



IOSCO Report on Good Practices on Processes for Deference. International Bulletin, November 2020.

In June 2019, IOSCO published a report on Market Fragmentation and Cross-Border Regulation (the “2019 Report”) which examined harmful, unintended market fragmentation in wholesale securities and derivatives markets. This report considered, among other things, the practical measures that IOSCO and its members could take to mitigate the adverse effects of this type of fragmentation and to further strengthen cooperation between market regulatory and supervisory authorities, in particular by exploring the concept of deference and its evolution in recent years.

The G-20, during its 2013 summit in St. Petersburg, had declared that *“jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes.”* Although this G-20 Declaration was formulated in the context of the regulations on OTC derivatives markets, the 2019 report and the working group analysed market fragmentation in the wholesale securities and derivatives markets in general.

In the June 2020 report, as a continuation of the work carried out in 2019, a more in-depth analysis was carried out of the concept of deference (which is related to the concept of equivalence, a term used in the legal framework of the European Union) and eleven Good Practices in the processes of determining deference were drawn up.

The term “deference” is used here, as it was in the 2019 Report, as an overarching concept to describe the reliance that authorities place on one another when carrying out regulation or supervision of participants operating cross-border. The term is used generically and is not intended to refer to the legal framework of any jurisdiction or regulatory mechanism that may be employed to achieve such deference.

The 2019 report found that deference between supervisory and regulatory bodies, through the use of cross-border regulatory tools, had increased considerably in recent years, along with an increase in cooperation in supervision and enforcement. While these developments have helped mitigate some instances of harmful market fragmentation, some problems remain. Some of these challenges relate to the underlying processes on which authorities rely to determine deference.

As a result, the 2019 report suggested that it could be beneficial to identify good and sound practices to make deference determination processes more efficient.

IOSCO has identified a number of good practices in the deference processes (the “Good Practices”) which are the subject of the report published in June 2020. While it is noted that there is no “one-size-fits-all” approach and that not all good practices may be applicable in all jurisdictions or in all circumstances, a number of good practices are set out in order to help members establish and apply efficient deference processes that are easily understandable by the entities or authorities that are evaluated for deference, without prejudice to the current legislative requirements or frameworks that the authorities have in force.

The report is structured in four sections. The first relates the background to the work carried out by IOSCO previously and the reasons put forward by other international institutions and organisations for the preparation

of these good practices.

The second section sets out the objectives and benefits of deference processes and indicates the main areas in which these are carried out through three broad mechanisms: (a) national treatment, which aims to create equivalent conditions between domestic and foreign entities within a jurisdiction and provides direct oversight by the host country's regulatory body. In this context, jurisdictions can make use of exemptions from their regulatory framework or resort to alternative compliance to mitigate the duplication of standards with which a foreign entity must comply, (b) recognition, which is based on a jurisdiction's assessment of a foreign regime as equivalent to its own and, consequently, minimises the duplication of regulations for companies that carry out cross-border activities and (c) passporting, in which a set of common rules is applicable to the jurisdictions covered by the passporting arrangements and provides a single point of entry for companies wishing to operate within those jurisdictions.

The third identifies several issues, identified in the 2019 report, related to the processes on which deference assessments are based and describes, with examples, deference processes carried out between jurisdictions. For example, the report notes that some jurisdictions highlighted the difficulty of providing relevant information when being evaluated, since there is sometimes a lack of clarity about the criteria on which the assessment is based. Other jurisdictions also mentioned that they run into problems due to the lack of indicative time frames for conducting assessments and difficulties in keeping up to date with the legislation of the foreign jurisdiction. This section concludes by reporting that some jurisdictions identified problems related to developing a clear understanding of one another's regulatory frameworks of each jurisdiction, particularly when regulatory approaches may differ or when information is not available in a common language.

The good practices apply to all phases of deference assessments and are primarily aimed at authorities assessing other jurisdictions, as they generally exercise greater control over deference processes. Assessed jurisdictions, for their part, also play a key role in ensuring that the process for achieving deference runs smoothly. They can therefore consider what steps should be taken to facilitate the assessment by the assessing jurisdiction's authorities.

The report divides the eleven good practices identified into three main areas:

1. **Initial stages of the assessment**, in which Good Practice 1 is established.
2. **During the assessment**. In this phase, Good Practices 2 to 7 are developed.
3. **Post-assessment**: Follow-up, adjustment and revocation. In this phase, Good Practices 8 to 11 are developed.

In the final section, the conclusions are presented and the list of Good Practices on processes for deference is attached as an annex to the report.

The report's conclusions call for the development of efficient deference mechanisms and processes that promote safe global capital markets, preventing the unintentional and harmful market fragmentation that may hamper capital formation and give rise to financial stability concerns and/or limit investor options.

The report also indicates that many authorities have become aware of the risks posed by this unintentional and harmful market fragmentation. It states that in recent years they have actively studied the way in which their regulatory frameworks can interact with those of other jurisdictions for the benefit of the effectiveness of global securities markets.

Finally, the eleven good practices are presented in order to help authorities build confidence, mitigate market fragmentation and better manage risks in global securities markets. The report also indicates that, because markets are constantly evolving, practices relating to cooperation and deference could also evolve accordingly.

The good practices identified in the report span all phases of deference evaluations, from the initial stages to

the final adoption of an assessment determination. The assessments are derived from a general consensus of the members on the fundamental philosophy that supports the determinations of deference and the processes that underpin them and which are usually the following:

I. Outcome-based – many authorities assess whether and to what extent a foreign regulatory, supervisory and enforcement regime achieves results that are broadly similar to those achieved by the country's regulatory regime in terms of investor protection, market integrity and reduction of systemic risk.

II. Risk-sensitive – depending on factors such as jurisdictional reach or significance of risks to the domestic stakeholders involved, an outcome-based assessment, where it occurs, may be adjusted to the scope and market implications of allowing access to foreign entities. For example, in certain cases an in-depth analysis and more detailed examination may be appropriate. In other cases, authorities, when assessing other jurisdictions, may decide to allow a foreign company access to the market without conducting a deference assessment, for example when the activities of the foreign company do not exceed a pre-determined threshold, thereby granting a different treatment depending on the risk that the foreign company may generate in the local market.

III. Transparent – authorities try to ensure that all parties are informed about the process and criteria to which they will be subject when undergoing a deference determination, as well as the criteria and process for withdrawing it once granted.

IV. Cooperative -- supported by strong and ongoing cooperation on regulatory, supervisory and enforcement matters. Supervisors promote a standardised approach to cooperation (for example, memorandums of understanding or similar agreements) between themselves and this is often a pre-requisite when deference is to be granted. Within the context of financial market infrastructures, the report notes that authorities with strong and trusting relationships are in a better position to fully reap the benefits of cooperation and to successfully achieve a shared goal.

V. Sufficiently flexible – allowing an assessed jurisdiction to introduce changes to its legislative or regulatory framework without its positive deference determination being revoked or amended, provided the assessed jurisdiction can demonstrate to the assessing jurisdiction that similar outcomes continue to be assured.

The good practices build on this foundational philosophy and focus on issues such as:

- arrangements that assessing authorities could consider to ensure the transparency of deference processes, including scope, steps and criteria.
- the criteria that assessing authorities could consider when making an outcome-based assessment of the assessed authority and/or firm, including the nature of the supervisory and enforcement practices in the assessed jurisdiction.
- considerations for assessing authorities on important factors such as the nature and degree of risk that entities from another jurisdiction may pose in their markets.
- considerations on the level of engagement, cooperation and communication between the assessing authority and the assessed authority and/or company throughout the process and once deference has been granted.
- considerations for jurisdictions regarding the revocation of a deference determination.

1 In line with the IOSCO taxonomy, supervisory and regulatory bodies could take these practices into account in their regulatory activities. However, they are not included in the IOSCO Methodology, as they do not represent a principle or standard that its members are necessarily expected to apply.

Links of interest:

[Market Fragmentation & Cross-border Regulation \(2019\)](#)

[Good Practices on Processes for Deference \(2020\)](#)

