II. GLOBAL COOPERATION GOING FORWARD

Issues at stake

The effects of the pandemic and the turbulence on financial markets remind us that our economies and financial systems are closely interconnected and that developments in different jurisdictions may have important contagion effects across the global financial system.

The G20 reforms have produced a more stable international financial system. However, market fragmentation subsists (e.g. with an often differing implementation of global rules at a jurisdictional level), creating risks and hampering the resolvability of banking groups by trapping funds in their different components. Examples include measures relating to bail-in, ring-fencing, resolution and capital buffers. Internationally coordinated action to support a well-functioning, resilient financial system therefore remains a priority.

Brexit is creating further challenges. Although the terms of a potential trade deal are still to be defined, future EU-UK relations in the financial sector will most likely be based on bilateral equivalence. This may have significant impacts on the current dynamics of EU capital and wholesale markets in particular, which are highly integrated with the UK and use the City as a hub. Efforts have been made to improve equivalence determination processes with more transparency, but these will remain a unilateral decision for which no long-term commitment can be guaranteed (e.g. if rules diverge over time) and not all activities benefit from such arrangements.

Content

Addressing growing global financial fragmentation

Heath Tarbert

**Chairman & Chief Executive,
U.S. Commodity Futures Trading Commission (U.S. CFTC)**

A sustainable system of supervisory cooperation

It is almost tautological to say that our derivatives markets are global, something we witnessed before the 2008 financial crisis and in its aftermath. As a result, exposed deficiencies in those markets required us to find a solution that went beyond national borders. In that regard, it cannot be said enough that the post-crisis G20 reforms have produced a more stable international financial system. The benefits have been manifold, as evidenced by the resilience of the derivatives markets during the recent period of extreme volatility wrought by the coronavirus pandemic. Unlike in 2008, the derivatives markets are now serving as shock absorbers of systemic risk.

In many ways, the G20 reforms promote ever more globally-integrated derivatives markets. Agreed internationally and implemented locally, the reforms enable local regulators to address the nuances of their markets while adhering to common principles around the world. When regulators operate on the basis of comity among jurisdictions applying comparable regimes, it both strengthens the effectiveness of the G20 reforms and enables the derivatives marketplace to serve its important role of mitigating risks within international financial system.

Now more than a decade after the G20 reforms, we are increasingly witnessing a transition from a collection of disparate and sometimes conflicting national regulatory regimes to a shared regulatory paradigm underpinning the world's largest derivatives markets. This has made the possibility of regulatory deference more than simply aspirational for national regulators. For our derivatives regulatory landscape now holds the promise of fostering a sustainable system of cross-border supervisory cooperation.

Pre-crisis, the U.S. regulated derivatives market was primarily a cleared futures market traded on exchanges. It was a mature market with deep liquidity that permitted foreign participants to access its liquidity without adhering to U.S. laws. The U.S. futures regime entailed, and still provides, a great deal of deference abroad. Post-crisis, the G20 reforms set out a new regulatory approach for the swaps market. In the U.S., an early adopter of the G20 swap market reforms, the swaps market was open for business but the price of admission was strict adherence to American rules.

In 2012, CPMI-IOSCO's PFMIs catalyzed a new path in financial market regulation. With internationally-agreed baseline standards for market infrastructures—generally CCPs, trade repositories, and payment systems—supervisors now had a means to harmonize different local adoptions of the G20 commitments. Equivalence, comparability, and substituted compliance became modes of trust between authorities in the oversight of globally active FMIs.

> *We set our sights on a cooperative supervisory approach, grounded in comity and mutual respect....*

From recognizing the comparability of our respective regimes, we set our sights on a cooperative supervisory approach, grounded in comity and mutual respect, where host country regulators may rely upon a home country regulator when each has adopted comparable international standards, such as the PFMIs and other G20 reforms. When effectuated as a two-way street, this approach streamlines burdens and limits the risk of inconsistency in host jurisdictions while recognizing the accountability of the home jurisdiction's authority.

The CFTC has taken many steps to pursue regulatory comity with like-minded jurisdictions. In July 2019, the CFTC and Japan Financial Services Agency agreed to assess comparability ▶

for regulating certain derivatives trading venues in the U.S. and Japan, respectively, using an outcomes-based approach. In December 2019, we issued proposed rules governing the cross-border swaps market that recognize the importance of a substituted compliance process for foreign-based swap dealers. These rules also establish a framework for seeking comparability determinations for applicable foreign regulatory regimes. In February 2020, we proposed swap data reporting rules to harmonize our reporting system with relevant CPMI-IOSCO standards and those utilized by other regulators, including ESMA. And we continue to pursue supervisory cooperation arrangements built on mutual respect and comity.

Supervisors in Europe, Asia, and the Americas can cooperate in mutually beneficial ways to maintain vibrant and resilient global derivatives markets. The alternative could be a state of overlapping and conflicting rules that introduces complexity and risk to the international financial system.

We must strike a balance that respects the supervision of primary authorities while preserving the ability of host country regulators to oversee their markets as appropriate. A supervisory approach based on comity and mutual respect among regulators, grounded in international standards, will help ensure that our markets continue to thrive in the decades to come.

Elke König

Chair, Single Resolution Board (SRB)

Closer international cooperation as the basis for mutual trust

Resolution strategies for banking groups with subsidiaries in several countries can follow either a single point of entry (SPE) or a multiple point of entry (MPE) approach. For groups with centralized structures, resolution authorities (RAs) will likely opt for an SPE approach and apply resolution tools at the parent level, while groups with a sufficiently decentralized structure may be subject to an MPE strategy.

SPE relies on the concept that the parent, being the resolution entity, will be the subject of any resolution action. This allows for the efficient allocation of resources within a group in going concern; in gone concern, the upstreaming of losses and down streaming of resources from subsidiaries and maintaining critical functions must be secured.

By contrast, an MPE strategy would be considered if a bank's structure is based on reasonably independent - in particular "self-funded" - entities or sub-groups. This would result in multiple, operationally independent resolution entities within a group that may be resolved without affecting the other entities or sub-groups. The prevention of contagion entails a challenging trade-off between banks not being fully decentralized in going concern for operational or supervisory reasons, but entirely separable in a resolution event, as outlined in a recent article by Antonio Carrascosa[1].

The Banking Package strengthens the feasibility and credibility of implementing SPE, by requiring RAs to set internal MREL and TLAC requirements, which should facilitate loss absorption within a group. However, the new provisions also provide for a high level of pre-positioning of internal MREL, potentially leading to locked-in capital. It is too early to judge the consequences, but the SRB is concerned that this de facto ring-fencing within the EU might reduce substantially the needed financial flexibility at parent level.

Ring-fencing can increase risks and hamper resolvability, by trapping funds in different parts of the group, thereby not allowing for the optimal allocation of capital, resources and bail-inable liabilities within a group. In contrast, host countries fear that they might have to foot the bill if the subsidiary of a foreign banking group in their jurisdiction were to fail.

Trust among authorities is the main driver to overcome ring-fencing attempts.

For this reason, we encourage policymakers to take forward concrete work on a legally enforceable group insolvency support mechanism for banking groups. These measures should apply to banking groups in Europe, but concrete solutions are also needed at FSB level. In the meantime, the SRB has made "bail-in playbooks" a priority of its work since 2018 and is focussing on credible and executable plans to upstream losses and downstream capital within a group, if need be.

Moreover, the SRB strives to further enhancing mutual understanding among RAs in the Banking Union and beyond. We are dedicating considerable efforts to reaching joint decisions on MREL and involving not least NRAs outside the Banking Union with material subsidiaries in determining resolution strategies. Similarly, the SRB has enhanced cooperation with third countries through cooperation agreements, workshops and multilateral simulation exercises. We remain convinced that trust among authorities is the main driver to overcome ring-fencing attempts.

1. https://www.risk.net/comment/6787136/how-to-adapt-a-bank-for-mpe-resolution-strategy

Debra Stone

Managing Director and Head of Corporate Regulatory Affairs, JPMorgan Chase &Co.

Market fragmentation: through a different lens?

In June 2019, the FSB and IOSCO each published reports on market fragmentation and frictions in global financial activities. In particular, they focused on whether regulatory reforms adopted in response to the 2008 global financial crisis may have given rise to fragmentation.

The reports make it clear that certain types of fragmentation may be intended, but unintended fragmentation could raise issues for financial stability and the effective oversight and supervision of financial markets.

The current COVID-19 pandemic is a public health crisis with spillover to the real economy. The crisis should demonstrate that strong banks can prudently support households and businesses through lending, intermediation, and other activities to ensure the smooth functioning of the global financial system.

Both global standard setters and individual jurisdictions have quickly begun to address aspects of the current regulatory framework that could constrain banks' full support for the economy, such as lack of clarity around the use of buffers. Various recent announcements from the BIS, FSB and IOSCO are positive indicators of coordination at the global level.

Decisions by Basel to delay the implementation of Basel III, and by BCBS and IOSCO to extend the deadline for completing the implementation phases of the margin requirements for non-centrally cleared derivatives, should assist in avoiding the type of fragmentation identified in the FSB Report that results from differences in timing of national implementation of international standards. However, it remains to be seen as this current crisis continues, whether issues arise that make the case for further cooperative mechanisms among jurisdictions.

A type of fragmentation that has been recognized as most difficult to address is described in the FSB report as "jurisdictional ring-fencing." Prior to this crisis, the discussion focused on whether these requirements, if excessive, could impact financial stability by impeding the ability of firms to allocate resources where needed in times of stress.

> *It remains to be seen whether issues arise that make the case for further cooperative mechanisms...*

Now, tensions may arise if a firm's need to allocate resources to support lending and markets is not aligned with the views of regulators and supervisors as to the level of resources that should be maintained in a particular jurisdiction or legal entity. The COVID backdrop may highlight these tensions and how these types of requirements should or could operate in a stress situation.

The COVID-19 crisis may also shed light on other regulatory approaches that had not been a focus of the 2019

▶ fragmentation reports, such as the development of standards and supervisory approaches around operational resiliency. This area may be informed by actual experiences from this crisis and further emphasize the need for a coordinated, rather than fragmented approach, across jurisdictions and regulators.

In the midst of this crisis, actions must be taken quickly to address the crisis; when the crisis subsides, there will be an opportunity for policymakers and financial institutions to look at the issues of fragmentation through a different lens. ●

Tetsuro Imaeda

Chief Executive Officer, Sumitomo Mitsui Banking Corporation Europe, Managing Executive Officer and Head of EMEA Division, Sumitomo Mitsui Banking Corporation

Regulatory fragmentation – potential approaches

Economic cooperation and international trade contribute to stability and wealth. Inconsistent regulation may introduce friction, reduce efficiency and use resources that could be put to better use. Through bodies such as the Basel Committee, FSB and IOSCO global policy makers have developed internationally agreed regulatory standards for the financial markets.

However, the stresses in the global financial system since the 2008 financial crisis have acted as a major brake on globalisation, partly because countries have focused on national legislative solutions and partly because detailed country or regional implementation of the post-crisis reforms has been inconsistent. Global policy makers have a central role in mitigating the effects of market fragmentation arising from financial regulation.

So, what are the factors which have contributed to market fragmentation?

Despite efforts by regulators to work collaboratively, implementation at a jurisdictional level often differs, sometimes in seemingly insignificant ways. However, the impact may be material. An example is the jurisdiction-specific implementation of the G-20 standards on trading, clearing and margining of over-the-counter derivatives. These standards were intended to make trading safer but have introduced friction and inefficiency in cross-border trading.

When combating crises, local policy makers tend to focus on protecting taxpayers and ensuring financial stability at a country level. Examples include measures relating to bail-in, ring-fencing, resolution and capital buffers.

The purpose is to insulate the national or regional economy from loss by ensuring firms' capital and liquidity is available at a local level. This comes at a cost to regulatory harmonisation and broader economic stability.

Fragmentation may also be driven by rules restricting the ability of non-nationals to access financial markets. Although the final stages of the UK withdrawal from the EU are yet to be played out, it is clear that the withdrawal will result in reduced access to the EU market for UK financial service providers and similar restrictions for EU firms accessing the UK market, giving rise to a patchwork of market access solutions across the EU.

How should global policy makers approach these issues?

It is crucial to develop a greater understanding of fragmentation. Policy makers can ensure that a review of cross-border regulatory issues becomes a regular item in their regional meetings, with detail of where and why fragmentation is happening, and at a global level they could add to their agenda an annual evidence-based report on the unintended consequences of fragmentation.

There should be a targeted expansion of the use of bilateral arrangements such as Memoranda of Understanding to gather information relevant to fragmentation.

Existing cooperation can be improved by making regulatory fragmentation a consistent topic in the work of supervisory colleges, examining topics such as resolution and the pre-positioning of capital and liquidity by international banks.

Finally, policy makers should use the emergence of the digital economy as a catalyst for enhanced international cooperation through the creation of a consistent cross-border approach to the regulation of new products and participants. ●

Wilson Ervin

Vice Chairman, Credit Suisse

Into the ring: Basel III vs. COVID Crisis

The COVID-19 pandemic is first and foremost a human tragedy. It is also wreaking havoc on health systems, social freedoms and economies. Will it do the same to the new Basel III (B3) regulatory regime? B3 was a powerful impetus for banks to strengthen their resources. But how will B3 perform when it leaves the training stage and enters the ring, for a real fight against a sharp economic crisis?

Round I – the initial shock: The last decade has been well used to address the glaring gaps exposed in the GFC and build robust capital and liquidity. Coupled with swift steps by central banks, the financial system has withstood the initial punch of the COVID Crisis. Unlike 2008 or 2012, banks are generally seen as strong and part of the solution. B3 has won the first round.

Round II – procyclicality: B3 is risk-sensitive, which is good for "point in time" risk assessment. But this creates problems for policymakers looking to smooth an economic cycle. In the last few weeks, economic and financial risk measures have spiked. This will push up RWA for existing balance sheets, as VaR models, credit downgrades, commitment drawdowns, counterparty risk rules, IFRS9, etc. roll into the calculation machinery of B3.

Estimates for RWA inflation range from ca. 10% to 30%+. This will cut capital ratios by 100 to 300 bps, eating into buffers when they're needed most. This will reduce banks' ability to absorb credit shocks or expand lending. Regulators have already leaned against some of the drivers, like IFRS calculations. More footwork is needed to parry this issue in the short term, together with a fundamental review in the longer term. The crisis looks to win this round, on points.

Round III – buffers: The capital B3 stack is a complex layer cake of minima and buffers. While the official minimum CET1 is 4.5% of RWA, few think regulators (or markets) would all allow all buffers to be released and allow a major bank to dip so low.

We don't yet know how much credit damage will be caused by the economic shutdown from COVID. If the credit cycle is harsh, some banks could see capital drawdowns on top of the RWA pressures noted above. This will force a tough tradeoff between two goals: supporting the real economy and supervisory comfort with lower capital levels. Round III will be close – it's too early to call.

Round IV – fragmentation. A fragmented banking market means that local COVID hotspots hit local banks, intensifying the impact in both financial and operational terms. An incomplete Banking Union is not helpful.

Home-host dynamics in the new regime are also untested. How will drawdowns be shared between nations: Will hosts release buffers to help a struggling home, or vice versa? Without cross-border cooperation (resource sharing), our research shows that bank risk can rise by 4x or more. Without clear rules of the road, local legal entity issues could create bottlenecks at exactly the wrong time. The FSB has identified fragmentation as a possible 'glass jaw' of the current system. Strong cooperation between homes and hosts is important to avoid a KO punch.

> *Pro-cyclicality, buffer flexibility and fragmentation were theoretical issues just a few months ago – now they are critical regulatory challenges.*

Europe could build on precedents like the successful 2009 Vienna Initiative (which addressed home-host tensions in the southeast region), perhaps via crisis-proof home host financial support agreements. Broader branching could provide another solution. Europe has often advanced in crises, and we hope it emerges stronger from this round.

Basel 3 – the new financial regime - won the first round but has several tough rounds to go. Procyclicality, buffer flexibility and fragmentation were theoretical issues just a few months ago – now they are critical regulatory challenges. A successful response to each is essential if banks are to both remain safe and support the critical needs of the real economy.

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Optimizing third-country approaches in the financial sector

John Berrigan

Director-General, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

EU equivalence policy – a tool for regulatory convergence

The EU is one of the most open financial systems in the world, with very significant financial flows to and from the EU. There are hundreds of non-EU players in the EU market and EU players are present in all financial systems around the world.

The key instrument, with which the EU manages risks deriving from interconnectedness and exposure to third-country financial systems, is equivalence. Equivalence is about risk management - ensuring that financial stability, market integrity, and the protection of EU investors and consumers are safeguarded, even when there is a level of deference to a third-country authority.

The key questions before granting equivalence are: will the third-country authorities manage risks for EU firms the same way as they manage their own? Even more importantly, in case of a crisis, does equivalence ensure that we can really rely on third country authorities to manage risks for our own economic operators?

The Commission has an established practice of deferring to and cooperating with third-country supervisors; 280 equivalence decisions have been granted in respect of more than 30 third countries. With its Communication of 29 July 2019, the Commission has reaffirmed that risk management is the cornerstone of its equivalence policy. It has also reiterated that equivalence requires a risk-based and proportionate approach. This means that the higher the potential impact of a third-country market on the EU, the more thorough the equivalence assessment.

The Communication highlighted that trust is essential to underpin deference and that EU foreign policy priorities are relevant for equivalence assessments, including for instance anti-money laundering arrangements and/or tax governance.

The Communication summarised recent developments, such as the targeted amendments to third-country regimes, in particular for Investment Firms, for CCPs and the enhanced role for the European Supervisory authorities, notably on monitoring equivalence decisions.

On process, the Communication detailed further transparency steps, e.g. through its better regulation practice of public consultation periods before adopting decisions. It presented plans to systematically monitor existing decisions. Normally, this would take place through dialogue with the Commission affording an opportunity for the third country to remedy any gaps identified. If gaps cannot be remedied, equivalence can be withdrawn as in the case of some Credit Rating Agencies decisions in July 2019. If conditions for equivalence were to change more suddenly, the process leading to withdrawal might become more rapid.

Equivalence policy is fit for purpose for the assessments of the UK, as for other any third country. It will be a key tool to handle EU-UK relations in the financial sector in the future. Irrespective of the outcome of equivalence assessments, UK-based financial institutions will lose their access to the single market based on their UK authorisation after the transition period. Those UK institutions that want to guarantee the provision of services to EU clients across the single market are aware that they will need an establishment in an EU Member State. Ultimately, it is a choice for each firm to decide how it organises itself and which clients it wants to serve.

On the risk of cliff-edge at the end of the transition period, the situation is different from the no-deal risk in 2019. The Withdrawal Agreement provides sufficient time for firms to take the necessary steps to cater for the change in their regulatory regime. Firms need to use the months left until the end of transition period to adapt their operations. Overall, counting from the day of the referendum in 2016, they will have had four and a half years to prepare.

The Commission will constructively engage with the UK in all equivalence areas and gather facts, with the intention of concluding its unilateral equivalence assessments by June 2020. However, the deadline refers to the mapping, not to the decisions themselves. Further, the UK's stated intention to diverge from EU rules makes assessments more complicated. Equivalence is typically the outcome of a convergence process but, in the case of the UK, the Commission will need to consider the extent of possible UK divergence in its initial assessments. This implies a thorough and forward-looking assessment of how the UK regulatory and supervisory framework will operate after the transition period, and whether it will deliver similar outcomes as the respective EU framework.

Steven Maijoor

Chair, European Securities and Markets Authority (ESMA)

Enhancements to the EU equivalence framework

Effective cross-border regulation and supervision is an essential prerequisite for the development of strong, efficient and safe global financial markets. In this regard, open access to financial markets needs to go hand-in-hand with an effective supervisory toolbox for authorities, in both home and host jurisdictions.

The financial market regulatory framework in the European Union (EU) offers market access by market participants from third countries based on equivalence and recognition regimes. While not available to all sectors, these regimes still constitute, from a global perspective, the most extensive application of the "deference" principle agreed back in 2013 by the G20.

Internationally active market participants have benefitted in the past years from the aforementioned European approach, and market fragmentation has been kept limited in areas such as securities trading and clearing.

With the United Kingdom leaving the EU, which has Europe's largest capital market, the EU needed to accelerate the improvement of third-country arrangements as they were designed many years ago. In January 2020, a number of important changes in the EU equivalence and recognition frameworks became applicable, without, however, changing the main underlying principles of these frameworks.

Firstly, ESMA will continue to play an advisory role to the European Commission regarding the assessment of non-EU regulatory and supervisory frameworks in order to facilitate equivalence determinations. In addition, ESMA will take up the important task of monitoring relevant developments in those areas and jurisdictions where equivalence has been declared. To this end, ESMA will strengthen its ongoing cooperation with non-EU regulators and seek to better understand their domestic frameworks as well as their effectiveness. The revised ESMA Regulation requires ESMA to report on its monitoring activities to the European Institutions on an annual basis.

Secondly, in relation to CCPs, the EU introduced a more proportionate framework for the recognition and supervision of non-EU market participants. In particular, EMIR 2.2 sets out an enhanced recognition regime for systemically important third-country CCPs, whereby such CCPs will have to comply with EMIR requirements and be subject to certain supervisory powers of ESMA's. The current arrangement with ESMA's full reliance on non-EU supervision will continue to apply with regards to all non-systemic third-country CCPs. The final legal framework allowing ESMA to distinguish between systemically important and non-systemic CCPs has however yet to be established.

ESMA will take up the important task of monitoring relevant developments in those areas and jurisdictions where equivalence has been declared.

Thirdly, enhancements were also introduced regarding non-EU Investment Firms (under the Investment Firms Review legislation), and here ESMA will receive improved monitoring and information powers as of mid-2021 in relation to firms from equivalent jurisdictions.

Fourthly, and finally, the revised ESMA Regulation contains a requirement for the European Commission to provide, in due course, a report regarding the need to enhance equivalence arrangements, with a possible supervisory role for ESMA, in relation to non-EU trading venues and CSDs.

Looking at these examples, it is clear that the EU equivalence regimes are changing. On the one hand, the equivalence frameworks will continue to be an important arrangement allowing to avoid market fragmentation while preserving open markets and a level-playing field between global market players active in the EU. On the other hand, a more proportionate approach to systemic and non-systemic non-EU market players is needed, combined with direct supervisory powers at European level, in the interest of EU financial stability and investor protection.

Shinzuke Toda

Managing Executive Officer, Deputy Head of EMEA, Mizuho Bank, Ltd.

The longevity of the equivalence framework in a post-Brexit world

The enhancements proposed to the EU approach towards cross-border regulation and supervision of third country entities include a more granular perspective in respect of determinations of equivalence where there is systemic risk and ongoing monitoring of compliance with applicable standards by the European Supervisory Authorities (ESAs). However, the increased scrutiny and consequent increased risk of withdrawal of equivalence poses serious risks to business continuity for market participants and the wider health of the European economy as there is an inherent paradox where compliance with internationally agreed standards does not result in the maintenance of equivalence. This is particularly the case when equivalence is used as a political tool rather than to promote the integrity and resilience required for the financial markets to flourish. Outcomes-based equivalence, based on compliance with international standards (such as the Basel accords), should therefore be the preferred option and we urge policymakers to prioritise the principles of objectivity, proportionality and risk sensitivity.

There will be greater scrutiny of delegation, outsourcing and material risk transfers (such as back-to-back business) to third countries by the ESAs, which is welcomed to ensure effective supervision and enforcement in respect of third country players, provided that the regime is proportionate and the rules are clear as to what is permitted. The increased cooperation of the ESAs with third country regulators is welcomed; as seen in the Japan / EU EPA, regulatory cooperation should reduce the risk of regulatory arbitrage and ensure a level playing field for non-EU players. It is important to remember that although the enhancements to the third country regimes have arguably been motivated by Brexit, the changes will also affect any non-EU firms operating on a cross-border basis into the EU (including those in the US and Asia). This strengthens the argument that any changes in enforcement should be proportionate. For this reason, special consideration should be given to equivalence regimes between the EU and third countries to develop stable and resilient regulatory relationships that do not significantly affect financial links between the EU and these jurisdictions.

In relation to Brexit, both UK and EU financial markets will inevitably be harmed by the UK's withdrawal. Although marginally differing regulatory regimes may be necessary to respect sovereignty, material gold-plating of requirements may trigger third country banks to consider the extent of their presence and business model in Europe. Regulatory divergence would result in (i) operational inefficiency due to the need for greater investment to set up operations in each jurisdiction, losing the economies of scale of a centralised model (ii) higher transaction and compliance costs, caused by different procedures and documentation required under different regulations, (iii) reduced liquidity if, for example, investors in the EU cannot invest in certain UK markets, ultimately impacting investor demand and (iv) more restrictive market access, which is highlighted by the potential loss of an EU passport for UK incorporated financial institutions after the transition period. Specifically, we would welcome UK CCPs being declared equivalent after the transition period to ensure that EU participants may continue to use them for clearing. Another market concern seems to be that UK and EU derivatives trading venues should be declared equivalent so as not to adversely affect liquidity and to allow UK and EU market participants to trade on the same venue (known as the derivatives trading obligation under MiFID II).

Therefore, we would welcome the EU maintaining close cooperation and dialogue with the UK post-Brexit, to preserve a consistent regulatory and supervisory framework and to encourage investment in the region as a whole. The reduction of market fragmentation was highlighted as a key priority during Japan's presidency of the G20, as well as by IOSCO and the FSB. We hope there will be a move towards greater globally harmonised financial regulation through increased home state recognition of regulatory and supervisory frameworks.

Beatriz Martin Jimenez

Investment Bank Global Chief Operative Officer
& UK Chief Executive, UBS

Outcomes-focused equivalence is key to delivering the EU's Capital Markets Union

There is broad agreement among regulators, policymakers and market participants on the risks that market fragmentation present to financial and to some extent operational resilience. Last year, the G20 and the FSB recognised that a coordinated policy response is needed to address these risks while IOSCO acknowledged a role for deference in the regulation of capital markets, complemented by measures to strengthen regulatory and supervisory collaboration. Despite this recognition, we continue to observe divergent implementation of global rules, while mutual recognition of rules by regulators is not widely applied.

In the EU, the Capital Markets Union (CMU), which aims to broaden the funding base for European corporates and households, remains a key project. UBS and other global firms want to play a role in making the CMU a success by continuing to facilitate capital, liquidity and investment flows into Europe. The CMU is fundamentally about breaking down barriers to these flows in Europe's capital markets and as such is an important channel through which market fragmentation issues can be addressed. However, achievement of this goal risks being undermined by insufficient trust by host regulators of firms' home regulation, both within and beyond Europe.

The EU has developed an equivalence framework which could become a powerful tool to allow cross-border business to be conducted safely and to high standards, to the benefit of EU firms, households and the overall economy. In order to achieve this, equivalence decisions must be grounded in a technical analysis that focuses on ensuring that third country rules achieve the desired outcome, taking into account relevant international standards; and to deliver legal certainty, the process must be consistent and transparent.

The EU's financial sector is highly integrated with that of key third country partners, including Switzerland, which has substantially reformed its regulatory framework to align with MiFID II standards. Yet the absence of a reliable equivalence mechanism could disincentivise convergence towards the EU, with consequences for businesses, savers and investors both in and beyond the EU if financial integration is eroded. The lapse of EU equivalence for Swiss trading venues just over a year ago illustrates the lack of legal certainty third country partners face with the current system. A more structured and predictable process for equivalence, supported by robust regulatory and supervisory cooperation, would underpin market confidence and stability.

As we look beyond the current concerns with COVID-19, it will be important to deliver clarity on the regulatory framework that will apply at the end of the UK's Brexit transition period as a matter of priority. Even as firms including UBS establish additional EU hubs, the financial sector needs assurance that all relevant equivalence decisions will be in place on both sides and applied by the EU and the UK in a coordinated fashion well before the end of the transition period. Equivalence is key both to avoid any market dislocation and, given that London remains an important centre for liquidity and term funding as well as for European and international talent, to maintain the investment flows that support the functioning of Europe's capital markets.

Going forward, if we are to achieve the full benefits of efficient and safe pan-European and globally-integrated capital markets, any temptation to establish new barriers that could ultimately inhibit the CMU's ability to deliver increased competition, choice and innovation, such as disproportionate requirements on third-country firms wishing to provide cross-border MIFID services to wholesale clients, should be resisted. Building the CMU in a way that integrates an outcomes-focused, transparent and consistent equivalence framework must be a priority. It will lead to more legal certainty, lower costs and higher productivity for all market participants and customers.