketplace. However, the Coalition is also conscious of the view that using the Principles alone as a sufficient means of measurement (bearing in mind also that they were produced in 1998) may not be sufficient – and reference is often made to the concept of “IOSCO+” (e.g. the need for rules and regulations to be transparent, accessible, intelligible and market flexible). Nevertheless, they are the most internationally accepted test of regulatory adequacy.

**C: *Industry priorities for “targeted” rules’ standardisation (see Appendix 1)***

- 4.10 The primary objective of standardisation should be (i) improve market and regulatory efficiency and supervision; (ii) facilitate customer understanding; (iii) reduce unnecessarily disproportionate compliance costs; or (iv) enhance market access. The evolution of standardisation in certain key areas, several of which are identified in Appendix 1, will also help to establish a more common approach to investor protection.
- 4.11 It is recognised that some of the rules of regulatory authorities may be so out of line that they obstruct the delivery of regulatory recognition. Bringing them into greater convergence may require greater rules’ standardisation. However, the degree of that standardisation, in this case, should only be to the point that is necessary to facilitate recognition, i.e. to bring it within an acceptable level of approximation in rules’ outputs rather than harmonisation of the rules themselves.

- 4.12 While the Coalition's preferred position is, as regards most of the regulatory areas identified in Appendix 1, for standardisation, it is understood that some of them may lend themselves to convergence in a broader sense and that this will depend upon, in the final analysis, the negotiating process and public policy priorities.

## 5 THE NEED FOR INDUSTRY INPUT

- 5.1 The Coalition recognises that regulatory authorities must be able to negotiate in confidence<sup>5</sup>, but also believes firmly:
- (a) that the industry are key "stakeholders" in the process;
  - (b) that "stakeholder" input is critical to delivering the commercial objectives that stand behind the initiatives established at the recent EU-US Summit; and
  - (c) that the regulatory authorities should facilitate that key "stakeholder" input through a structured and substantial dialogue and a process of regular debriefings.<sup>6</sup>

The Coalition notes that, in their January 08 Joint Statement, Chairman Cox and Commissioner McCreevy stated "*As we consider implementation of this concept, we encourage input from market participants*". The Coalition welcomes that recognition, but would emphasise that, as stated above, it should be through a structured and substantial dialogue with the stakeholders.

- 5.2 Further, the Coalition is willing to undertake detailed work on any of the "targeted" areas for standardisation / convergence identified in Appendix 1 of this paper – some of which has already been undertaken by a number of global firms working under the auspices of the International Institute of Finance (IIF). In putting forward this proposal, the Coalition recognises that the regulatory authorities will have the absolute discretion to accept, reject or alter any or all of any work product submitted by the Coalition.
- 5.3 By way of conclusion, the Coalition would refer to the Foreword to its first Report, "*Moreover, the critically important economic and commercial objectives of facilitating innovation, enhancing efficiency and liberalising customer choice can only be attained if the process of change is taken forward on a genuinely consensual basis in which all the "stakeholders" in the process are not just consulted, but become an integrated part of the process and their views given full and proper consideration. To do anything less will be to achieve less.*"

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<sup>5</sup> See footnote 1.

<sup>6</sup> See footnote 2



**PRIORITIES FOR CONVERGENCE TO  
ENHANCE REGULATORY AND COMMERCIAL EFFICIENCY**

## **TARGETED PRIORITIES FOR REGULATORY STANDARDISATION TO ENHANCE REGULATORY AND COMMERCIAL EFFICIENCY**

### **1. Introduction**

1.1 In putting forward its priorities for regulatory modernisation, the Coalition recognises:

- (a) that the regulatory authorities are likely to develop their own priority agenda for rules' convergence;
- (b) that, in that event, the two agendas may be merged into a single forward work programme;
- (c) that there will almost certainly be some analysis of that merged work programme with a view to determining which of the items are susceptible to prompt negotiation and early agreement, i.e. "quick wins" and which are capable of being addressed on a standardised basis;
- (d) the need for a realistic approach in addressing the priority items and that some of those priorities may be more quickly addressed through exemptive relief or regulatory recognition;
- (e) that the list is subject to change and that may mean not just reprioritisation, but possible introduction of new areas of regulation being put forward for standardisation.

*The Coalition would emphasise, however, that all the priority areas identified for standardisation (or, where appropriate, exemptive relief or regulatory recognition) are important and, while some of them may not be capable of being categorised as "quick wins" and may even require changes in primary legislation, they all merit early consideration and expedited negotiation.*

1.2 The Coalition, recognising that there are now a growing number of industry initiatives addressing the regulation of cross-border transatlantic business, would reiterate that its priorities take into account the work of the IIF and have been the subject of consultation internally amongst the member associations of the Coalition and with leading banks and brokerage houses engaged in transatlantic financial services business.

1.3 The Coalition supports the strong focus placed by regulatory authorities on recognition, but believes that, if the objectives of delivering greater commercial and cost as well as regulatory efficiencies are to be met in the context of cross-border transatlantic business, equal focus must be given to taking forward "fast track" exemptive relief and "targeted" areas for rules' standardisation identified in this section.

1.4 Reconciling and standardising the text of rules and regulatory approaches is not a stand-alone exercise. It will have to be supported (progressively) by a common approach to

interpretation and implementation and, while this will be the subject of agreed understandings between regulatory authorities, that process may be readily facilitated by a regulatory programme of short- and long-term staff secondments between European and US regulatory authorities.

### **First tier issues**

#### **1. Development of a framework for facilitating cross-border access by and to institutional and other sophisticated customers and investors based on exemptive relief**

The principal first step is the need to establish a basis for facilitating the carrying on of cross-border wholesale business along the lines indicated in paras 4.2 to 4.5 of the main report. As noted in para 4.4, a foreign firm should, in the case of business with local institutional and other sophisticated investors, be exempted from a host licensing requirement. Even if the foreign firm is exempt from local licensing requirements for transactions with institutional and other sophisticated investors, it may still be subject to host notification requirements (or requirements to consent to the local jurisdiction) or business conduct or market conduct rules, although the scope of such rules should be limited in such a way as to avoid replicating home-state rules required to be observed by the foreign firm or deliver protections that, by mutual regulatory agreement, are recognised as neither needed nor necessary in the context of business conducted with institutional or other sophisticated investors. In these circumstances, it may be appropriate for any such rules to be disapplied. It is also important for the regulatory authorities to address the issue of extra-territoriality and, in particular, to agree a broader basis of inter-reliance in the areas of enforcement and regulatory actions to ensure that extraterritorial rights of action are exercised fairly and proportionately.

#### **2. Standardisation in the classification of counterparties**

The numerous definitions of customer, client and counterparty in the transatlantic marketplace:

- prevent the development of appropriate, common standards of care for customers;
- are confusing to customer and investors to the extent that they are classified in different ways by different brokers;
- require firms to classify and reclassify customers according to different criteria and recalibrate applicable rules, which exacerbates the risk of inadvertent classification breaches;
- impose a significant cost and resource burden on firms;
- impairs the establishment of a common understanding of what is meant by wholesale business and the ability to deliver on the priority areas of regulatory action identified in this paper.

It is recognised that (a) there are major public policy sensitivities as regards the classification of customers; (b) fundamental change in this area will necessitate legislative changes (although it is anticipated that there is a significant amount of customer-facing material that could be standardised to the advantage of both the providers and customers of financial services); and (c) differences in law may impose unique requirements for particular jurisdictions that may have to be maintained.

Standardisation in this area would (a) *materially advance customer understanding* as to how they are classified; (b) simplify the customer-facing requirements and procedures of firms; (c) deliver major cost benefits for firms and their customers; and (d) *establish a common definition of an institutional investor* to facilitate a common scope for item 1 relief as well as supporting standardisation in a number of other identified areas in this Appendix, including the rules on private placements and other offering restrictions and on business conduct rules.

### **3. Standardisation of requirements for disclosure of large shareholdings**

The many differences in these requirements between jurisdictions have significant cost implications and make diligent compliance unnecessarily difficult.

Rules requiring the disclosure of significant shareholdings share the common objective of providing greater market transparency and improving market integrity. A common set of standards would therefore not only make it easier for regulatory authorities to identify non-compliance and simplify compliance for firms, but would also improve significantly the transparency of markets for both listed firms and investors.

### **4. Convergence of investment fund marketing restrictions**

There are very significant obstacles to the cross-border marketing of investment funds between the US and the EU, including US broker-dealer registration requirements and restrictions on marketing materials. Regulators should work towards achieving significant convergence of private placement exemptions, building on the work on standardisation in the area of classification of investors. There should be no need for artificial barriers on the ability of institutional investors to access a broad range of international funds. Additionally, it should be possible to work towards recognition of the authorisation of funds in one jurisdiction as the basis for the marketing of the fund in the other jurisdiction.

### **5. Standardisation of reporting standards**

Firms are required to submit an extraordinary range and number of regulatory reports. Complying with multiple requirements with different definitions, due dates and technical variations is highly complex, costly and resource intensive. This differentiated multiplicity of requirements often raises difficult questions of interpretation and imposes a high cost systems burden on firms. Reducing unnecessary differentiation to what is a common regulatory objective will reduce cost and

compliance risk for firms, increase regulatory reporting efficiencies and better facilitate information-sharing between regulatory authorities.

**6. Formulation and agreement on a common set of registration and examination requirements for those countries that operate licensing regimes or other forms of competence standards for individuals active in financial services**

Where regulatory authorities apply individual registration requirements, there should be convergence, but only to the extent necessary to establish a basis for regulatory recognition.

A parallel target for convergence would be the development of a common set of examination requirements (standardisation or convergence in the other areas identified in this list would facilitate mutual recognition of such requirements).

Both these areas of convergence would facilitate cross-border movement of personnel and adherence to mutually recognised training standards and, where applicable, individual registration requirements.

**7. Formulation and agreement on a common set of know your customer (KYC) and risk-based anti-money laundering (AML) and counter terrorist finance (CTF) standards and requirements**

International cooperation to combat terrorist financing has rightly increased in recent years, but individual countries have understandably often acted quickly and unilaterally to amend their own laws in pursuit of this shared public policy objective. Whilst the FATF regime does provide a level of consistency and convergence, firms operating in a number of different markets are now confronted by disparate approaches to interpretation and enforcement of KYC and AML. The importance of this issue calls for acceptance and consistent implementation of the risk-based principles recently adopted by FATF with common “goals” and a wider and more commonly-held ability for firms to inter-rely on each others’ process in terms of KYC.

**Second tier issues**

**8. Common understanding of stabilisation practices**

Stabilisation safe harbours from general market abuse regimes are quite different in different jurisdictions, notably between the EU and in the US. This causes complications when primary issues are launched globally as firms are generally unable to comply with multiple regimes at the same time. Before the implementation of the EU’s Market Abuse Directive, the US and UK recognised each other’s national safe harbours. This is now no longer the case, at least where the securities concerned are to be admitted to trading on regulated markets.

**9. Account documentation for institutional and other sophisticated customers and investors**

There are major cost, intelligibility and process benefits for firms and their customers if the differing approaches in the national material and the related requirements can be reduced to a core that suffices in all jurisdictions in the EU and US. While it is recognised that differences in law may impose unique jurisdictionally-driven terms, there is a significant amount of material that could be converged to the advantage of both the providers and consumers of financial services.

#### **10. Convergence of no-action approvals**

Regulatory authorities have different procedures for clarifying the regulatory position of new transactions, products and services. Greater convergence in policy and process in this area (e.g. “no action” letters) and in interpretive practices is critically important to underpinning shared regulatory outputs and developing commonality in supervision and enforcement, and establishing a commonality in regulatory scope. The Coalition recognises that differences in capital markets law may make elements of this identified area for standardisation difficult to achieve.

#### **11. Convergence of recognition of rating agencies**

In view of the greater reliance being placed on rating agencies by the regulatory authorities and by firms, a high priority should be given to establishing greater consistencies in standards comparable to those set in the G-10, particularly as regards the management of conflicts of interest. The sub-prime crisis has generated a “fresh look” at the role (and possible regulation) of credit rating agencies. Whatever steps are taken as a result of this review, it is important that a consistent and cooperative approach is taken by regulators in both the EU and the US so that full effect may be given to the principles of “recognition” and inter-reliance that have been addressed in this paper.

#### **12. Convergence towards global standards on conflicts of interest**

The management of conflicts of interest is a key issue for the financial services sector. Greater commonality in regulatory scope and rules and the consequential development of common policies and procedures would lead to the more efficient management of conflicts of interest and reduce cost to the benefit of both firms and their customers.

### **Third tier issues**

#### **13. Establishing a common approach to clearing**

The EU Clearing and Settlement Code of Conduct has been developed by industry interests and the European Commission to improve rights of access and choice, encourage interoperability and provide for unbundling of services and separate accounting as between execution and clearing. The Coalition notes also the concerns expressed in the letter of the US Department of Justice sent to the US Treasury on 31<sup>st</sup> January 2008, expressing concern over the market impact where clearing services were

under the control of an exchange. The Coalition believes that this convergence in thinking calls for the regulatory authorities in the EU and the US to collaborate more closely with each other and the industry to ensure the development of a common approach to the delivery of clearing services and its interface with the function of execution.

#### **14. A more consistent approach towards softing and unbundling**

The policy approach of the SEC and European regulators towards soft dollar and bundling issues has converged to a noticeable extent and recognised the benefits of Commission Sharing Agreements in delivering best execution. However, there is room for further standardisation, e.g. the extent to which unbundling is mandated. In other cases, there is room for recognition, e.g. addressing the difficulties for sub-advisors when executing aggregated trades for affiliated managers where there are divergent soft dollar safe harbours which have been developed for specific domestic markets.

#### **15. Formulation and agreement on a common set of standards and requirements relating to outsourcing**

Outsourcing poses significant challenges to financial services regulatory systems, including a decrease in control over people and processes delivering the outsourced function; reduced local regulatory access to books and records regarding an outsourced activity; and increased concentration risk where numerous financial services firms use a common service provider.

This is exacerbated in the context of cross-border outsourcing. Many local regulators have identified outsourcing as impairing the ability of regulated entities to manage their risks (although it can enhance it) and monitor their compliance with regulatory requirements. So while individual regulators have enacted standards and controls on outsourcing, these vary in scope and can result in conflicting controls on outsourcing, and can effectively prohibit organisations operating across national borders from employing a common outsourcing policy.

#### **16. Common multi-regulator requirements, such as rationalisation of risk disclosure statements**

Developing common generic risk disclosure statements for “plain vanilla” asset classes would be a useful contribution to enhancing investor protection through the use of common risk disclosure terms, facilitating inter-reliance between regulatory authorities and simplifying the disclosure requirements of firms.

Since highly complex / structured products will often require tailored risk disclosures, the suggested common approach could only be addressed at a very high level.

## **OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION**

**(1998)**

*IOSCO was established in 1983 with the specific purpose of creating an international “college” of securities market regulators able to cooperate together to ensure the better regulation of markets, sustain market integrity, encourage the pooling of regulatory information and set, apply and rigorously enforce regulatory and supervisory standards. IOSCO’s current membership are responsible for regulating over 100 jurisdictions which, between them, cover 90% of the world’s securities markets and, in the case of broad scope regulatory authorities, a high percentage of other financial services and markets.*

*In 1998, IOSCO published its thirty principles of securities regulation on the basis that they were consistent with the following four attributes of “sound economic growth”, namely:*

- *There should be no unnecessary barriers to entry and exit for markets and products*
- *The market should be open to the widest range of participants who meet the specified entry criteria*
- *In the development of policy, regulatory bodies should consider the impact of the requirements imposed*
- *There should be an equal regulatory burden on all who make a particular financial commitment or promise.*

*The attached Foreword and Executive Summary is taken directly from the IOSCO paper.*



## OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

### Foreword and Executive Summary

This document sets out 30 principles of securities regulation, which are based upon three objectives of securities regulation. These are:

- **The protection of investors;**
- **Ensuring that markets are fair, efficient and transparent;**
- **The reduction of systematic risk.**

The 30 principles need to be practically implemented under the relevant legal framework to achieve the objectives of regulation described above. The principles are grouped into eight categories.

#### **A. Principles relating to the Regulator**

- 1 The responsibilities of the regulator should be clear and objectively stated.
- 2 The regulator should be operationally independent and accountable in the exercise of its function and powers.
- 3 The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
- 4 The regulator should adopt clear and consistent regulatory processes.
- 5 The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.

#### **B. Principles for Self-Regulation**

- 6 The regulatory regime should make appropriate use of Self-Regulatory Organisations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.
- 7 SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

#### **C. Principles for the Enforcement of Securities Regulation**

- 8 The regulator should have comprehensive inspection, investigation and surveillance powers.
- 9 The regulator should have comprehensive enforcement powers.

- 10 The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

**D. Principles for Cooperation in Regulation**

- 11 The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
- 12 Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
- 13 The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

**E. Principles for Issuers**

- 14 There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions.
- 15 Holders of securities in a company should be treated in a fair and equitable manner.
- 16 Accounting and auditing standards should be of a high and internationally acceptable quality.

**F. Principles for Collective Investment Schemes**

- 17 The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
- 18 The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
- 19 Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
- 20 Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

**G. Principles for Market Intermediaries**

- 21 Regulation should provide for minimum entry standards and market intermediaries.

- 22 There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries take.
- 23 Market intermediaries should be required to comply with standards for internal organisation and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
- 24 There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systematic risk.

#### **H. Principles for the Secondary Market**

- 25 The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
- 26 There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
- 27 Regulation should promote transparency of trading.
- 28 Regulations should be designed to detect and deter manipulation and other unfair trading practices.
- 29 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
- 30 Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systematic risk.

**SUMMARY OF CFTC PART 30 RULES**

## SUMMARY OF THE PART 30 RULES OF THE COMMODITY FUTURES TRADING COMMISSION

*Interpretative Statement with Respect to the Commodity Futures Trading Commission's (the "Commission") Exemptive Authority Under §30.10 of Its Rules as set out in Appendix A to Part 30 of Title 17 Chapter I of the Code of Federal Regulations (CFR).*

Part 30 of the Commission's regulations establishes the regulatory structure governing the offer and sale in the United States of futures and options contracts made or to be made on or subject to the rules of a foreign board of trade. Section 30.10 of these regulations provides that, upon petition, the Commission may exempt any person from any requirement of this part. Specifically, section 30.10(a) states:

*"Any person adversely affected by any requirement of this part may file a petition with the Secretary of the Commission, which petition must set forth with particularity the reasons why that person believes that he should be exempt from such requirement. The Commission may, in its discretion, grant such an exemption if that person demonstrates to the Commission's satisfaction that the exemption is not otherwise contrary to the public interest or to the purposes of the provision from which exemption is sought. The petition will be granted or denied on the basis of the papers filed. The petition may be granted subject to such terms and conditions as the Commission may find appropriate."*

As the provisions of that section make clear, any person subject to regulation under part 30 may petition the Commission for an exemption. In adopting these regulations, however, the Commission noted in particular that persons located outside the United States that solicit or accept orders directly from United States customers for foreign futures or options transactions and that are subject to a comparable regulatory scheme in the country in which they are located may apply under section 30.10 for exemption from some or all of the requirements that would otherwise be applicable to such persons. This interpretative statement sets forth the elements that the Commission intends to evaluate in determining whether a particular regulatory program may be found to be comparable to the Commission's program.

The Commission wishes to emphasize, however, that this interpretative statement is not all-inclusive, and that information with respect to other aspects of a particular regulatory program may be submitted by a petitioner or requested by the Commission. In this connection, the Commission would have broad discretion to determine that the policies of any program element generally are met, notwithstanding the fact that the offshore program does not contain an element identical to that of the Commission's regulatory program and conversely may assess how particular elements are in fact applied by offshore authorities. Thus, for example, in order to find that a particular program is comparable, the regulations thereunder would have to be applicable to all United States customers, notwithstanding any exemptions that might otherwise be available to particular classes of customer located offshore. A petitioner, therefore, must set forth with particularity the factual basis for a finding of comparability and the reasons why such policies and purposes are met, notwithstanding differences of degree and kind in its regulatory program.

No exemptions of a general nature will be granted unless the persons to which the exemption is to be applied consent to submit to jurisdiction in the United States by designating an agent for service of process pursuant to the provisions of rule 30.5 with respect to any activities of such persons otherwise subject to regulation under this part and to notify the National Futures Association of the commencement or termination of business in the United States. In this connection, to be exempted, such person must further agree to respond to a request to confirm that it continues to do business in the United States.

Persons located outside the United States may seek an exemption on their own behalf or an exemption may be sought on a general basis through the governmental agency responsible for the implementation and enforcement of the regulatory program in question, or the self-regulatory organizations of which such persons are members. The appropriate petitioner is a matter of judgment and may be determined by the parties seeking the exemption. The Commission, however, notes that it will be able to address petitions more efficiently if they are filed by the governmental agency or self-regulatory organization responsible for the regulatory program.

In this connection, as will be discussed in more detail below, any exemption of a general nature based on comparability will be conditioned upon appropriate information sharing arrangements between the Commission and the relevant governmental agency and/or self-regulatory organization. Representations from the appropriate governmental agency with respect to the applicability of any blocking statutes that may prevent the sharing of information requested under private arrangements would also be considered. Finally, in considering an exemption request, the Commission will take into account the extent to which United States persons or contracts regulated by the Commission are permitted to engage in futures-related activities or be offered in the country from which an exemption is sought.

In the Commission's review, the minimum elements of a comparable regulatory program would include: (1) Registration, authorization or other form of licensing, fitness review or qualification of persons through which customer orders are solicited and accepted; (2) minimum financial requirements for those persons that accept customer funds; (3) protection of customer funds from misapplication; (4) recordkeeping and reporting requirements; (5) minimum sales practice standards, including disclosure of the risks of futures and options transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; and (6) compliance.

(1) **Qualification**

Under domestic law, registration identifies to the Commission, the public and other governmental agencies the individuals and entities that are properly authorized to solicit and accept customer orders and are in good standing. Equally important, the procedure provides the Commission, through the National Futures Association, the opportunity to determine whether applicants are unfit to deal with the public. In this connection, the standards for determining whether a person through its principals is fit for registration with the Commission are set forth in section 8a(2)–8a(4) of the Act. Timely access to information as to a firm's good standing and the application by relevant authorities of membership and licensing criteria, as well as the criteria themselves, will be considered by the Commission in assessing comparability.

(2) **Minimum Financial Requirements**

Minimum financial requirements for persons that handle customer funds serve at least three critical functions. First, they provide a cushion together with margin such that in the event of a default of a customer, the losses of that customer need not adversely affect the funds held on behalf of other customers. Second, they help ensure that the person has sufficient funds to operate its business and, therefore, is less likely to be tempted to misapply customer funds for its own purposes. Third, they ensure that the person holding customer funds has some financial stake in its business and, therefore, is serious in its intent. In assessing comparability, capital rules or their equivalent will be considered together with any provisions made for insuring customer losses, the scope of clearing guarantees and segregation or customer trust calculation and accounting requirements which, to the extent they cover undermargined accounts, can provide significant protection of one customer from another customer's losses.

(3) **Customer Funds**

The Act requires the strict segregation of customer funds from those of the person holding such funds. One of the primary purposes of this requirement is to prevent the misapplication of those funds for purposes other than those intended by the customer, which may affect not only the customer but the market as a whole. The purpose of segregation is also to identify customer deposits as assets of the customer, rather than the firm, in order that in bankruptcy such funds are payable only to satisfy the carrying firm's obligations to such customers and not other obligations of the firm. In assessing comparability of protection of customer funds, the Commission will consider protections accorded customer funds in a bankruptcy under applicable law, as well as protection from fraud.

(4) **Recordkeeping and Reporting**

Recordkeeping requirements have long been recognized as the linchpin of the Commission's regulatory scheme. Reporting and recordkeeping requirements assist in determining that a registrant is acting in accordance with the provisions of the Act and the rules, regulations and orders of the Commission thereunder. Similarly, reporting requirements ensure that customers are timely advised of the transactions that have been executed on their behalf, thus ensuring that they are aware of their positions in the markets and may object to any transactions that they believe are in error. The Commission will consider the types of records maintained, the ability through those records to trace funds and transactions, and the period of retention and accessibility of records under the information sharing arrangements discussed below in considering comparability.

(5) **Sales Practice Standards**

In 1982, Congress reaffirmed the importance of minimum sales practice standards to protect customers from fraud or misrepresentation by requiring any futures association registered by the Commission to adopt and enforce rules governing the sales practices of

its members. The Commission has consistently provided that written disclosure of the risks of futures and options trading is essential to ensure that potential customers are aware of these risks and are not otherwise misled and that other appropriate disclosure is made. The Commission will review the type and manner of disclosure given and the mechanisms for assuring the disclosure requirements are met and, in particular, the treatment of discretionary accounts for which, for example, Commission rule 166.2 requires particularized documentation of intent to confer discretion in the case of foreign futures and options transactions.

(6) **Compliance**

Finally, in assessing comparability of a program, the Commission will examine the procedures employed by the governmental authority or the appropriate self-regulatory organization to audit for compliance with, and to take action as appropriate against those persons that violate, the requirements of that program.

As noted above, any exemption of a general nature would also require an information sharing arrangement between the Commission and the appropriate governmental or self-regulatory organization to ensure Commission access to information on an as needed basis as may be necessary to fulfill its regulatory responsibilities. The information subject to these arrangements generally would be of a type necessary in the first instance to monitor domestic markets and to protect domestic customers trading on foreign markets.

Firm-specific information that is potentially relevant to protection of domestic customers engaged in foreign transactions could include the following: (1) Registration qualification status; (2) names of principals; (3) current capital; (4) location of customer funds; (5) address of main office and branches; (6) exchange and self-regulatory organization memberships; (7) the existence of any derogatory information such as that required to be disclosed on the Commission's Form 7-R; (8) notice of limitations imposed on activities; (9) notice of undersegregation or undercapitalization; (10) notice of misuse of customer funds; and (11) notice of sanctions or of expulsion from exchange or self-regulatory organization membership. The Commission believes that much of the above information would be public in the ordinary course in most jurisdictions. From time to time, the Commission also may need immediate access to financial information concerning risks posed to domestic firms by the carrying of foreign positions.

In addition to information that relates to the financial stability and creditworthiness of the firm, the Commission should have access to transaction-specific information that confirms the execution of orders and prices and facilitates tracing of customer funds. Such data could include records reflecting: (1) that an order has been received by a firm on behalf of one or more United States customers; (2) that an order has been executed on an exchange on behalf of one or more United States customers; (3) that funds to margin, guarantee or secure United States customer transactions have been received by a firm and deposited in an appropriate depository; and (4) the price at which a transaction was executed and general access to pricing information.



Again, such information is likely to be maintained in the ordinary course of business. Tracing of customer funds would be most essential in cases of insolvency where repatriation of funds is at issue.

The Commission may also seek relevant position data information, including the identity of the position holder and related positions, in connection with surveillance of a potential “market disruption.” This is particularly true in the case of integrated markets.

The Commission wishes to emphasize that the information sharing arrangements discussed herein are not necessarily a substitute for, nor would they preclude, a more formal agreement or arrangement with respect to the sharing of information.