

IOSCO Task Force on Cross-Border Regulation

Consultation Report



OICU-IOSCO

**THE BOARD OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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The Board of the International Organization of Securities Commissions (IOSCO Board) has published this consultation report prepared by the IOSCO Task Force on Cross-Border Regulation.

Comments may be submitted by one of the two following methods **on or before 23 February 2015**. To help us process and review your comments more efficiently, please use only one method.

Important: All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

1. Email

- Send comments to Ms. Rohini Tendulkar, IOSCO General Secretariat, C/ Oquendo 12, 28006 Madrid, +34 91 417 55 49, consultation-2014-09@iosco.org
- The subject line of your message must indicate *Task Force on Cross-Border Regulation*
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc.) to create the attachment
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files

2. Paper

- Send 3 copies of your paper comment letter to:

Ms. Rohini Tendulkar
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- Your comment letter should indicate prominently that it is a *Public Comment on the Task Force on Cross-Border Regulation*

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1. Introduction

1.1 Background

In today's global securities¹ markets, financial activities often cross national borders. As a result of these developments and their supervisory responsibilities over markets, trading, products and market participants, securities regulators often have regulatory interests that extend beyond their borders. Specifically, the process of applying national regulations to businesses operating and transactions taking place on a cross-border basis is not just the result of regulators being bound by national laws to consider how cross-border securities market activities could impact their own domestic² markets. Rather, the extent to which domestic financial institutions operate in multiple jurisdictions also appears to be a significant driver of the degree to which domestic laws and regulations, including supervisory and enforcement cooperation, may have effects in other jurisdictions, and thereby interact with the laws and regulations of such other jurisdictions.

Consequently, implementation issues requiring deliberation and resolution could arise, particularly in cases where the relationship between domestic and foreign regulators is still being built and developed. Representatives of the securities industry that operate on a global level have been vocal in raising concerns about the impact of differences in, and duplication of, regulatory approaches to cross-border financial activity.

In this context, authorities considering the adoption of new cross-border regulatory tools (or the modification of existing ones) are frequently called upon to consider how their national rules will apply to global financial markets and interact with international standards. The challenge is to ensure such interaction is done in a way that does not compromise the effectiveness of national rules while, at the same time, avoiding certain negative consequences from failing to take into account cross-border issues.

It is also likely that authorities will look to balance any potential trade-offs between increasing market access and financial activity on the one hand, and maintaining appropriate levels of investor protection and preventing the importation of risks on the other. Further, if a jurisdiction considers adopting a cross-border regulatory solution based on consideration of international standards or principles of consultation at the global level, it will typically need to consider whether such an approach can be applied locally and still maintain the same level of investor

¹ For the purposes of this report, the term "securities" has a wide meaning which includes equities, debt and derivatives.

² Throughout this report, the terms "domestic", "local", "host", and "national" are used interchangeably when referring to a particular jurisdiction, regulator, or market participant, as are the terms "foreign" and "home." Although the Task Force has endeavored to draft this report using consistent terminology wherever possible, any discussion of cross-border activity will, by its nature, contain some ambiguity when describing the relationship of the relevant players and activities. As a general matter, however, all references in this report to a jurisdiction, regulator, or market participant should be viewed as being relative to the location of the transactional activity in question – with the term "location" having the meaning ascribed to it in the English language dictionary and not as a legal term (i.e., for purposes of resolving jurisdiction questions).

protections for market participants. Any analysis of the possible effects of the cross-border application of securities regulation should take into account the fact that an approach or tool that works effectively in one market may not be easily replicated in, or applied to, other markets, as well as the fact that jurisdictions may have different reasons for pursuing different cross-border approaches.

In order to facilitate the analysis described above, it is important to have a better understanding of how regulatory actions and initiatives undertaken by jurisdictions impact cross-border securities markets. This consultation report describes three cross-border regulatory tools that have been used, or are under consideration, by IOSCO members with respect to a variety of entities, products and services. These three tools provide a basis for developing a cross-border regulatory toolkit and common terminology describing potential options for IOSCO members to consult when considering cross-border regulation. The consultation report also includes a detailed discussion of the key challenges and experiences faced by regulators in implementing cross-border securities regulations.

1.2 Setting up of the Task Force

In June 2013, IOSCO established the Task Force on Cross-Border Regulation (Task Force) to examine, consider and analyze cross-border regulatory issues and tools. Cross-border regulatory tools describe the legal and supervisory requirements used by a jurisdiction (host jurisdiction) to regulate, oversee, or otherwise address the extent of foreign entity activity in or affecting that jurisdiction. The Task Force will not prioritize one regulatory tool over another because there is an overall recognition that any attempt to fashion a one-size-fits-all approach would likely be unworkable because it would not recognize the nuances and realities of cross-border securities regulatory activity.

The work of the Task Force aims to assist policy makers and regulators in addressing the challenges they face in protecting investors, maintaining market quality, and reducing systemic risk. Importantly, while the Task Force's work is designed to be applicable broadly to markets and not limited to any one particular area, the Task Force will not duplicate the work of other relevant international work streams, in particular the ongoing work relating to the over-the-counter (OTC) derivatives reform agenda.

1.3 Key Mandate of the Task Force

The key mandate of the Task Force is:

- (i) To develop a cross-border regulatory toolkit (Toolkit), containing common terminology, of regulatory options for use by IOSCO members. This includes highlighting the characteristics associated with various approaches to cross-border regulation and the impact that the use of such cross-border regulatory tools may have on investor protection, markets and systemic risk.
- (ii) Where appropriate, to lay a foundation for the development of guidance on the coordinated use of the Toolkit to help IOSCO members consider how a particular tool

can be used to achieve IOSCO's three core regulatory goals: protection of investors, ensuring that markets are fair, efficient and transparent, and reduction of systemic risk.³

In undertaking this mandate, the Task Force will, among other things, also take into account the following:

- IOSCO core regulatory goals of investor protection, ensuring that markets are fair, efficient and transparent, and reducing systemic risk.
- The impact and relevance of cross-border regulatory tools on the relevant IOSCO objectives and principles of securities regulation,⁴ including the principles relating to the regulator, principles concerning supervision and enforcement, and principles for cooperation in regulation.
- Whether and how IOSCO may facilitate the development and implementation of cross-border regulatory tools.

1.4 IOSCO's Previous Work relevant to Cross-Border Regulation

IOSCO has not previously studied or developed an overall understanding of various approaches to cross-border regulation. Completion of such a study by the Task Force should serve as an important step in the broader goal of developing IOSCO members' understanding of issues regarding cross-border securities regulations, including by helping to establish a compendium of knowledge in this area.

Nevertheless, IOSCO has over the years focused on various areas of cross-border securities-related activities. IOSCO's most significant work to date regarding cross-border cooperation is the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMoU). Established in May 2002 and revised in May 2012, the IOSCO MMoU is the key instrument used by market regulators around the world to request assistance in securing compliance with and enforcing securities and derivatives laws and regulations.

In addition, IOSCO has taken the following actions:

- February 2014: The IOSCO Board issued the revised report on Joint Cross-Border Investigations and Related Proceedings⁵ to enhance coordination among regulators in

³ Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, IOSCO, September 2011.

⁴ *Objectives and Principles of Securities Regulation*, IOSCO, June 2010, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>.

⁵ *Joint Cross-Border Investigations and Related Proceedings*, IOSCO, February 2014, available at https://www.iosco.org/members_area/file.cfm?file=members-area\documents\pdf\Joint-Cross-Border-Investigations-and-Related-Proceedings-pdf.

carrying out enforcement actions. The report addresses some of the issues that regulators should anticipate when contemplating joint investigations. It also identifies issues by the stage of investigation at which they will become relevant.

- September 2013: IOSCO adopted measures to encourage non-signatory members to sign the IOSCO MMoU.⁶
- May 2010: The Technical Committee of IOSCO published the final report on the Principles Regarding Cross-Border Supervisory Cooperation.⁷ This report discusses the different types of regulated entities that operate in securities markets, regulatory needs and the challenges of globalization. It describes cooperative mechanisms and offers suggestions as to how regulators can enhance cross-border cooperation to better supervise regulated entities that operate across borders. It also suggests that regulators should explore opportunities to further collaborate on identifying, assessing and mitigating emerging risks on a global basis.
- April 2007: The Technical Committee of IOSCO published the final report on Multi-jurisdictional Information Sharing for Market Oversight,⁸ which provides guidance to enhance the supervision of markets and trading in member jurisdictions through the exchange of information on a routine or ad hoc basis.
- March 2007: The Technical Committee of IOSCO published the final report on International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers,⁹ which aims to facilitate a better understanding of issues that should be considered in developing disclosure requirements for debt securities as a means of enhancing investor protection.
- March 2005: The Emerging Markets Committee of IOSCO published the Report on Cross-Border Activities of Market Intermediaries in Emerging Markets.¹⁰ This report discusses the international experience of developed jurisdictions, including factors that determine the regulation of a foreign intermediary, information sharing frameworks and regulatory approaches to foreign versus domestic intermediaries. It also analyzes the regulatory practices of cross-border trading in member jurisdictions of the Emerging Markets Committee and provides recommendations for emerging markets in regulation of cross-border trading.

⁶ IOSCO media release on reinforcing standard on cross-border cooperation, 18 September 2013, available at <http://www.iosco.org/news/pdf/IOSCONEWS299.pdf>.

⁷ *Principles Regarding Cross-Border Supervisory Cooperation*, IOSCO, May 2010, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf>.

⁸ *Multi-jurisdictional Information Sharing for Market Oversight*, IOSCO, April 2007, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD248.pdf>.

⁹ *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, IOSCO, March 2007, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD242.pdf>.

¹⁰ *Report on Cross-Border Activities of Market Intermediaries in Emerging Markets*, IOSCO, March 2005, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD193.pdf>.

- February 2004: The report on the Regulation of Remote Cross-Border Financial Intermediaries¹¹ which, based on the results of a survey conducted amongst the members of the Standing Committee on the Regulation of Financial Intermediaries, identifies and discusses the factors that countries consider in determining how to regulate cross-border service providers that do not have a physical presence within their borders.
- October 2002: The Technical Committee of IOSCO published a report titled Investment Management: Areas of Regulatory Concern and Risk Assessment Methods.¹² The report assessed issues of regulatory concern regarding collective investment schemes (CIS) in the hope that international cooperation could be improved if regulators formed a common view of the risks inherent in the CIS business.
- September 1998: IOSCO published the International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers,¹³ which enhances the comparability of information provided by multinational issuers when conducting a cross-border public offering or listing and ensures a high level of investor protection. These standards are broadly accepted as a disclosure benchmark, and the equity disclosure regimes of many IOSCO members are based on these standards.
- October 1994: IOSCO published the Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems,¹⁴ the objective of which was to identify and explore the range of issues relevant to the regulation of, and to discuss the regulatory issues relating to, the cross-border operation of such systems.

Many other IOSCO reports and initiatives also contain elements related to cross-border regulation and activities.

1.5 Developing this Report

As a first step in developing this report, the Task Force conducted a survey from late October 2013 to April 2014 among its members, as well as members of the IOSCO Board and the Growth and Emerging Markets Committee (GEMC). Thirty-seven members participated in the survey, of which twenty-one were members from the GEMC. In terms of participation by region, four members were from Africa / Middle-East, eleven members were from the Americas, eight members were from Asia-Pacific, and fourteen members were from Europe.

¹¹ *Regulation of Remote Cross-Border Financial Intermediaries*, IOSCO, February 2004, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD162.pdf>.

¹² *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods*, IOSCO, October 2002, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD136.pdf>.

¹³ *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, IOSCO, September 1998, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf>.

¹⁴ *Report on Issues in the Regulation of Cross-Border Proprietary Screen-Based Trading Systems*, IOSCO, October 1994, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD42.pdf>.

The survey elicited information on tools that respondents have adopted, planned to adopt, or are aware of, to address cross-border regulatory issues across activities involving, among others, market intermediaries, securities exchanges and markets, CIS, and financial market infrastructures. Specifically, the survey elicited information on:

- the characteristics of the cross-border regulatory tools, including their purposes and underlying rationale;
- members' experiences and challenges in effectively coordinating and implementing such tools; and
- members' perspectives on how, if appropriate, IOSCO could facilitate the development and implementation of these tools.

The survey responses may provide important input and ideas to incorporate into the final report following this consultation and to inform the IOSCO 2020 Working Group which is tasked to identify and develop IOSCO's priorities over the next five years.

As a second step, in April 2014 the Task Force held meetings in Hong Kong, London and Washington D.C. with industry representatives, academics, and other key stakeholders to seek their views on what they believe to be the most important issues and challenges in complying with cross-border regulation, and to elicit their suggestions on how regulators could enhance cross-border coordination.

This consultation report summarizes and analyzes the cross-border regulatory tools described by survey respondents broadly in order to form a more comprehensive understanding of these tools that can serve as the basis for a Toolkit. This report aims to solicit further views on cross-border regulatory tools, use of these tools and other cross-border issues from all stakeholders including, but not limited to, investors, members of the securities industry, representative trade bodies, market professionals, academics, regulators, self-regulatory organizations, and policy makers.

While this report is based on feedback and responses describing cross-border tools in different areas, namely the regulation of products, services, and entities, the report itself is not broken down along those lines. As a result, certain discussions may focus on one area, but may not be applicable to others. For example, some aspects of an approach that has historically been used to regulate securities offerings on a cross-border basis may be largely untested in, and potentially not compatible with, the cross-border regulation of market intermediaries.

2. The Cross-Border Regulatory Toolkit

2.1 Overview of the Tools and Key Features

The purpose of this section is to provide an overview of the identified cross-border regulatory tools for public consultation.

The Toolkit, which is visualized in the diagram in Section 2.2 below, compiles the tools which are currently utilized by surveyed jurisdictions to regulate cross-border securities market activities. These tools can be broadly classified into three main types, namely, national treatment, recognition, and passporting.

These three main tools are general categorizations only and the cross-border approach adopted and utilized by a jurisdiction may, to varying degrees, involve elements or characteristics of more than one tool.

Two key features of the tools are worth noting. First, passporting may require a legal framework or an international treaty, together with a high degree of rule harmonization. Unless these conditions exist, the primary tools available are national treatment or varying degrees of recognition. Second, the need to consider the other jurisdiction's regulatory regime varies significantly among these tools, ranging from passporting, which requires a significant amount of reliance on other jurisdictions, to national treatment, where the regulatory focus is on the domestic market and formal consideration is not given to the operation of the foreign regulatory regime.

Another feature to note is that the regulatory objectives of a jurisdiction using a particular tool may focus on particular elements of domestic securities regulation, such as enabling market access and cross-border securities market activities, or on protecting investors and preventing the importation of risks. The cross-border tools used by jurisdictions are typically designed to achieve varying objectives, and different regulatory objectives involving the same tool do not have to be mutually exclusive. Other key features of the tools are summarized in the diagram.

Further details of the tools and the different approaches in which they are implemented can be found in the illustrative examples presented in subsequent sections.

Tool 1: National Treatment

- Foreign persons, entities, and products are generally treated in the same manner as domestic ones regardless of the foreign regulatory regime
- No need for the domestic regulator to develop a detailed understanding of foreign regulatory regimes
- Can be supported by cooperative mechanisms with foreign regulators
- Can be supported by exemptions and accommodations

Tool 3: Passporting

- May require an international treaty or similar legal instrument
- May require an agreement on a common set of rules which permits market access
- Is based on a single authorization/ registration which allows for the provision of services within the area under the supervision of a single (“home”) authority
- Where regulator of other market (“host”) has concerns over compliance, may be required to discuss these with home authority
- May include the creation of a common authority to supervise compliance with the rules, draft guidelines and provide recommendations as well as foster and facilitate supervisory cooperation (e.g. ESMA, the European Securities and Markets Authority)

2.2 Diagram of the Cross-Border Regulatory Toolkit

Tool 2: Recognition

- Upon assessment, domestic regulator recognizes that the foreign regulatory regime is sufficiently comparable to the domestic regime to allow for reliance on the other jurisdiction’s regulatory regime
- Enables activities of persons and entities and the distribution of products from recognized foreign jurisdictions to take place on specific terms under unilateral recognition, or on agreed terms under mutual recognition
- Commonly supported by cooperative mechanisms with foreign regulators

Unilateral Recognition

- Recognition of the domestic regulatory regime not required

Mutual Recognition

- Requires an arrangement between domestic and foreign regulators to recognize each other’s regimes
- Requires mutual cooperation with the regulator and involves reliance on the regulatory regime in the other jurisdiction

3. Tool 1 – National Treatment

3.1 Definition of National Treatment

National treatment, for the purposes of this report, refers to a tool in which, regardless of the details of the foreign regulatory regime or how they may compare to the domestic one, entities domiciled in or operating from foreign jurisdictions are generally treated in the same manner as domestic ones in terms of domestic entry and ongoing regulatory requirements. In some limited situations, alternative treatment, exemptions or other regulatory accommodations may be granted and/or be available.¹⁵

Among survey respondents that employ this tool, foreign entities¹⁶ are commonly required to register or obtain authorization, approval or licenses from the domestic regulator on the same basis as domestic entities. In addition, ongoing requirements often apply to all entities and do not differentiate between domestic or foreign entities. In some surveyed jurisdictions, this may effectively require a foreign participant to take certain steps to operate as a domestic participant.

As illustrated in the following example, national treatment is commonly applied by regulators from both developed and emerging markets across a wide range of cross-border market participants.

Example 1: Broad application of national treatment to various types of market participants

A number of developed and emerging markets in the Asia-Pacific region and Africa commonly require all market participants to be licensed or obtain other forms of authorization before carrying on a regulated securities business. In Hong Kong, corporations must be licensed to carry on a business in a regulated activity unless exemptions apply. Similarly, individuals must also be licensed to perform a regulated activity for a licensed corporation. Currently there are 10 types of regulated activities in Hong Kong under the Securities and Futures Ordinance (Cap 571,¹⁷ Laws of Hong Kong), including:

- dealing in securities;
- dealing in futures contracts;

¹⁵ The Task Force recognizes that the term “national treatment” also has a well-understood meaning in the context of international trade law and wishes to clarify that all references to “national treatment” throughout this report should be interpreted solely for the purposes described herein and should not be conflated with the use of the term in international trade law or any related context.

¹⁶ The term “foreign entity” has a unique meaning within each regulatory regime and entities may be classified as “foreign” based on domicile, place of business, or other characteristics.

¹⁷ See details at <http://www.hkllii.hk/eng/hk/legis/ord/571/sch5.html>.

- leveraged foreign exchange trading;
- advising on securities;
- advising on futures contracts;
- advising on corporate finance;
- providing automated trading services;
- securities margin financing;
- asset management; and
- providing credit rating services.

It is considered a breach of provisions of the law if someone actively markets any regulated activity to the Hong Kong public whether in Hong Kong or from a place outside Hong Kong without the appropriate Hong Kong license to do so.

3.2 Regulatory Objectives of National Treatment

Jurisdictions using national treatment generally aim to treat all relevant entities substantively the same and in a non-discriminatory manner, regardless of whether they are domestic or foreign entities for a number of important reasons including, among other things, to promote regulatory transparency, create a level playing field for all market participants, and to improve capital flows and domestic market access. Use of this tool is intended to maintain a high level of investor protection, maintain market integrity and reduce systemic risks by ensuring that all entities and their activities within a particular market are subject to the direct oversight of the local regulator of that market.

Some survey respondents highlighted the fact that because national treatment does not require the host regulator to conduct an assessment of a regulatory regime that applies to a foreign entity in its home jurisdiction or to issue any type of determination with respect to that regime, there is less of a risk that participants from smaller markets would be excluded by virtue of the fact that authorities would target evaluations of foreign regulatory regimes toward larger and more sophisticated markets which, regardless of any lack of discriminatory intent, could have a discriminatory impact. Under this tool, market participants, rather than regulators, choose where to focus their efforts, one result of which is that foreign entities would be able to register and operate within a host market without regard to the size and level of development or sophistication of their home markets. All foreign entities that intend to operate in the host jurisdiction would generally have to bear the same costs of compliance as local entities operating within that jurisdiction.

In addition, national treatment is intended to promote predictability, transparency, and efficiency in the regulation of cross-border securities activities from the perspectives of both regulators and market participants. For example, all foreign entities seeking to conduct business within a host market are aware from the outset of the specific requirements necessary to register and operate

within the applicable jurisdiction. Furthermore, under national treatment, it is not incumbent on host regulators to devote time, resources, and expenses to develop and maintain expertise in one or more foreign regulatory regimes.

Finally, to the extent that a foreign entity operating in a jurisdiction experiences problems, investors in that jurisdiction are likely to look first to the host regulator, with whom they have greater familiarity and exposure, for relief. National treatment operates in a manner that provides potentially greater control over the foreign entity by the host regulator under those circumstances. Similarly, national treatment mitigates the need for investors to become familiar with multiple regulatory regimes, which could ultimately lead to confusion and unanticipated gaps in investor protections, because the tool requires that each foreign entity comply with the rules and regulations of the host jurisdiction in generally the same manner as domestic entities. All market participants can expect that any regulated entity operating in the jurisdiction with which they choose to deal is held to the same standard.

Below is an example for illustration.

Example 2: Equal treatment for both domestic and foreign issuers

“Host” registration of a transaction to offer or sell securities is required for both domestic and foreign issuers that publicly offer or sell securities in the United States, unless an exemption applies. One of the main purposes of registration is to protect investors by requiring that material information regarding the issuer and the securities being offered or sold is disclosed in a standardized and/or uniform manner to help investors with their investment decision to transact in a security.

Additional considerations and justifications of utilizing national treatment are described in section 6 of this report.

3.3 Regulatory Accommodations for Foreign Entities

Although foreign entities are generally subject to the same domestic entry and ongoing requirements as domestic ones, survey respondents have cited instances where relief, exemptions or regulatory accommodations are available to foreign entities. For example, and based on considerations of the foreign entities’ circumstances, the domestic regulator may provide accommodations as illustrated below.

Example 3: Disclosure accommodation for foreign private issuers

Continuing with the above example, although foreign issuers seeking to publicly offer or sell securities in the United States may register in the same manner and using the same forms and making the disclosures as domestic issuers, a separate disclosure regime that is consistent with

the IOSCO cross-border disclosure standards¹⁸ and tailored to foreign issuers exists for foreign issuers that satisfy the definition of “foreign private issuer”.¹⁹ This separate disclosure regime is similar to the disclosure regime for domestic issuers, but is tailored in certain instances. For instance, unlike domestic issuers who are required to use U.S. Generally Accepted Accounting Principles (GAAP), foreign private issuers may file financial statements prepared in accordance with U.S. GAAP or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Foreign issuers that do not satisfy the definition of “foreign private issuer” are required to register their securities and report using the same forms and rules as domestic issuers.

Survey respondents have, in some cases, provided limited modifications to the application of national treatment to facilitate domestic investors’ access to foreign markets and expertise while maintaining domestic investor protection safeguards. For example, in these circumstances, instead of requiring foreign entities to comply with the full domestic regulatory regime, some jurisdictions offer limited conditional exemptions from compliance with certain market entry or registration requirements. An example of this type of limited conditional exemption is provided below.

Example 4: Conditional exemptions from broker-dealer registration

Certain Asian, Canadian jurisdictions, and the U.S. Securities and Exchange Commission (U.S. SEC) provide conditional exemptions to foreign market participants from broker-dealer registration. Under the U.S. SEC regime, such conditional exemptions (which are contained in Rule 15a-6 of the Securities Exchange Act of 1934) apply to certain foreign broker-dealers that engage in a limited range of specified activities involving U.S. persons. These activities generally include: (1) effecting “unsolicited” securities transactions; (2) providing research reports to some types of U.S. institutional investors and effecting transactions in the securities discussed in the reports; (3) soliciting and effecting transactions with or for institutional investors through a registered broker-dealer acting as an intermediary; and (4) soliciting and effecting transactions directly with or for registered broker-dealers, banks, non-U.S. citizens “temporarily present in the United States”, and certain other specified persons.

¹⁸ *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, IOSCO, September 1998, supra fn 13.

¹⁹ The term “foreign private issuer” means any foreign issuer other than a foreign government except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter: (i) More than 50 percent of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and (ii) Any of the following: (a) The majority of the executive officers or directors are United States citizens or residents; (b) More than 50 percent of the assets of the issuer are located in the United States; or (c) The business of the issuer is administered principally in the United States. See *Securities Act Rule 405* available at: <http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&sid=20c66c74f60c4bb8392bcf9ad6fcea3&rgn=div5&view=text&node=17:2.0.1.1.12&idno=17#17:2.0.1.1.12.0.39.98>.

The above regulatory relief is intended to provide U.S. institutional investors greater access to overseas securities markets while, at the same time, retaining a number of key investor protections.

3.4 Compliance with Domestic Regulatory Regime

It broadly appears from the survey responses that the most important consideration for allowing foreign entities to operate cross-border in a host jurisdiction in the case of national treatment is that such entities are required to comply with requirements of the domestic regulatory regime in generally the same manner as domestic entities and to be subject to the direct oversight of the domestic regulator. The regulatory requirements and standards of foreign jurisdictions are thus far less important considerations to the domestic regulator than in cases where tools such as unilateral or mutual recognition are employed. Furthermore, the regulatory accommodations described in section 3.3 above may be structured in such a manner as to not be directly conditioned on the structure of the foreign regulatory regime and the existence of particular laws, regulations, requirements or standards in the relevant foreign jurisdiction. To the extent that the availability of a particular accommodation is entirely independent of the foreign regulatory regime and from the legal and practical feasibility of enforcing the domestic regulatory regime upon the foreign entity, it would not be necessary for the domestic regulator to conduct assessments of foreign regulatory regimes, nor would the domestic regulator need to devote time and resources to periodically review prior assessments of foreign regulatory regimes, in each case as would be expected under unilateral or mutual recognition.

3.5 Cooperation with Foreign Regulators

Another consideration for allowing cross-border securities market activities under national treatment is, in certain cases, cooperation between the domestic and foreign regulators. Enforcement cooperation is most commonly achieved through the IOSCO MMoU. In certain cases, a bilateral supervisory memorandum of understanding (MoU) also may be used to facilitate information sharing between or among regulators in supervisory matters in cross-border inspections or examinations of globally-active entities that are regulated in more than one jurisdiction. Section 4.4.2 below provides more detailed information on the typical form of and the types of provisions included in such MoUs. An example of the cooperation between regulators through the use of a MoU in the context of a national treatment regulatory regime is provided below.

Example 5: Cooperation with Foreign Regulators by entering into a MoU

The U.S. Commodity Futures Trading Commission (CFTC) has negotiated and entered into supervisory MoUs or similar arrangements with the relevant foreign regulator, or regulators, prior to approving an application from a central counterparty (CCP) organized outside of the United States for registration as a derivatives clearing organization (DCO). In order for such a CCP to be registered as a DCO, a MoU or similar arrangement satisfactory to the CFTC must be in effect

between the CFTC and the foreign regulator(s), pursuant to which, among other things, each foreign regulator agrees to share information and cooperate with the CFTC in the supervision of the CCP.

The negotiation of supervisory arrangements presents a good opportunity to develop close working relationships between or among regulators, as well as to highlight any potential issues related to cooperation and information sharing. These arrangements establish expectations for ongoing cooperation, address direct access to information, provide for notification upon the occurrence of specified events, memorialize understandings related to on-site visits, and include protections related to the use and confidentiality of non-public information shared pursuant to the arrangement.

As example 5 demonstrates, some methods of implementing national treatment have cooperation as a critical component of the tool's application and may require entering into a MoU to facilitate such cooperation between regulators.

Cooperation may not be expressly required in law because foreign entities, to the extent registration, licensing, approval, or other form of authorization is required, generally interact directly with the domestic regulator. However, a cooperative arrangement may be negotiated even where the law does not expressly require cooperation, either in recognition of the benefits of cooperation or out of practical necessity. For example, some domestic regulators may choose to consider issues relating to supervisory cooperation when assessing an application submitted by a foreign entity.

3.6 Challenges to Cooperation under National Treatment

In utilizing national treatment, some surveyed regulators have experienced challenges. Some have encountered difficulties in conducting examinations or inspections of entities domiciled and regulated abroad due to legal restrictions in the foreign jurisdictions. According to these surveyed regulators, such restrictions may limit or prohibit their direct access to the books and records of, and direct communication with, entities located abroad that are of regulatory interest to them.

From the perspective of other surveyed regulators which also oversee these cross-border entities, foreign requests to conduct on-site inspections within their jurisdictions may conflict with local laws, which may require that such inspections be conducted through, or coordinated by, the local regulator. In such circumstances, cooperation is critical between those that have regulatory interests over these cross-border entities in order to develop a solution and, ultimately, consider whether such entities are able to maintain their authorization or licenses in the respective jurisdictions.

4. Tool 2 – Recognition

4.1 Definitions of Unilateral and Mutual Recognition

Recognition, for the purposes of this report, refers to a tool under which a host regulator “recognizes” a foreign regulatory regime, or parts thereof, following an assessment of the foreign regulatory regime by the host regulator. This may be unilateral or mutual, depending on whether two-way recognition is required between the jurisdictions.

Under unilateral recognition, cross-border activities involving, among others, intermediaries, issuers of securities and investment products, securities exchanges and markets, or financial market infrastructures from recognized foreign jurisdictions can take place on specific terms, which usually involve enhanced regulatory cooperation and, in some cases, the use of regulatory relief or a certain level of reliance on the foreign regulator’s supervisory oversight when it is supported by an assessment of the foreign regulatory regime or parts thereof.

Under mutual recognition, the cross-border activities mentioned above can also take place within the domestic and foreign jurisdictions on agreed terms, which commonly involve the use of regulatory relief, enhanced cooperation with, and reliance on, the foreign regulator’s supervisory oversight when it is justified by the foreign regulatory regime or parts thereof. A defining characteristic of mutual recognition is that the two sides agree to recognize each other, which distinguishes it from unilateral recognition.

Example 6: Unilateral recognition of foreign CIS

The offer of a CIS constituted overseas (foreign CIS) to investors in Singapore must be recognized by the Monetary Authority of Singapore (MAS) under a recognition framework. The MAS will only recognize foreign CIS if the laws and practices of the foreign jurisdiction afford investors in Singapore protection at least equivalent to that provided under the Securities and Futures Act for CIS constituted in Singapore. Additional conditions on the foreign CIS may be imposed to ensure that the necessary investor protection safeguards are in place. MAS also expects that the foreign regulator can be relied upon to provide mutual assistance and exchange of information in respect of the schemes.

Among other things, the MAS will assess the equivalence of the foreign jurisdiction under which the CIS is constituted and regulated by undertaking a comparative assessment of its laws and regulations with specific focus on the requirements that are applied to the CIS and its operators as well as the adequacy of investor protection safeguards.

Example 7: Integration of stock exchanges through mutual recognition

The “Mercado Integrado Latinoamericano” (MILA), also known as the Integrated Latin American Market, is the virtual integration of the stock markets of Chile, Colombia, Mexico and Peru. Investors are able to access MILA through one of the registered brokers that have access to the common trading platform for buying and selling stocks in any of the four countries.

Mutual recognition of the regulatory and supervisory framework among MILA member countries is the key feature that, from a regulatory perspective, allows the proper functioning of this virtual platform. Foreign participants are subject to the supervision of the foreign authority regulating its own market, without prejudice of the supervisory role of the domestic authority for what concerns the operations performed by foreign entities in the market under its supervision. The securities supervisors of the MILA countries have signed a multilateral memorandum of understanding (MMoU) that allows for the exchange of information for authorization, on-going supervision, and enforcement actions on a cross-border level. It also sets up the basis for a regional supervisory committee made up by representatives of each regulator, so they can monitor the MILA market and take necessary supervision and enforcement actions.

4.2 Regulatory Objectives of Recognition

Survey respondents using this tool indicated that the primary objectives that they intend to achieve by recognizing foreign regulatory regimes, or parts thereof, are:

- **to improve capital flows and domestic market access** by reducing duplicative regulations or other barriers in terms of time, market entry and ongoing cost to market participants through the use of regulatory relief or other facilitation measures;
- **to enhance the international outlook of the domestic market** by attracting foreign investments, increasing investors’ access to a broader range of financial products, facilities and services, and enhancing competition and innovation in the financial services industry;
- **to ensure adequate investor protection, maintain market integrity, and reduce systemic risks and regulatory arbitrage** in the face of the increased presence of foreign services, products and market infrastructures;
- **to strengthen regulatory ties with foreign counterparts** through enhanced cooperation with and/or reliance on recognized foreign jurisdictions for ongoing supervisory oversight of dually regulated entities through the use of, for example, substituted compliance.

Example 8: Approaches to unilateral recognition of foreign issuers

The Mexican International Quotation System (SIC) allows investors in Mexico to invest in foreign securities listed on overseas stock exchanges that have been recognized by the Comision Nacional Bancaria y de Valores (CNBV) or whose issuers have received corresponding recognition by the CNBV.

The SIC has two types of recognition of foreign securities markets. The first one allows foreign issuers from IOSCO Board member jurisdictions and securities issued by central banks or governments from European Union (EU) member states to be directly recognized by the CNBV to trade on the SIC without any additional requirement or administrative procedure.

The second type of recognition allows a domestic stock exchange to request for recognition of a specific country and/or issuer. This only applies to foreign issuers from the EU, member jurisdictions of the Organization for Economic Cooperation and Development (OECD) and MILA. Such recognition is granted by the CNBV to trade on the SIC if, among other criteria, the foreign country and/or issuer can demonstrate that their regulatory requirements are consistent with Mexican provisions relating to investor protection, transparency, insider trading, market manipulation, conflict of interests and disclosure requirements.

Example 9: Temporary license framework for promoting broader access to financial services

Under the Temporary License Framework, the Malaysia Securities Commission (SC) may grant temporary licenses, via a streamlined process, to foreign professionals who wish to serve only institutional and sophisticated investors in Malaysia. Among other requirements, these professionals must be regulated in foreign regulatory regimes that are sufficiently equivalent to that of Malaysia. In addition, there must be arrangements between the SC and the foreign regulator to ensure prompt sharing of information and effective cooperation regarding supervision, investigations and enforcement.

This framework is intended to provide local issuers and sophisticated investors with access to high end services which may not be readily available domestically, and to assist in the capacity building of local licensed companies in terms of training and transfer of skills.

The regulatory objectives identified above apply to both unilateral and mutual recognition. It is unlikely that a jurisdiction would consider all of the above regulatory objectives at the same time or with equal weight when designing or implementing a unilateral or mutual recognition framework. In regulating a specific type of cross-border activity, regulators may place different weighting and importance on each objective depending on the strategic priorities and needs of the particular market. For example, the first two objectives are commonly associated with market-opening policies, while the last two objectives, especially investor protection, focus more on enhancing regulatory oversight. Survey respondents generally indicated a desire to try to strike a balance between market facilitation and regulatory oversight, although some jurisdictions appear

to place more emphasis on market development, while the more developed economies tend to focus more on regulatory oversight.

4.3 Regulatory Regimes of Foreign Jurisdictions

Jurisdictions that have implemented unilateral and mutual recognition tend to have very similar considerations when determining whether such tools are feasible and, if so, how they should be implemented. Typically, respondents have reported considering, among other things, the regulatory regime of the foreign jurisdiction and the level of cooperation with foreign regulators.

Prior to establishing unilateral or mutual recognition, almost all survey respondents find it critical to first assess and understand the foreign regulatory regime. The assessment of foreign regulatory regimes is intended to be a systematic assessment conducted by a domestic regulator to determine if the foreign jurisdiction or entity can be considered for unilateral or mutual recognition. To arrive at this determination, many regulators conducting the assessment utilize an outcomes-based approach in that they evaluate whether and to what extent the foreign regulatory regime achieves regulatory “outcomes” that are generally predetermined and comparable to those achieved by the domestic regulator (as opposed to focusing solely on a line-by-line comparison of the language of the rules and regulations).

Example 10: Assessment and unilateral recognition of foreign regulatory regimes in granting licensing relief to foreign financial services providers

The Australian Securities and Investment Commission (ASIC) may grant conditional license exemption to foreign financial services providers (foreign providers) who wish to serve only wholesale clients in Australia.²⁰

One of the conditions in granting such relief is that the foreign provider is regulated in its home jurisdiction, and that the foreign regulatory regime is sufficiently equivalent to that of Australia. For instance, considerations may be given to the foreign jurisdiction’s regulations, license issuing criteria, the foreign provider’s obligations under home regulation and how those obligations are monitored and enforced. Since the foreign provider is not seeking to service retail clients, ASIC considers the equivalence of regulatory outcomes from the perspective of market integrity and systemic risk, and will not focus on investor protection issues.

Another condition in granting such relief is whether there is effective cooperation arrangement between the foreign regulatory authority and ASIC. The foreign provider will also have to submit to the non-exclusive jurisdiction of the Australian courts in legal proceedings, comply with any order of an Australian court, and take practicable steps to enable and assist its home regulatory authority to disclose any relevant information to ASIC.

Currently, there are 638 foreign providers relying on this relief. They include foreign providers

²⁰ See ASIC’s Regulatory Guide 176 on foreign financial services providers, available at <https://dv8nx270cl59a.cloudfront.net/media/1240973/rg176-published-29-june-2012.pdf>.

regulated in Germany, Hong Kong, Singapore, the United Kingdom and the United States.

The following sections provide an overview of the methodology employed in a typical assessment, as described by survey respondents. Further details and illustrative examples of the assessment process for unilateral or mutual recognition are set out in Appendix 1.

4.3.1 Guidelines used in the Assessments

Compared with emerging markets, surveyed regulators from developed markets appear to have more established guidelines with regard to conducting assessments of foreign regulatory regimes. These are often high-level guidelines that explain the concepts and processes of the assessment, and are revised on an ongoing basis to ensure that they remain valid or compatible with changing requirements and market conditions. Depending on the regulator, the guidelines may or may not be made publicly available.²¹

4.3.2 Initiation of the Assessment

The assessment of foreign regulatory regimes is initiated at different times for unilateral and mutual recognition. Under unilateral recognition, the assessment is typically initiated when the domestic regulator receives an application from a foreign regulator or entity seeking to operate, or to continue to operate, in the domestic market. For mutual recognition, the assessment begins when both the domestic and foreign jurisdictions negotiate the possibility of having such an arrangement. The assessment may need to be conducted on an ongoing or periodic basis as the relevant regulatory regimes evolve and develop.

4.3.3 Participants in the Assessment

The assessment of a foreign regulatory regime normally involves 3 parties:

- **Domestic regulator** identifies regulatory outcomes (in agreement with the foreign regulator if the assessment is conducted for a proposed mutual recognition arrangement), conducts an assessment of the foreign securities regulatory regime, including with respect to supervision and enforcement, discusses with the foreign regulator ways to address areas of concerns, documents the analysis and where necessary, considers whether there are alternative ways to achieve the desired regulatory outcomes.
- **Foreign regulator** provides information about its regulatory regime, discusses with the domestic regulator and where necessary, considers whether to adopt measures to meet domestic regulatory outcomes.
- **Foreign entity** seeking to operate or to continue to operate on a cross-border basis under a unilateral recognition arrangement provides the domestic regulator with details of the

²¹ See ASIC's Regulatory Guide 54 on principles for cross-border financial regulation, available at <https://dv8nx270c159a.cloudfront.net/media/1238990/rg54-published-29-june-2012.pdf>

foreign regulatory regime to which it is subject. It may have to coordinate with other market participants and its home regulator in the process.

4.3.4 Timeframe of the Assessment

Some surveyed regulators have target timeframes or deadlines to complete the assessment. Others have specific deadlines for the various parts of the assessment, including an assessment of the application's completeness, followed by the formal assessment of equivalence. However, most surveyed regulators do not set a specific timeframe for completion of the assessment since the time taken depends on the following:

- the availability of resources of the domestic regulator to conduct the assessment relative to the amount of material to be evaluated;
- the complexity of, and the domestic regulator's familiarity with, the material to be evaluated; and
- the completeness of the material to be analyzed and the time it takes for the foreign regulator or entity to respond to requests for further information and clarification.

Consequently, a number of factors will weigh in the decision of which foreign regulatory regime to assess first. These include:

- the order in which applications are submitted (for unilateral recognition only);
- the foreign jurisdiction's interest in having a mutual recognition arrangement (for mutual recognition only);
- domestic policy development;
- the extent of cross-border activity or anticipated cross-border activity; and
- the existence of a cooperation mechanism with the foreign jurisdiction.

In many cases, entities from foreign jurisdictions that have yet to be assessed cannot operate in the jurisdiction yet to assess them under unilateral or mutual recognition. One exception to this statement is illustrated in the example below in relation to the operation of foreign clearing agencies in Ontario and Québec.

Example 11: Interim approval to conduct clearing business

The Ontario Securities Commission (OSC) and the Autorité des marchés financiers of Québec (AMF Québec) have the practice of assessing the regulatory and oversight regime of a foreign jurisdiction upon receiving an application from a foreign clearing agency to carry on business in Ontario and Québec. While the regulatory preference is to complete the assessment first, the OSC and AMF Québec may allow certain entities to operate in Ontario and Québec, respectively, in the interim, provided that they comply with certain terms and conditions, including a requirement

that a full application for recognition or exemption to recognition be submitted by a certain date. These terms and conditions have an expiry date, by which OSC or AMF Québec expect the entity to submit an application and for the application to be assessed.

4.3.5 Post-Assessment Communication and Re-assessment of Foreign Regulatory Regimes

In most cases, following a determination under either a unilateral or mutual recognition framework, domestic and foreign regulators will communicate to discuss matters regarding the entities and transactions operating cross-border or any regulatory changes that may arise.

In the case of mutual recognition, notification mechanisms are often set out in the MoUs between the domestic and foreign regulators, so that both are informed of any significant changes in the other's regulatory regime which may have a material impact on the recognition arrangement. In the case of unilateral recognition, foreign entities operating on a cross-border basis are also often required to notify the domestic regulator. In addition, some survey respondents hold regular meetings with foreign regulators to discuss market and regulatory developments.

This ongoing dialogue is essential because regulatory changes may affect the extent to which the foreign regime achieves the necessary regulatory outcomes, such as those affecting the foreign jurisdiction's:

- regulatory structure;
- supervision of entities under its authority;
- obligations or requirements imposed on these entities; and
- supervision or legislative responsibility for the activities of these entities in the domestic jurisdiction.

Such changes will, in turn, have an impact on the unilateral or mutual recognition arrangement concerned. As a result, a periodic update to the assessment of a foreign regulatory regime will need to be conducted on an ongoing or periodic basis as it evolves and develops.

Some survey respondents conduct the assessment every four to five years, while others rely on the notifications from foreign regulators on changes to relevant laws and requirements of the foreign jurisdiction, or information about their compliance with international principles and standards.

4.3.6 Challenges of Assessing Foreign Regulatory Regimes

Survey respondents have highlighted a number of common challenges in the assessment process. These are summarized as follows:

- In many instances, jurisdictions have limited human or other resources to assess foreign regulatory regimes. Assessments can be resource-intensive due to the amount and complexity of the materials to be evaluated.

Example 12: Demand on resources for conducting assessments

In preparation for the mutual recognition arrangement between ASIC and the U.S. SEC on market operators and broker-dealers, ASIC deployed one full time senior staff member to conduct a desk based assessment which took 2.5 months. In addition, ASIC sent one senior executive to the U.S. SEC for a month to complete the assessment following liaison with U.S. SEC staff. The U.S. SEC staff also committed a substantial amount of resources, spread across a number of its different offices and divisions and at all levels of seniority, consulting with their ASIC counterparts and independently analyzing and assessing Australian law.

- Survey respondents have generally found it challenging to assess foreign regulatory regimes due to insufficient knowledge and expertise. Without an understanding of the context in which regulations operate, there are limitations to how much those without practical experience with the foreign regulatory regime can understand. Ongoing changes in foreign requirements, standards and market developments may place further demands on regulators to keep up to date with such changes and assess how these changes may impact the way foreign entities operate cross-border. There may also be a language barrier if foreign laws and regulations are written in a foreign language and the domestic regulator has to rely on translations. It was noted that the meaning and intent of the regulations may not always be fully captured in a translation.
- Regulatory gaps, inconsistencies or conflicting requirements identified from comparing domestic and foreign laws and regulations may pose difficulties to the assessment process due to differences in frameworks and concepts. Internationally-agreed standards are often not used as the benchmarks for cross-border reviews, possibly because they do not reflect local regulatory regimes, legal requirements and cultural differences and are not sufficiently detailed. Furthermore, there are no regulatory requirements to transpose them into domestic law. A degree of judgment will be required in assessing the extent to which the regulatory frameworks of particular jurisdictions deliver substantively similar outcomes to those intended by the standards.
- Some surveyed jurisdictions have found it difficult or inappropriate to conduct the review when overseas laws and regulations are not yet in place or are being finalized.

4.4 Cooperation with Foreign Regulators

4.4.1 Importance and Extent of Cooperation

Cooperation with foreign regulators is another essential component in establishing unilateral and mutual recognition.

Under unilateral and mutual recognition, the domestic regulator generally expects the foreign entity to be established and regulated in a jurisdiction which can be relied upon to provide a broad range of assistance including, as applicable, by cooperating and sharing information in a timely manner. This requirement is intended to enable better supervisory oversight of the cross-border

entity and its activities which may affect investors, markets and systemic risks in the domestic market.

A distinguishing difference between unilateral and mutual recognition is the greater extent of supervisory reliance placed on the foreign regulator in the latter case. Compared to unilateral recognition, it broadly appears from the survey results that although each regulator under mutual recognition reserves full authority to enforce its laws and regulations, the domestic regulator places significant reliance on the foreign regulator, who continues to be the primary supervisor of the foreign entity operating within the domestic jurisdiction.

4.4.2 Means and Areas of Cooperation

Given the importance of cooperation and reliance on foreign oversight efforts under unilateral and mutual recognition, most developed markets, as well as the more developed emerging markets, establish cooperative mechanisms with their foreign counterparts to foster cooperation and complement the IOSCO MMoU. These mechanisms are usually in the form of supervisory and/or enforcement MoUs, and are negotiated bilaterally or multilaterally between or among domestic and foreign regulators according to their supervisory responsibilities and capacities to share information on enforcement and/or supervisory matters.

In particular, survey respondents have indicated that the contents of these MoUs are consistent with IOSCO's May 2010 Final Report on Principles Regarding Cross-Border Supervisory Cooperation²² and/or the terms and conditions of the IOSCO MMoU. For supervisory MoUs, the Principles Regarding Cross-Border Supervisory Cooperation include an annotated sample Supervisory MoU²³ to assist regulators in designing bilateral supervisory arrangements.

MoUs and other arrangements provide for timely assistance in accordance with applicable laws and confidentiality requirements.

Supervisory MoUs typically include provisions on:

- Sharing information and documents upon request for supervisory purposes;
- Consulting with the relevant regulator(s) regarding general regulatory issues and issues relevant to the operations, activities, and supervision of cross-border regulated entities;

²² *Principles Regarding Cross-Border Supervisory Cooperation*, IOSCO, May 2010, Supra fn 7.

²³ As indicated in the final report on the Principles Regarding Cross-Border Supervisory Cooperation, the sample Supervisory MoU "is not designed to serve as a model MoU. Rather, it describes the issues and possible provisions that may prove effective for supervisory cooperation arrangements, and illustrates some (though clearly not all) of the ways different jurisdictions might approach regulatory and legal issues that might arise when constructing such arrangements in practice. Fundamentally, the terms of any arrangement will have to be determined by the partners to such an arrangement and will necessarily reflect their own legal and regulatory circumstances and needs."

- Notification by the relevant regulator(s), in advance where possible, when certain triggering events occur. These events may include regulatory changes that have a significant impact on the operations, activities or reputation of the foreign entity, significant changes in laws and market conditions, or any other matter affecting the unilateral or mutual recognition arrangement; and
- Cooperating in conducting on-site visits.

Enforcement MoUs typically include provisions on:

- Sharing information and documents upon request for investigative or enforcement purposes;
- Taking or compelling a person's statement or testimony under oath upon request of the requesting authority; and
- Providing unsolicited assistance without prior request, if it is likely to assist the foreign regulator(s) in securing compliance with or enforcement of laws or regulations applicable in their jurisdiction.

Formal arrangements often complement ad-hoc interactions and informal communications with foreign regulators, and participation in supervisory colleges and international organizations. More detailed information is provided in the Principles Regarding Cross-Border Supervisory Cooperation.

For many emerging markets that act as host jurisdictions of foreign activity using unilateral recognition, cooperative mechanisms may not be required or established.

Among those jurisdictions that are not subject to a requirement to establish a cooperative mechanism, some are in the process of enacting new legislation and will be transitioning to a more formal structure with greater reliance on cooperative mechanisms in the form of MoUs. Others have adopted the customary practice to ensure that supervisory cooperative mechanisms, though not mandatory, are in place to enable effective cooperation with foreign regulators in authorizing and supervising foreign entities operating cross-border. Authorization of these foreign entities may be deferred in the event that the necessary cooperative mechanisms are not yet in place with the regulator(s) in the respective foreign jurisdictions.

4.4.3 Challenges to Cooperation under Recognition

Cooperation between regulators is based on principles of international comity. At the practical level, many surveyed jurisdictions have faced the following challenges:

- **Resource constraints:** Recognition, especially mutual recognition, demands intensive supervisory and enforcement cooperation. The challenge is for regulators to find additional resources to ensure that obligations under mutual recognition arrangements are fulfilled. With an increasing number of international requests, regulators may lack

sufficient operational resources to provide timely and accurate information which is presented in usable form.

- **Lack of appropriate and effective access to information for supervisory purposes:** This issue mainly concerns the implementation of unilateral recognition, which involves less cooperation with and reliance on the other jurisdiction when compared to mutual recognition. Surveyed regulators have significantly different views on the channels through which the domestic regulator can receive information about the foreign entity operating cross-border.

Some respondents believe that it is essential for the foreign entity to be able to provide information directly to the domestic regulator if requested for supervisory purposes, because this is often one of the terms and conditions of entry into the domestic market. Some hold the same view because they are bound by statutory mandate to have direct, unfettered access to those under their oversight. However, other respondents have indicated that having the foreign entity provide information directly to the domestic regulator may conflict with foreign legislation or may require closer cooperation with the foreign regulator so as to do so in accordance with applicable foreign laws and regulations.

Some also mentioned that they do not need to request information from the cross-border entity as all information filed with the foreign regulator must also be filed with the domestic regulator.

On the other hand, some survey respondents believe that information requests should go through the foreign regulator instead. However, some of those who have sought information from foreign regulators have experienced complications at times due to the foreign regulator's lack of power to obtain such information solely for supervisory purposes. Others, on the contrary, have found it very easy to obtain all needed information from the foreign regulator through effective cooperation and exchange of information.

- **Issues regarding the power to conduct on-site inspections or examinations:** Responses to the Task Force survey revealed a range of differences in regulators' supervisory power to conduct on-site inspections or examinations of cross-border entities in a foreign jurisdiction. Some regulators lack the power to conduct such inspections or examinations but can rely on the foreign regulator's supervision, while others are able to conduct inspections or examinations in cooperation with the foreign regulator in certain instances, based on bilateral MoUs on supervisory cooperation and provided that advance notice is given to the foreign regulator. Further discussions between regulators on a bilateral or multilateral basis may be appropriate for addressing these issues.

4.5 Market Response, Investors' Level of Sophistication, and Government Support

The majority of survey respondents utilizing this approach take into account how the market will respond to unilateral and/or mutual recognition, and how these arrangements, if implemented, will impact on the level of capital flows between the jurisdictions. Requests or statements of support from the industry may be triggers for home regulators to establish unilateral recognition or mutual recognition. Regulators may also propose such arrangements on their own initiative or in response to pressure from other regulators or policy makers. Many regulators using this tool

consult with the industry at an early stage to gauge their demand and preparedness, so that any foreseen implementation difficulties from the industry's practical perspective can be flagged. The level of sophistication of domestic investors is also an important consideration among surveyed jurisdictions.

Example 13: Enhancing investor protection under unilateral and mutual recognition of foreign CIS

Under ASIC's unilateral recognition of Singaporean CIS²⁴ and the mutual recognition of CIS between Australia and Hong Kong,²⁵ foreign scheme operators are required to have an internal dispute resolution process and join an ASIC-approved external dispute resolution scheme so that Australian retail investors can have their complaints addressed. These are conditions for granting certain registration, licensing, or disclosure relief under foreign recognition arrangements.

For mutual recognition, several respondents also emphasized the importance of having sustained, reciprocal interests among regulators and governments of both jurisdictions in order to drive a market-opening policy forward.

²⁴ See details at <http://www.comlaw.gov.au/Details/F2012C00715>.

²⁵ See details at <http://www.comlaw.gov.au/Details/F2012C00716>.

5. Tool 3 – Passporting

5.1 Definition of Passporting

Passporting, for the purposes of this report, refers to a tool that is based on a common set of rules which are applicable in the jurisdictions covered by the passporting arrangement.

Passporting of financial products and financial services providers allows the holder of a regulatory license or authorization in one jurisdiction that is a party to the passporting arrangement to offer the financial product or provide financial services covered by the authorization or license in any of the other jurisdictions which are parties to the arrangement. No further authorization requirements are needed. The home jurisdiction may only issue an authorization or a license if the financial products or intermediaries meet an agreed set of rules.

Passporting in the EU

Passporting is extensively used in the EU legislation.²⁶ Most types of financial services providers and products benefit from the possibility of passporting within the EU according to the relevant sectorial legislation. Examples include the regulation of prospectuses for public offering of securities or admissions to trading, management and marketing of CIS in transferable securities (UCITS) and alternative investment funds (AIFs), provision of investment services, the activities of central counterparties and central securities depositories, as well as operating trading platforms.²⁷ The passport mechanism introduced under the various sectorial legislation (see

²⁶ The EU single market developed over time. In 1999, a single market for financial services was established. The EU has its own institutions, including the political institutions which represent either the heads of States or governments, the EU citizens or the EU as a whole. In the field of financial services, the EU established in 2011 the European System of Financial Supervision (ESFS) in order to ensure financial stability through the consistent implementation of the single rulebook, foster supervisory cooperation and convergence, and ensure confidence in the financial system. The European Securities and Markets Authority (ESMA), as part of the ESFS along with other European Supervisory Authorities (ESAs), has the aim of improving coordination amongst securities regulators and fostering a harmonized implementation of community legislation in EU Member States. ESMA's work on securities legislation contributes to the development of a single rule book in Europe. ESMA also has certain direct supervisory responsibilities for certain entities with pan-European reach, such as credit rating agencies and trade repositories. ESMA has been granted with powers which enable it to foster the consistent implementation of EU law as well as to ensure the convergence of supervisory practices of national authorities such as through the use of peer reviews. It has also been granted with powers of mediation and binding mediation, as well as the power to address instances of non-application or incorrect application of Union law amounting to a breach thereof.

²⁷ In addition to this sectorial legislation, there are other pieces of legislation which underpin the functioning of the passporting system in the EU, while offering protections to investors. These include the Market Abuse Regulation and Market Abuse Directive which support the framework for ensuring investor protection and market integrity. ESMA has also established a MMoU related to exchange of information and cooperation among its members and, in certain circumstances, with ESMA itself in relation to the regulation of securities and financial markets in the EU and in the EEA. In addition, investment firms are subject to capital and prudential requirements derived from the standards of the Basel Committee on Banking Supervision.

examples in section 5.3 below) is based on the grant of a single authorization by the home Member State authority valid throughout the EU and the application of the principle of home Member State supervision.²⁸

In the EU, holders of an authorized “passportable” activity may either be able to provide their services in other Member States directly, under the freedom of providing services, or by establishing a branch. In order to benefit from passporting, the firm will have to notify its home Member State competent authority that it wishes to provide these services in a particular jurisdiction. The home competent authority will communicate to the host competent authority the passport (by using standardized templates). The possibility for an authorized entity to use its passport extends to the three European Economic Area (EEA) States, which have agreed to enact legislation similar to that passed in the EU and to adapt the EEA Agreement accordingly, although not all of the relevant legislation has been incorporated into the EEA Agreement yet (the Alternative Investment Fund Managers Directive (AIFMD) being one example).

In the EU, the effectiveness of the passporting arrangement is ensured by substantive implementation of common rules across the jurisdictions involved. There are limitations in the ability of host regulators to prevent or control access to their markets by firms that hold passporting rights in other jurisdictions or to challenge authorization given by the home Member State. Often host regulators are expected to contact the home regulator in the first instance in the case of concerns over the conduct or compliance of firms operating in their markets. In other cases where the home and host regulators have agreed on how supervisory tasks are shared, the host regulator may take supervisory action directly. Hence, effective cooperation arrangements and dispute resolution processes will remain important.

Passporting in Canada

In Canada, members of the Canadian Securities Administrators, other than Ontario, adopted a Multilateral Instrument 11-102 Passport System (MI 11-102). MI 11-102, in effect, provides that a market participant can obtain receipt for a prospectus, seek exemptive relief, or may become registered by generally dealing only with its principal regulator (i.e. the regulator in the Canadian jurisdiction in which its head office is located or with which it otherwise has the most significant connection).

In order to implement MI 11-102, the participating provinces and territories adopted specific rule-making powers in their respective statutes. Moreover, a key foundation for the passport system is a set of nationally harmonized regulatory requirements that are consistently interpreted and applied throughout Canada. Although Ontario has not adopted MI 11-102, interfaces have been implemented that provide for decisions made by the Ontario Securities Commission to apply automatically in the jurisdictions of the other provinces and territories.

²⁸ The principle is subject to limited exemptions. As discussed below in relation to the MiFID passport and the UCITS management company passport, the supervision and enforcement of compliance with conduct of business rules in the territory where the branch is located is entrusted to the host Member State authority.

The passport system provides market participants with a single window and streamlined access to Canada's capital markets:

- Issuers who file a prospectus in multiple Canadian jurisdictions:
 - comply with harmonized prospectus disclosure requirements;
 - are subject to a prospectus review by only one securities regulator, namely, their principal regulator;
 - obtain a receipt for the prospectus from their principal regulator; and
 - have their prospectus automatically deemed to be issued in each of the other relevant jurisdictions following the decision by their principal regulator.

- Market participants requiring discretionary exemptions in multiple Canadian jurisdictions:
 - generally need only file an application in their home jurisdiction;
 - have their application reviewed by their principal regulator;
 - obtain a decision from their principal regulator; and
 - are automatically exempted from equivalent provisions in each of the other relevant jurisdictions following the decision by their principal regulator.

- Firms or individuals that are registered in a category as dealer or adviser in their home jurisdiction and apply for registration in the same category in another passport jurisdiction:
 - make a single submission;
 - have the submission reviewed by their principal regulator; and
 - are automatically registered in the other jurisdiction if the firm or individual is a member of any self-regulatory organization required for that category.

- Credit rating organizations that wish to be designated as a “designated rating organization” in multiple jurisdictions so that their ratings may be relied upon for securities regulatory purposes:
 - make a single application;
 - have their application reviewed by their principal regulator; and
 - are automatically deemed to be designated in each of the other relevant jurisdictions following the decision by the principal regulator.

5.2 Regulatory Objectives

Passporting requires extensive harmonization and implementation of a common set of rules in each jurisdiction that is a party to the arrangement.

Survey respondents have identified specific regulatory objectives which they intend to achieve through passporting. The main objectives are as follows:

- to ensure adequate investor protection through harmonized standards;
- to facilitate market access, enhance competition and improve capital flows by providing market participants with efficient access to the entire EU market;
- to enhance convergence in supervision practices;
- to reduce risks of regulatory arbitrage;
- to strengthen regulatory ties and improve supervisory and enforcement cooperation with foreign market regulators; and
- to guard against systemic risks in the face of increased access to foreign services, products and market infrastructures.

5.3 Examples

5.3.1 Offering of Securities and UCITS Funds

Example 14: UCITS Passport

The UCITS Directive in the EU facilitates, inter alia, the cross-border marketing of funds which invest in transferable securities, allowing a UCITS authorized by its home Member State to be distributed to investors across the EU upon notification by the home to the host Member State competent authorities. The UCITS passport is based on the principle of home country supervision and the existence of harmonized rules concerning, inter alia, the authorization, supervision, structure and activities of UCITS and the information that they are required to publish.

Example 15: Prospectus Passport

The Prospectus Directive in the EU introduces a single passport for issuers so that once a prospectus has been approved by the home country authority of the issuer in one Member State it will be accepted throughout the EU for public offer and/or admission to trading on regulated markets. One of the objectives of this passport is to make it easier and less expensive for companies of all sizes to raise capital throughout the EU while also ensuring that investors are protected by one set of regulations regarding the drafting, approval and distribution of the prospectus. The passporting process is based on a notification procedure by the home to the host Member State competent authority, which includes a certificate of approval of the prospectus being issued by the former to the latter authority at the request of the issuer. The main responsibility for the approval of a prospectus and for taking actions in case of irregularities lies with the competent authority of the home Member State. ESMA also has a role in fostering a harmonized approach by providing guidance.

Issuers from non-EU/EEA states (“third countries”) may also benefit from the passport in case of an offer to the public or admission to trading on a regulated market in a Member State different from the home Member State of the issuer (as defined in the Directive). This process is described in Example 18.

5.3.2 Provision of Investment Services and Collective Portfolio Management Activities

Example 16

A. MiFID Passport

According to the Markets in Financial Instruments Directive (MiFID) in the EU, investment firms authorized in their home Member State may provide any or all of the investment services and activities for which they have received authorization throughout the EU by establishing branches or under the freedom to provide services, on the basis of the home country authorization and supervision. By way of derogation from this principle, the responsibility for enforcing certain rules in relation to business conducted through a branch within the territory where the branch is located is conferred on the host Member State competent authority.²⁹ The revised Markets in Financial Instruments Directive (MiFID 2) retains the principle of the EU passport described above.³⁰

²⁹ For firms operating with a MiFID passport, a Transaction Reporting Exchange Mechanism has been put in place, under which the intra-EU availability of data regarding trades is ensured. Moreover, under the framework of MiFID, the Committee of European Securities Regulators (CESR), which was later replaced by ESMA, issued a “Protocol on the Supervision of Branches under MiFID” regarding the practical cooperation arrangements under MiFID for the supervision of business conducted through branches established in a Member State other than the home Member State of the investment management company. CESR issued a “Protocol on MIFID Passport notifications” to harmonize the communication procedure.

³⁰ MiFID does not regulate the provision of services by third country firms in the EU, which remains subject to national regimes and requirements. Firms authorized in accordance with such national regimes do not enjoy the freedom to provide services and the right of establishment in Member States other than the one where they are established. MiFIR introduces a harmonized third country equivalence regime for the access of third country investment firms to the EU when providing services to “professional clients per se” and eligible counterparties. The access is subject to a number of conditions, including an equivalence decision taken by the European Commission and the existence of cooperation arrangements between ESMA and the third country authority. Moreover, MiFID2 introduces a minimum common regulatory framework at Union level with respect to the authorization of third country firms, where a Member State requires that a third-country firm establish a branch to provide investment services or to perform investment activities in its territory to retail clients or to those retail clients who request to be considered professionals. The conditions includes the existence of appropriate co-operation arrangements between the two countries.

Example 16 (Continued)

B. UCITS Management Company Passport

In addition to the UCITS passport, the UCITS Directive permits a UCITS management company authorized by its home Member State to provide the activities for which it has received authorization throughout the EU by establishing branches or under the freedom to provide services, subject to a notification procedure by the home to the host competent authorities (UCITS management company passport). This means that a UCITS is permitted to be managed by a management company authorized in a different Member State. In such case the management company is required to comply with the rules of its home Member State which relate to the organization of the management company as well as with the rules of the UCITS home Member State which relate to the constitution and functioning of the UCITS. To establish a branch, the management company is required to observe the conduct of business rules established by the management company's host Member State.

C. Alternative Investment Fund Managers Passport

The aforementioned UCITS Directive does not cover alternative investment funds (AIFs), which are directed at professional investors. The Directive on Alternative Investment Fund Managers (AIFMD) creates a harmonized regulatory structure for alternative investment fund management across the EU. It sets harmonized regulatory standards for the authorization, ongoing operation and transparency of all the AIFMs within its scope, including those which have their registered office in a third country. As part of this, the Directive contains provisions for a 'passporting' system which allows the marketing of AIFs (EU and non-EU) to professional investors within the EU by authorized AIFMs (EU and non-EU). The Directive also gives passport rights to authorized EU or non-EU AIFMs in relation to the management of EU AIFs established in a different Member State, either directly or by establishing a branch.

5.4 Assessment

Survey respondents utilizing this tool in the EU generally considered that a single passport, especially the passport for prospectuses, allows market participants access to the market of the whole EU, reduces risks of regulatory arbitrage and enhances convergence in supervision practices, while also ensuring investor protection.

Survey respondents considered that the EU framework:

- allows market participants access to the market of the whole EU;
- is sufficiently granular;
- is based on binding rules, agreed at the EU level;
- ensures timely and consistent implementation within the EU and enhances convergence in supervision practices;

- prevents duplication of supervisory work as it provides for shared responsibilities among national competent authorities and/or between national competent authorities and ESMA;
- reduces risks of regulatory arbitrage; and
- allows for the emergence of a level playing field among participants in the system.

6. Choice of Cross-Border Regulatory Tools

This section sets out issues identified by survey respondents as considerations when choosing a cross-border regulatory tool. The following items are not intended to be prescriptive nor comprehensive because the choice of cross-border regulatory tools and how they are applied are inherently situation- and jurisdiction-specific considerations. Regulators should review all the tools available and afford sufficient flexibility in determining which tool would be the most appropriate for their market in order to achieve their regulatory objectives.

Based on the survey responses, the main considerations in determining the choice of cross-border regulatory tools are as follows:

- **Type of cross-border securities market activity and associated risks**

Survey respondents broadly agree that in any situation, the type of product, service, or entity being regulated is critical in determining which tool to utilize and how it is to be applied. Depending on the activity involved, the risk posed to the domestic market varies and can be best addressed in different ways. A more cautious approach may be used where a particular activity could threaten financial stability or a particular vulnerable group, such as retail investors.

For example, the operation of a cross-border clearing facility could involve issues of financial stability, while the offering of a managed investment product cross-border may involve mainly investor protection issues. If the relevant activity involves less-sophisticated investors, additional regulatory obligations may be imposed to reflect their greater vulnerability. Some types of activity may lend themselves to particular regulatory relief that are available, while others, for various reasons, including systemic importance or inherent risks, may necessarily continue to be subject to the full panoply of applicable regulations or, in some cases, even restrictions on the location of its operations.

- **Robustness and effectiveness of the foreign regulatory regime**

Another factor that could play a part in determining the choice of cross-border regulatory tool is the robustness and effectiveness of the relevant foreign regulatory regimes. Some survey respondents remarked that reliance on foreign regulatory regimes was more likely if they were found able to achieve similar regulatory outcomes and objectives as the domestic regime.

- **Costs and benefits to regulators and securities markets**

There are both monetary and non-monetary costs and benefits to consider when determining the appropriate cross-border regulatory tool.

In the case of national treatment for instance, some survey respondents who utilize this tool indicated that they do not need to expend time and resources in conducting and

maintaining assessments of foreign regulatory regimes, time which they can use instead to pursue other regulatory imperatives. According to these respondents, this tool could have the benefit of:

- enabling cost-effective use of finite regulatory resources;
- eliminating the need to make judgments regarding foreign regulatory regimes;
- promoting fairness among all market participants, by placing domestic and foreign entities on the same footing;
- promoting transparency in the regulatory process for accessing the domestic market;
- ensuring that important protections normally provided to investors in the domestic market continue to apply;
- ensuring consistent application of enforcement tools;
- decreasing the risk of regulatory arbitrage; and
- giving domestic policy makers and regulators the freedom to adapt domestic regulation to market developments as appropriate.

Survey respondents who utilize the national treatment tool also indicated that it creates a level playing field for market participants in that they (i) are aware from the outset of the specific requirements necessary to register and operate within the applicable jurisdiction and (ii) are not subject to potential discriminatory effects (even where discriminatory intent is lacking) in markets where participants from less-developed markets are potentially excluded by virtue of the fact that authorities would target evaluations of foreign regulatory regimes toward larger and more sophisticated markets.

On the other hand, the use of national treatment may have down sides:

- in the absence of full cooperation with the foreign regulator(s) that also has oversight over the given entity or affiliated entities, the domestic regulator may not readily identify governance problems of the supervised entity;
- risks that investors are unable to recover losses, enforce judgments, or otherwise be made whole;
- it may limit cross-border activity by certain market participants, as entities may not wish to conduct business in a jurisdiction which applies national treatment due to the cost of compliance with the standards and reporting requirements of the foreign regulator; and
- it may require licensing/registration and supervision of the same activity by two or more supervisory authorities.

In the case of recognition, jurisdictions may enjoy the following benefits:

- cost-effectiveness of the supervision process, due to reliance on foreign regulators on certain aspects of supervision;
- strengthening of regulatory ties once unilateral or mutual recognition is established and operating smoothly; and
- increased competition as the compliance costs for domestic and foreign entities are lower than if such entities had to fully comply with several sets of regulations. Operating on a cross-border basis under mutual recognition may involve lower costs than operating under unilateral recognition. This is because mutual recognition involves greater reliance on the relevant foreign regulator, and closer cooperation between regulators reduces the need for direct contact between the foreign entity and the relevant regulator in the host jurisdiction. Example 17 is provided below to illustrate this point.

The recognition tool also has possible negative aspects, including the following:

- the assessment of foreign regulatory regimes before the set-up of a recognition regime can be a resource-intensive exercise;
- reliance does not exclude the right of a regulator to intervene in the case of supervisory gaps or non-compliance. However, spotting these regulatory gaps may be a difficult task when a regulator attempts to rely on another regulator for supervision purposes; and
- risks that investors are unable to recover losses, enforce judgments, or otherwise be made whole.

Between mutual and unilateral recognition, some survey respondents expressed a preference for mutual recognition as it incentivizes and drives an expectation of reciprocity.

Example 17: Tangible benefits of mutual recognition

In 2008, Australia and New Zealand established mutual recognition for securities offerings so that an issuer who is lawfully offering a product in its home jurisdiction can offer it in the other jurisdiction by using a single disclosure document prepared under home regulations. This mutual recognition arrangement is premised on the principle of substituted compliance which allows each jurisdiction to rely on an issuer's substantive compliance with the rules of the other jurisdiction.

From 30 June 2008 to 12 November 2013, there were 80 New Zealand offers made to Australia and 1035 Australian offers made to New Zealand to facilitate financial integration. In 2009, ASIC published a report setting out outcomes of a survey of 10 firms that participated in the Australia-New Zealand mutual recognition of securities offers. The report found that the mutual recognition scheme was viewed as a welcome policy development because it:

- reduced firms' costs. Firms cited legal and documentation cost savings as being the predominant savings available. The cost-savings for some firms who were able to quantify them varied from approximately 55% to 95%.
- accelerated the regulatory approval process, which allowed securities offerings to reach the market more quickly.

It was further noted from some survey responses that mutual recognition will be pursued if possible once unilateral recognition has been established. This means that in certain cases, markets may still have the benefits of unilateral recognition where mutual recognition is not immediately feasible.

With regard to passporting in Europe, the jurisdictions which implemented this tool identified the following benefits:

- prevents duplication of supervisory work as it provides for shared responsibilities among national regulators and, where applicable, ESMA;
- encourages fair and equal treatment of all market participants, as passporting creates a level playing field for those able to comply;
- establishes a high level of common regulatory standards, which is beneficial from the perspective of investor protection, market integrity, reduction of systemic risks, crime and misconduct and effectiveness of anti-money laundering and counter-terrorist financing measures;
- allows for increased competition due to efficient market access;
- decreases risks of regulatory arbitrage, as the applicable rules are the same throughout all states that are party to the passporting agreement;

- enhances convergence in supervision practices; and
- ensures that states participating in the passporting agreement have similar enforcement standards and practices in the field concerned by the passporting agreement.

On the down side:

- Passporting may be difficult to implement outside of an integrated framework of economies such as the EU/EEA, because the standards to be applied require the agreement of all participating states, usually in the form of a treaty or a convention;
- the passporting agreement must be sufficiently granular for participating states to implement the system; and
- there is a need for a system to share information among regulators, which may be costly to put in place.

In the only currently existing example of passporting under a treaty (i.e., the EU), a central governing body has oversight of all the states participating in the passporting agreement, to provide implementation guidance and ensure harmonized supervision practices. Such a central governing body may be necessary to implement passporting effectively in the international context, which may be difficult to create in other geographical contexts.

7. Cross-Border Regulatory Challenges

7.1 Challenges from a Regulator's Perspective

In the previous sections of this report, the Task Force has attempted to capture an overview of the cross-border regulatory tools currently adopted by survey respondents in the form of a Toolkit. This section provides a summary of the main challenges which survey respondents have raised regarding the coordination and effective implementation of those tools. In this regard, the survey did not limit respondents' views solely to regulatory tools described in their own survey responses.

Cross-border regulatory challenges identified by regulators in the survey are summarized as follows:

- There are **few universal principles** that guide the way regulators coordinate on cross-border regulation and resolve disputes arising from potential or apparent conflicts of interest and laws among jurisdictions. **National law**, which binds the actions of regulators, predominantly governs cross-border interaction. Members rely on their **relationships with one another**, including bilateral or multilateral non-legally binding arrangements between regulators, to facilitate cross-border activities. National policy, legislation and sovereignty are important factors that affect how cross-border issues are addressed.
- **Lack of granularity and consistent implementation as well as interpretation of IOSCO principles and standards.** IOSCO has set out high-level principles and standards that it believes should be universally adopted, but there is no legal commitment by governments to follow the standards and principles and translate them into specific and detailed laws at a national level. In some cases, a government or regulator could validly argue that another jurisdiction's application of the principles and standards, while it may be adequate in that jurisdiction, would not be appropriate if applied in the circumstances of another jurisdiction. Consequently, internationally-agreed principles and standards often become the minimum standards of regulation among regulators in more advanced markets.
- **Lack of consensus on the level of sufficient quality that enables the domestic regulator to rely on foreign regulatory regimes.** There is still an ongoing debate on what a "similar outcome" means. This may result in inconsistencies in how this concept is interpreted, especially when assessments of foreign regulatory regimes are typically made on a bilateral basis.
- **Lack of legal certainty on cross-border interactions and no early warning system as to whether a national regulator's rules may have a cross-border element.** Some survey respondents believe that the main challenges lie in communications with relevant regulators to exchange views on how cross-border regulatory tools with cross-border impact should be implemented in practice, taking into account jurisdiction-specific circumstances. The extent to which domestic financial institutions operate in multiple jurisdictions also appears to be a significant driver of the degree to which domestic laws

and regulations may have effects in other jurisdictions, and thereby interact with the laws and regulations of such other jurisdictions. This means that jurisdictions with similar, extensive commercial reach overseas (so that their financial institutions have a material presence in each other's territories) tend to have more complex legal and regulatory interactions with each other than those that have less commercial reach overseas. In addition, where the degree of commercial reach might be unbalanced, the jurisdiction with less reach may be subject to cross-border effects and accordingly, implementation issues that would require deliberation and resolution could arise.

- **Challenges in facing cross-border impact from regulatory reforms overseas.** Some surveyed regulators indicated that the one-size-fits-all application of regulatory reforms initiated overseas may be inappropriate for other markets of different sizes and levels of maturity.
- **Limitations on supervisory and enforcement oversight of cross-border securities market activities.** Supervisory information sharing arrangements among certain relevant regulators are in development to address potential issues relating to the oversight of certain cross-border securities market activities. In some cases, there may be a lack of clarity on whether the domestic or foreign regulator is responsible for oversight and the measures which the responsible regulator is authorized to impose in cases of violations of laws and regulations. This lack of clarity, together with the difficulties in establishing a dispute resolution mechanism for investors who have purchased cross-border financial products or services, could have an adverse impact on domestic investor protection. In addition, the implementation of cross-border regulatory tools and the ongoing oversight regarding their effective implementation could imply a heavy commitment of regulatory resources.
- **Insufficient access to overseas data and documents.** Regulators may experience difficulty obtaining access to data and documents due to barriers such as data protection laws and regulations, privacy laws and regulations, client confidentiality laws and regulations or legal professional privilege that preclude the sharing of relevant information with other regulators, including key supervisory information.
- **Issues stemming from reliance.** Some jurisdictions are uncomfortable in relying on a foreign regulatory framework due to lack of data and experience. Even if the rules as written are identical in both jurisdictions, there is a need for adequate enforcement and supervision before a jurisdiction may consider relying on a foreign jurisdiction's set of rules. Some survey respondents are of the view that their domestic legal framework focuses on the role and responsibilities of the domestic regulator and may not allow for reliance on overseas regulators even where appropriate safeguards are put in place.
- **Limitations on regulatory coordination.** Some survey respondents believe that regulatory coordination is less likely to be successful or may not be feasible at all where differences in regulatory approaches arise from differences in regulatory regimes governing diverse market structures, having different market objectives, enforcement or inspection intensities and the level of retail versus institutional market participation.

7.2 Stakeholders' Perspective

In April 2014, the Task Force organized three meetings in Hong Kong, London, and Washington D.C. with industry representatives, academics and other key stakeholders to gather views on the current state of cross-border regulations, challenges, and possible solutions.³¹

Representatives from the industry and academia also provided written comments, including case studies from various business lines, to demonstrate the challenges market participants face in operating and investing in markets around the world.³²

In summary, participants reported particular issues in a number of areas of cross-border business and its regulation:

- Reporting requirements (both for derivatives and otherwise): Participants indicated that the area of OTC derivatives reporting raised significant compliance challenges.
- OTC derivatives clearing and settlement: Participants highlighted serious ongoing issues arising in this area.
- Client classification frameworks (e.g. definitions of professional investors): Participants noted problems raised by inconsistent approaches to client classification frameworks across jurisdictions.
- Limitations on business conducted (e.g. the Volcker Rule, Vickers Plan): Participants indicated that jurisdictionally-applied limits on business lines posed particular issues at present.
- Inconsistent approaches to trading hours and exchange settlement systems: This was a particularly problematic issue in the context of cross-border securities settlement.
- Inconsistencies in anti-money laundering, tax evasion and know-your-customer rules: Issues were raised regarding the difficulties with compliance across jurisdictions.
- Differences in licensing standards and exemptions (e.g. for investment advisors): Variances in treatment posed challenges for firms in marketing products and services.
- Impediments to domestic and/or cross-border sharing of data among regulators: This was a particularly relevant issue for firms active across a large number of markets.
- Differences in accounting standards: This has been identified for a long time and continues to raise issues.

At the same time, participants identified a number of areas where cross-border approaches had, from their point of view, been successful, including:

³¹ Minutes of the stakeholder meetings in Hong Kong, London, and Washington D.C. are available at: http://www.iosco.org/library/index.cfm?section=tf_xbr_roundtable_meeting_notes

³² Written comments from industry associations are available at http://www.iosco.org/library/index.cfm?section=written_submissions_tf_xbr

- Harmonization of performance reporting standards for asset managers;
- The Legal Entity Identifier initiative;
- Cross-border liberalization of asset management (e.g. in the EU and elsewhere through UCITS recognition);
- Intra-regional access in the EU via the passporting system;
- Margin rules on non-centrally cleared derivatives;
- IOSCO's work on benchmarks; and
- Rules on short selling and position reporting.

Participants thus felt that there was clear scope to learn from the successes and for IOSCO to support efforts which could help to identify and address issues where there were particular challenges for firms. Overall, industry participants expressed a clear preference that regulators agree to harmonize rules that would apply to large firms operating cross-border, before the enactment of domestic rules which have a cross-border effect on firms. They identified challenges stemming from a lack of sufficient coordination among regulators in supervising cross-border businesses and sharing information on regulatory requirements or approaches. In certain cases, industry representatives believe that a lack of coordination among regulators in setting implementation dates for rules impacting global markets and promulgating duplicative, inconsistent and conflicting requirements which lead to significant compliance burdens and unnecessary barriers to cross-border trading and investment.

From the industry's perspective, many of the current cross-border challenges arise due to the fact that there is an inherent focus on domestic markets among regulators as they generally have as their primary responsibility the regulation of their domestic territory and are explicitly required by national law to consider the impact of their rule-making, supervision and enforcement on their domestic market as a priority, rather than consider any effect outside their jurisdiction. Further, if instead regulators were also to focus on the impact of cross-border inconsistencies, there would be improved implementation of rules and increased coordination between regulators both domestically and internationally.

8. Regulators' and Industry's Preliminary Suggestions on IOSCO's Role regarding Cross-Border Issues

From the information and analysis derived from consultation so far, no consensus exists on the question of whether cross-border regulation of the securities markets would best be achieved by full coordination and total harmonization of cross-border rules among jurisdictions, even if those goals were somehow achievable. The responses, however, make clear that such a result is not achievable in the current context, noting the absence of any supranational institution with legal authority to impose harmonized regulations from the top down.

This section of the report presents a summary of the suggestions and viewpoints provided by surveyed and consulted regulators and industry representatives on IOSCO's potential role regarding cross-border issues. The Task Force notes that such suggestions and viewpoints have not been verified or discussed substantively to determine their viability. Accordingly, the summary below should not be construed to represent guidance from the Task Force, nor should it be viewed as the understanding, agreement, or support of any particular Task Force member or its respective institutions or principals.

- **Enhancing international dialogue:** According to certain survey respondents and commenters, IOSCO could consider enhancing international dialogue between policy makers and regulators among the various jurisdictions. Respondents believe that this could allow for better coordination and early identification of cross-border implications and of possible conflict areas before final laws and regulations with cross-border impact are adopted, taking into account the diverse political and regulatory circumstances of concerned jurisdictions. Further, this dialogue could potentially enable regulators to highlight limitations in their ability to resolve conflicts arising from the cross-border impact of certain cross-border regulations, which are often predetermined by and the result of distinct national policy choices made on a political level.
- **Central hub of information:** Some survey respondents and commenters also believe that IOSCO could provide a central hub of information where regulators can share their analysis relating to the implementation or cross-border impact of existing or proposed cross-border regulatory tools. In this view, the establishment of a clearinghouse for information could facilitate better understanding of the success, or the obstacles to success, of a particular tool in different jurisdictions, and could also help to share experiences in supervision and/or regulation.
- **Forum:** Certain survey respondents and commenters further believe that IOSCO and its regional committees can provide a forum for members to discuss the potential advantages and disadvantages of various cross-border regulatory tools, while recognizing the unique regulatory regime and tool and, in some instances, objectives of each jurisdiction.
- **Technical assistance:** According to certain surveyed regulators and industry representatives, a number of benefits can be derived from IOSCO serving as a facilitator to provide assistance when cross-border regulatory tools are formulated and when regulators are assessing foreign regulatory regimes for their ability to achieve similar regulatory outcomes.

Some commenters believe that IOSCO could consider organizing capacity building programs and providing technical assistance for members to enhance their understanding of the regulatory tools they envisage to use and the applications of such tools to govern cross-border securities market activities. Survey responses have indicated that it may be helpful to regulators from growth and emerging markets with limited resources if IOSCO could provide technical assistance in conducting equivalence or comparability assessments of overseas regulatory regimes.

- **Development of informative guidance on cross-border regulatory tools:** According to certain survey respondents and commenters, IOSCO could develop informative guidance on cross-border regulatory tools for policy makers and regulators to consider when developing or revising such tools. In particular, these commenters believe that such non-binding guidance may be helpful when the domestic regulator is evaluating tools to regulate entities operating in foreign jurisdictions whose regulatory regime or oversight is unfamiliar. Such guidance may be sector-specific e.g. to address the particularities and risks of each given sector in terms of financial stability, risks of contagion, risks inherent to the activity as well as volume of cross-border activity.
- **Guidelines for assessing foreign regulatory regimes:** Some respondents also noted that IOSCO could attempt to establish guidelines for assessing foreign regulatory regimes. In their view, any principles or common guidelines developed should be flexible enough to take into account the size of the economies involved, the nature and complexity of the markets, their different stages of development, etc. These respondents further expressed a view that such a step would help promote convergence when regulators are developing frameworks both for cross-border activities and for supervisory regulation.
- **Increasing level of granularity of standards:** Certain surveyed regulators also believe that IOSCO could encourage the use of international standards and principles (as applicable) as benchmarks by increasing their level of granularity. These respondents posit that this action could help avoid frequent and material differences in implementation. Nonetheless, others have also highlighted the need for a certain level of flexibility in order to accommodate national and regional differences. There were also suggestions to include, as a standard practice, specific chapters in international standards which discuss the effects of international standards on cross-border activities, including cooperation among supervisory authorities.

While increasing granularity may be feasible in some instances, some survey respondents believe that it is unlikely that IOSCO would be able to successfully adopt sufficiently granular standards in many instances due to jurisdiction-specific laws, regulations, and policy choices. Incorporating existing international standards and principles as “benchmarks” for cross-border regulatory approaches runs the risk of transforming them into a hard ceiling, which may limit a member country’s flexibility in properly regulating its markets, and discourage the development of innovation in regulation or the imposition of higher standards given vastly different market structures, regulatory philosophies, or other jurisdiction-specific reasons.

- **“Conflict of regulations” framework:** Some respondents and commenters also suggested that IOSCO could propose a “conflict of regulations” framework, which would

be used to determine the regulation that applies and the regulator which has jurisdiction in a specific cross-border situation. In their view, such a framework may increase efficiency and prevent duplication of supervisory work with regard to reporting. These responses also noted that IOSCO could propose a granular set of rules determining the regulation that applies with regard to the reporting duties and designate the regulator to which the concerned market participant has reporting duties. The other regulators involved could have a right of access to the information. Regulators applying these rules would benefit from a predictable regulatory outcome as well as a reduction of supervisory workload.

Based on the survey responses, there was little support for IOSCO to attempt to coordinate the timing among jurisdictions' implementation of cross-border regulatory tools or to facilitate the settlement of disputes arising from the assessment of foreign regulatory regimes.

As such, if IOSCO was to have a role in dispute settlement it would most likely be informal and non-binding.

9. Request for Comments

The Task Force requests and encourages all interested persons to submit comments regarding their experiences with, and understandings of, the cross-border securities markets as characterized in this report.

The Task Force welcomes comments from all members of the public and other relevant stakeholders, including, but not limited to, investors, members of the securities industry, representative trade bodies, market professionals, academics, regulators, self-regulatory organizations, and policy makers. While the Task Force appreciates all of the feedback it receives, comments are of particular assistance when they are accompanied by supporting data and analysis of the issues addressed therein. The Task Force also urges commenters to be as specific as possible.

10. Next Steps

After the conclusion of the consultation period, the Task Force will review and analyze the responses and feedback received. The key findings from this exercise will be used to form the basis of the final report and may provide important input and ideas to the IOSCO 2020 Working Group which is tasked to identify and develop IOSCO's priorities over the next five years.

Appendix 1

Process for Assessing Foreign Regulatory Regimes

A1.1 Introduction

The purpose of Appendix 1 is to provide additional information and illustrative examples of the process for assessing foreign regulatory regimes in the context of an assessment for unilateral or mutual recognition as outlined in section 4. It is based solely on an analysis of the responses from surveyed jurisdictions that assess foreign regulatory regimes in order to establish unilateral or mutual recognition and should be viewed simply as a compendium of the survey responses received by the Task Force thus far. Appendix 1 is not a comprehensive summary or list of the processes used by all jurisdictions, and it is not intended to serve as a model, recommendation, or guidance from the Task Force for how jurisdictions should review foreign regulatory regimes. Specific contexts of the assessments being undertaken are illustrated in selected examples below.

A1.2 Assessment Steps

There are four steps in the assessment process: identify regulatory outcomes, select regulatory outcome measures, gather materials for evaluation, and evaluate gathered materials. Each of these steps are described in the following sections using actual examples and information on the current practices of jurisdictions derived from the survey responses.

A1.3 Identifying Regulatory Outcomes

The first step is for the domestic regulator to identify a set of regulatory outcomes for the purposes of the assessment. Based on the survey results, these outcomes have to be achievable by the domestic regulator itself, and relevant to the unilateral or mutual recognition arrangement under consideration. The foreign regulatory regime will be assessed in subsequent stages as to whether and to what extent it also achieves these regulatory outcomes.

The key regulatory outcomes commonly identified by survey respondents are as follows:

- domestic investor protection;
- maintenance of local market integrity;
- reduction of regulatory arbitrage;
- reduction of systemic risk, crime and misconduct in the domestic financial system; and
- effectiveness of anti-money laundering and counter-terrorist financing measures implemented in the foreign jurisdiction.

A1.4 Selecting Regulatory Outcome Measures

After identifying regulatory outcomes, the second step is for the domestic regulator to select the regulatory outcome measures. Regulatory outcome measures are defined as the different aspects of the foreign regulatory regime or methods that would provide information about the extent to which the foreign regulatory regime has achieved the regulatory outcomes identified.

The survey results point out 8 of the most commonly used regulatory outcome measures:

- **General analyses of foreign securities laws, regulations, requirements and standards:** Such analyses provide a means to determine the clarity and transparency of the foreign regulatory regime, and to obtain an overview of the foreign legal and regulatory framework. Such analyses can also be valuable to the domestic regulator by providing insights into the foreign regulator's objectives, roles and general powers, and whether it operates in a regulatory environment with an independent legal system and a well-founded reputation for integrity.
- **Specific analyses of foreign securities laws, regulations, requirements and standards, both as written and implemented, with respect to the cross-border activity considered under the proposed unilateral or mutual recognition arrangement:** The domestic regulator can assess whether the relevant provisions are comprehensive and how they are applied in practice, including, for example, the criteria for licensing, authorization or registration, and the obligations of the foreign entity under its home regulation.
- **The level of investor protection in the foreign jurisdiction:** Investor protection safeguards in the foreign jurisdiction provide insights into how well domestic investors who are involved in cross-border securities transactions are protected. These safeguards can include the exercise of rights by investors, investor compensation schemes, disclosure requirements imposed on market participants and dispute resolution mechanisms.
- **Enforcement capability of the foreign jurisdiction:** This provides information regarding the foreign regulator's powers and tools of investigation and enforcement. The domestic regulator can examine if the foreign regulator has the resources to use those powers and tools, and whether it effectively uses those powers and resources to promote compliance with the regulatory regime.
- **The level of supervisory oversight in the foreign jurisdiction:** This provides information about the nature, comprehensiveness and extent of the foreign regulator's oversight program for a particular cross-border entity. For example, the domestic regulator can understand how issues are identified and resolved by the foreign regulator, whether there is a dedicated team assigned to the oversight of a specific entity, and whether periodic on-site inspections or examinations are performed.
- **Legal framework for and implementation of international cooperation:** Analysis of the foreign jurisdiction's legal framework provides information about the nature of its supervisory and enforcement cooperation with other jurisdictions, including the ability to cooperate when conducting on-site inspections or examinations. This can be

complemented by further information about the foreign jurisdiction's actual track record for international cooperation, which provides a certain degree of assurance in its ability and willingness to provide mutual assistance to the domestic regulator. Past dealings with the foreign regulator based on existing cooperation arrangements provide evidence as to whether it has been generally forthcoming in rendering assistance when called upon.

- **Analysis of results from standardized assessments by international organizations:** Results from standardized assessments³³ conducted by international organizations such as the Financial Action Task Force (FATF), the Financial Stability Board (FSB), the International Monetary Fund (IMF), IOSCO and the World Bank show the foreign jurisdiction's level of compliance with international principles and standards, such as the IOSCO Principles and Objectives of Securities Regulation. This may be useful to the domestic regulator in evaluating the extent to which predetermined regulatory outcomes can be achieved by the foreign jurisdiction.
- **Membership and status in international organizations, regional communities or groups:** These reflect certain qualities of the foreign jurisdiction's securities regulatory regime, including the extent to which the foreign regulatory regime complies with international principles and/or standards, the effectiveness of its anti-money laundering and counter-terrorist financing measures, and/or its ability and willingness to cooperate closely and exchange information with the domestic regulator.

There are numerous issues to consider when selecting regulatory outcome measures. Surveyed regulators typically select a combination of the above outcome measures to match the needs of the unilateral or mutual recognition concerned, their regulatory philosophies and practices, and the resources and expertise available to conduct the assessment.

Different weights may also be given to the selected regulatory outcome measures. For example, some survey respondents consider the foreign jurisdiction's level of supervisory oversight as an important outcome measure while others do not assess it at all. Some regulators tend to give more weight to the foreign jurisdiction's enforcement capability than to its level of supervisory oversight because, in some cases, information on the nature, extent and mechanism of supervision is considered not as relevant in forming a view on whether the foreign regulatory regime achieves the predetermined regulatory outcomes.

A1.5 Gathering Materials for Evaluation of a Foreign Regime

The next step is for the domestic regulator to gather materials for evaluation with respect to the selected regulatory outcome measures. Information is usually gathered from the regular observation and review of foreign regulatory and market developments, foreign regulators, foreign entities in case of unilateral recognition, international organizations, participation in international regulatory fora, external law firms, and central banks in cases where foreign

³³ Examples include the Financial Sector Assessment Program (FSAP), which is a joint effort of the IMF and the World Bank, country peer reviews conducted regularly by the FSB, and thematic reviews conducted by the IOSCO Assessment Committee.

exchange issues are involved. Almost all survey respondents rely heavily on frequent and extensive discussions with foreign regulatory counterparts to address areas of concerns and seek clarifications.

A1.6 Evaluation and Use of Benchmarks

When evaluating materials gathered for the selected outcome measures, regulators find it useful to set benchmarks, where possible, to determine the extent to which the foreign regulatory regime meets the predetermined regulatory outcomes.

Benchmarks commonly used by survey respondents to evaluate a foreign regime can be divided into 2 main groups: benchmarks that reflect international standards and domestic requirements.

Benchmarks some respondents report they have used that reflect international standards include:

- aspects of domestic laws and regulations that are as strict as internationally-agreed standards, such as the IOSCO Objectives and Principles of Securities Regulation;
- a grading of “broadly implemented” assigned by international organizations such as the IMF and World Bank after the FSAP, or similar scores indicating broad compliance with internationally-agreed principles and/or standards in assessments conducted by other international organizations;
- status as a Board and/or ordinary member of IOSCO, and as a signatory under Appendix A to the IOSCO MMoU; and
- among survey respondents from emerging markets, membership in the Caribbean Community (CARICOM), the EU, the FATF, the MILA or the OECD is considered favourably.

Domestic requirements include:

- aspects of domestic laws and regulations that are stricter than or are not based on internationally-agreed standards due to the need to accommodate local market characteristics.

Evaluations of the foreign jurisdiction’s results based on international standardized assessments, international membership and status against the corresponding benchmarks above are less burdensome, but also would involve a regulator relying on an assessment whose quality it cannot verify.

Evaluations that are based on the other selected outcome measures are more complex. Survey results broadly indicate that respondents do not have a consensus on the choice and number of benchmarks used when evaluating foreign laws, regulations, requirements and standards against those of their own jurisdictions, which may be as strict as or stricter than internationally-agreed standards, or may not be based on them at all. Using whatever benchmark(s) that survey respondents deemed appropriate, any major differences and conflicts arising from the comparison

are highlighted for further discussion and analysis. This allows parties to the assessment to have a better understanding of the rationale behind the differences and conflicts, so that alternative solutions can be explored.

It appears that even though the foreign regulatory regime may operate under different mechanisms, the common emphasis among survey respondents is on whether the foreign regime can achieve actual regulatory outcomes that are overall substantively similar to those of the domestic regime (as predetermined in the first step of the assessment). Foreign regulatory regimes that satisfy this emphasis are granted a positive determination which can be labelled “equivalence”, “sufficient equivalence” or “comparability” depending on the jurisdiction concerned.

The evaluation of gathered materials may also require a careful weighting of possible defensive responses or retaliation from the foreign jurisdiction in cases where a negative determination is concluded from the assessment. There is a significant range of views from the survey responses on the importance of this consideration. While some do not think that this is important at all, others believe that any possible defensive responses or retaliation from the foreign jurisdiction may provide important insight into the regulatory relationship and the expected level of cooperation. The uncooperativeness of the foreign regulator is likely to preclude the feasibility of both unilateral and mutual recognition. Others think that this consideration is rather important as they are interested in building a solid and cordial relationship with the foreign regulator.

A1.7 Examples of Assessments

The following section provides examples from survey respondents which illustrate current approaches in conducting assessments of foreign regulatory regimes under 3 different scenarios.

- **Scenario 1 – Assessment of foreign regulatory regimes which have been implemented and can readily achieve substantively similar regulatory outcomes**

Example 18: Recognition of the equivalence of a foreign regulatory framework and of the foreign regulator’s powers

The CESR and the Israel Securities Authority (ISA) entered into discussion to look into the possibility of establishing an agreement to enable the cross-listings of companies on the Euronext and on the Tel Aviv Stock Exchange (TASE) respectively.

A task force set up by CESR in this matter conducted an assessment of the Israeli regulatory environment on the following items:

- The role and responsibilities of the regulator;
- The powers of the regulator for conducting supervision, investigation and surveillance; and
- The specific sharing of responsibilities among the parties involved for the approval of a

prospectus including the role of auditors, accounting standards, pro forma information and other information related to financial statements.

Based on this assessment and in accordance with an ESMA statement on the framework for third country prospectuses under Article 20 of the Prospectus Directive, ESMA declared that a prospectus drawn up according to Israeli laws and regulations, together with a wrap containing further information required by certain items in the Prospectus Regulation which were set out in the statement, can constitute a valid prospectus under the Prospectus Directive for the purpose of its approval by the home competent authority of a Member State. Further to this recognition, the Autorité des marchés financiers of France (AMF France) and ISA developed a process to facilitate cross-listing based on the procedures already accomplished by the home authority when delivering the prospectus to a company for the listing of its shares on the home market. This was translated into a MoU signed in 2008 and updated in 2013. The MoU is to be reviewed periodically by both authorities.

- **Scenario 2 – Assessment of foreign regulatory regimes which have been implemented but requires further efforts to demonstrate substantively similar regulatory outcomes**

It could happen in the assessment process that the foreign regulatory regime cannot readily achieve substantively similar regulatory outcomes, but may ultimately do so. In such cases, efforts from both sides to explore the feasibility of adopting other measures are crucial in order for the foreign regulatory regime to demonstrate substantively similar regulatory outcomes compared to the domestic regime.

Example 19: Limiting the scope of recognition

In preparation for the mutual recognition arrangement on market operators and broker-dealers between ASIC and the U.S. SEC, both sides identified regulatory outcomes and provided information about their respective regimes. Analyses of the operation of the two regulatory systems were undertaken and the comparison was based on consideration given to the general outcomes of the regulatory regime, rather than on comparing regulatory mechanisms used to achieve those outcomes. The comparison identified different obligations about conduct of business requirements applicable to retail clients. These differences meant that the scope of mutual recognition was limited to Australian wholesale clients.

Example 20: Applying the stricter requirement

The Hong Kong SFC and the Malaysia SC entered into a mutual recognition agreement concerning Islamic funds whilst both jurisdictions have unique market requirements. In preparation for the agreement, both jurisdictions engaged in extensive discussion to assess and analyze each other's regulatory regime, including the overall investment management framework, authorization procedures, operational requirements on the management company, content of

offering documents, and requirements on the trustee/custodian and auditor.

In areas where the requirements of the two jurisdictions differ, the stricter requirement would generally apply to ensure regulatory parity between domestic and foreign players, such as:

- Malaysian management companies are required to produce a Chinese language version of the prospectus, provide additional information in the trust deed and offering document, financial report and upon submission of application, comply with investments limits pertaining to futures contract, investments in warrants and options, etc.
- Recognized funds from Hong Kong are required to comply with additional Malaysian regulatory requirements on the content of the offering document, marketing and distribution of unit trust funds, advertisement and promotional materials, and the appointment of a representative for listed funds. In addition, the management company of the fund from Hong Kong must take various other measures to ensure that the fund is Shariah compliant.

- **Scenario 3 – Assessment of foreign regulatory regimes that are being implemented in an incremental manner**

It may not be feasible to assess the foreign regulatory regime as a whole when foreign jurisdictions are in the process of finalizing regulations and are implementing them in an incremental manner. The last example in this section illustrates an assessment approach currently employed in such a situation.

Example 21: Use of substituted compliance for assessing developing regimes

The U.S. Dodd-Frank swaps provisions and the CFTC’s related regulations apply cross-border to swap activities outside the United States if those activities have a direct and significant connection with activities in, or effect on, commerce in the United States. As such, foreign swaps dealers and major swaps participants who engage in swaps activities above certain thresholds are expected to register and comply with the CFTC’s entity-level requirements and transaction level requirements.

However, in consideration of international comity principles, the CFTC has been conducting assessments of foreign swap regulatory regimes to explore the possibility of relying on the foreign jurisdictions’ supervisory oversight through substituted compliance, where foreign swaps dealers and major swaps participants can comply with comparable regulations in their home jurisdictions as substitutes for compliance in certain relevant CFTC regulations. The assessments involve consultation with foreign regulators so that the CFTC may better analyze their regulatory regimes.

One of the difficulties in conducting the assessments to determine comparability is that many foreign jurisdictions are still in the process of finalizing and implementing their derivatives reforms incrementally. Consequently, the CFTC’s comparability determinations were made on a requirement-by-requirement basis, rather than on the basis of the foreign regime as a whole. Specific foreign requirements were analyzed against specific U.S. requirements for comparability. Using an outcomes-based approach, foreign requirements which are not identical

to U.S. requirements may be deemed comparable if they achieve substantively similar regulatory outcomes.

The CFTC has approved a series of broad comparability determinations with respect to several jurisdictions that would permit substituted compliance. It recognizes that some jurisdictions may not have swap-specific regulations in certain areas, and instead may have regulatory or supervisory regimes that achieve substantively similar regulatory outcomes as the U.S. requirements, but on a more general, entity-wide, or prudential basis. The CFTC anticipates that it will work with regulators and registrants in such jurisdictions to consider alternative approaches that may result in a determination that substituted compliance applies, and may need to take into account the timing of regulatory reforms in foreign jurisdictions that have been proposed or finalized, but not yet implemented.

Appendix 2

IOSCO Task Force on Cross-Border Regulation

Chair:	Mr. Ashley Ian Alder, Chief Executive Officer Securities and Futures Commission (Hong Kong)																														
Vice-Chair:	Prof. Anne Héritier Lachat, Chair of the Board of Directors Financial Market Supervisory Authority (Switzerland)																														
Members:	<table><tr><td>Australian Securities and Investments Commission (Australia)</td><td>Mr. Steven Bardy</td></tr><tr><td>Comissão de Valores Mobiliários (Brazil)</td><td>Mr. Eduardo Manhães Ribeiro Gomes</td></tr><tr><td>British Columbia Securities Commission (British Columbia)</td><td>Mr. Michael Brady</td></tr><tr><td>Financial Supervisory Commission (Chinese Taipei)</td><td>Ms. Yolanda Wu</td></tr><tr><td>European Securities and Markets Authority (European Union)</td><td>Mr. Patrick Starkman</td></tr><tr><td>Autorité des marchés financiers (France)</td><td>Ms. Françoise Buisson</td></tr><tr><td>Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)</td><td>Mr. Philipp Sudeck</td></tr><tr><td>Securities and Futures Commission (Hong Kong)</td><td>Ms. Christine Kung</td></tr><tr><td>Securities and Exchange Board of India (India)</td><td>Mr. Amarjeet Singh</td></tr><tr><td>Commissione Nazionale per le Società e la Borsa (Italy)</td><td>Ms. Nicoletta Giusto</td></tr><tr><td>Financial Services Agency (Japan)</td><td>Mr. Akiyoshi Kitamura</td></tr><tr><td>Securities Commission (Malaysia)</td><td>Ms. Foo Lee Mei</td></tr><tr><td>Comisión Nacional Bancaria y de Valores (Mexico)</td><td>Mr. Jose Trujillo Loyola</td></tr><tr><td>Authority for the Financial Markets (Netherlands)</td><td>Mr. Niels de Kraker</td></tr><tr><td>Ontario Securities Commission</td><td>Mr. Jean-Paul Bureaud</td></tr></table>	Australian Securities and Investments Commission (Australia)	Mr. Steven Bardy	Comissão de Valores Mobiliários (Brazil)	Mr. Eduardo Manhães Ribeiro Gomes	British Columbia Securities Commission (British Columbia)	Mr. Michael Brady	Financial Supervisory Commission (Chinese Taipei)	Ms. Yolanda Wu	European Securities and Markets Authority (European Union)	Mr. Patrick Starkman	Autorité des marchés financiers (France)	Ms. Françoise Buisson	Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)	Mr. Philipp Sudeck	Securities and Futures Commission (Hong Kong)	Ms. Christine Kung	Securities and Exchange Board of India (India)	Mr. Amarjeet Singh	Commissione Nazionale per le Società e la Borsa (Italy)	Ms. Nicoletta Giusto	Financial Services Agency (Japan)	Mr. Akiyoshi Kitamura	Securities Commission (Malaysia)	Ms. Foo Lee Mei	Comisión Nacional Bancaria y de Valores (Mexico)	Mr. Jose Trujillo Loyola	Authority for the Financial Markets (Netherlands)	Mr. Niels de Kraker	Ontario Securities Commission	Mr. Jean-Paul Bureaud
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