IOSCO Report on Market Fragmentation and Cross-border Regulation. June 2019.

The G-20 Leaders, during their Saint Petersburg summit in 2013, agreed 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."*

That same year, the International Organisation of Securities Commissions (IOSCO) formed a Task Force to assist regulators and legislators with the challenges they face in creating regulation without unduly constraining the cross-border offering of financial services or products. The Task Force released its Final Report in 2015, which established three broad types of approach for cross-border regulation:

• **National treatment**, which aims to create a level playing field between domestic and foreign firms within one jurisdiction and provides direct oversight to the host regulator. Within this context, jurisdictions may make use of exemptions from their regulatory framework or use substitute compliance to mitigate the duplication of rules a foreign entity is required to follow.

• **Recognition**, which is based on a jurisdiction's assessment of a foreign regime as equivalent to its own and therefore minimises duplicative regulations for firms doing cross-border business.

• **Passporting**, where one common set of rules is applicable to jurisdictions covered by the passporting arrangements and which has the advantage that it provides a single point of entry for firms wishing to operate within these jurisdictions.

Since publication of this 2015 report, there have been changes in financial markets, particularly as a result of progressive implementation by different jurisdictions of the financial reforms promoted by the G-20.

After identifying signs of fragmentation in certain segments of financial markets, the Japanese Presidency of the G-20, together with IOSCO and other global bodies such as the Financial Stability Board (FSB), agreed to analyse these signs in those cases in which they were due to the implementation of regulations.Specifically, IOSCO established a new Follow-Up Group for the aforementioned Task Force with a mandate to examine market fragmentation in wholesale securities markets and derivatives markets, specifically as it arises as an unintended consequence of regulation, and taking the document published in 2015 as the starting point.

This year, the Follow-up Group has prepared a report on **Market Fragmentation and Cross-border Regulation**, which was sent to the IOSCO Board on 17 April and the FSB on 26 April. It is important to note that the FSB has, in parallel, prepared its own document on market fragmentation and that IOSCO and the FSB have maintained contact throughout the process in order to avoid duplication of the work between the two reports.

In order to prepare this report, which was published on 4 June 2019, IOSCO requested the Follow-up Group, among other things, to:

(i) Conduct a brief survey of IOSCO members in order to clarify whether there has been any type of fragmentation in financial securities markets and/or OTC derivatives markets.

(ii) Identify new developments in cross-border regulatory issues since publication of the 2015 report.

In order to fulfil this mandate from its Board, IOSCO participated in two roundtables in January and March 2019 with the public and private sector and issued a survey to its Board Members about market fragmentation and their respective experiences with cross-border regulations since 2015. These activities have led to many regulators becoming aware of the risks associated with market fragmentation and to increased cooperation in order to mitigate its effects.

The report prepared by the Follow-up Group proposes possible measures to the IOSCO Board, which include:

(i) Fostering mutual understanding among IOSCO members of their respective regulatory frameworks.

(ii) Strengthening cooperation in the area of supervision and regulation.

(iii) Contributing towards making the processes of deference to other authorities and associated tools (passports, recognition/equivalence, etc.) more efficient.

With regard to the first point, the report proposes, on the one hand, that IOSCO make use of its Regional Committees to promote the discussion of issues relating to market fragmentation and, on the other hand, the preparation of a regular report on the state of financial markets in relation to this phenomenon.

With regard to the second point, IOSCO acknowledges the usefulness of Memoranda of Understanding (MoU) between different jurisdictions, which have been increasingly used since 2015. In order to further promote their use, IOSCO is building a central repository of all the MoUs agreed to date to provide more transparency and visibility to regulators and industry participants in the different jurisdictions. Bilateral arrangements in the form of Memoranda of Understanding (MoUs) are now a common tool used by regulators, particularly with respect to information exchanges. In addition, regulators have developed novel processes to work multilaterally to the benefit of the markets they oversee.

With regard to the third point, it is necessary to clarify that the term “deference” is used in the 2019 IOSCO document as an overarching concept to describe the process through which the competent authority places its confidence in another authority from a different jurisdiction when carrying out regulation and supervision of participants operating cross-border. This clarification is relevant as, in practice, the word “deference” is associated with certain specific mechanisms used in some jurisdictions (for example, exemptions, passports, recognition and equivalence, etc.). In this case, the term is used in the IOSCO document in a general manner and does not, therefore, refer to any specific practice used in the regulatory framework of any jurisdiction in particular.

In addition, IOSCO acknowledges that while the use of deference may help mitigate the risk of market fragmentation, it might not be a suitable tool in all circumstances. To this end, IOSCO proposes serving as a forum for the exchange of information with regard to its members’ different practices and approaches to cross-border regulation and, in addition, working on identifying good practices that may serve as a benchmark to IOSCO members.

The document also proposes taking into account existing work undertaken by supervisory bodies and regulators on market fragmentation. In addition, it proposes determining whether existing supervisory colleges currently achieve their objectives and, if appropriate, identifying ways to increase their use.

Finally, it is necessary to mention that, despite all the successes achieved, significant challenges remain which need to be considered in relation to market fragmentation. In this regard, strengthening cooperation between the different competent authorities might make a decisive contribution towards preventing the negative effects of market fragmentation caused by cross-border rules and regulations.

Link of interest:

IOSCO Final Report: Market Fragmentation & Cross-border Regulation