

18 April 2013

Dear Secretary Lew

CROSS-BORDER OTC DERIVATIVES REGULATION

We, the undersigned, are writing to express our concern at the lack of progress in developing workable cross-border rules as part of reforms of the OTC derivatives market.

We are already starting to see evidence of fragmentation in this vitally important financial market, as a result of lack of regulatory coordination. We are concerned that, without clear direction from global policymakers and regulators, derivatives markets will recede into localised and less efficient structures, impairing the ability of business across the globe to manage risk. This will in turn dampen liquidity, investment and growth.

We share a common commitment with respect to OTC derivatives reform, and are implementing rules across very different markets with different characteristics and different risk profiles, to support this global initiative. We believe the basic principles on which cross-border rules should be based are clear and widely shared, and we summarise them in the annex to this letter. An approach in which jurisdictions require that their own domestic regulatory rules be applied to their firms' derivatives transactions taking place in broadly equivalent regulatory regimes abroad is not sustainable. Market places where firms from all our respective jurisdictions can come together and do business will not be able to function under such burdensome regulatory conditions.

A coherent collective solution is therefore needed for cross-border derivatives, and regulators must work together to avoid outright conflicts in regulation and minimise overlaps as far as possible. In this regard, mutual recognition, substituted compliance, exemptions, or a combination of these would all be a valid approach, and careful consideration should be given with respect to registration requirements for firms operating across borders.

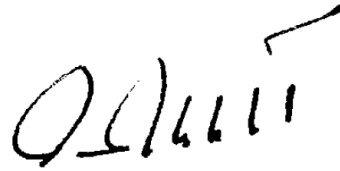
Recent experience shows that these discussions can only proceed if they are based on a shared understanding of the overall outcome being sought. For this reason, we are writing to urge that jurisdictions consider carefully the attached principles to avoid cross-border conflicts and support the Pittsburgh G20 reforms. We hope that these principles might provide a useful foundation for regulatory discussions to make progress.

We urge all authorities to work with us to achieve an outcome that meets the principles outlined in this letter and we, in turn, commit to continue to work to address the areas of concern which are most fundamental to others. To this end, this letter is copied to the Chairman of the FSB; the Chairman of the CFTC; the Chairman of the SEC; the Chairman of the US Senate Committee on Agriculture, Nutrition and Forestry; and the Chairman of the US House of Representatives Committee on Agriculture.

Yours sincerely



GUIDO MANTEGA
Minister of Finance
Government of Brazil



MICHEL BARNIER
Commissioner for Internal Market and Services
European Commission



PIERRE MOSCOVICI
Minister of Finance
Government of France




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PRAVIN GORDHAN
Minister of Finance
Government of South Africa



EVELINE WIDMER-SCHLUMPF
Finance Minister
Government of Switzerland



GEORGE OSBORNE
Chancellor of the Exchequer
UK Government

Annex: principles for cross-border swaps

Core principles

The core principles for cross border-swaps are as follows:

- 1. Cross border rules should be adopted that, if they were replicated by all other jurisdictions, would not result in duplicative or conflicting requirements, or regulatory gaps.**
- 2. This should be achieved through *substituted compliance* or equivalence arrangements. These will provide regulatory recognition of our mutual efforts to put in place measures to deliver the 2009 Pittsburgh commitments on OTC derivatives. The arrangements will be without prejudice to the right to withhold equivalence or substituted compliance arrangements where regulatory reforms are materially different in outcome.**

Substituted compliance is a critical component of these principles and the basis for applying substituted compliance is outlined further below.

Substituted compliance

Properly regulated cross-jurisdictional derivatives trading is an essential part of an efficient global financial market. The simultaneous application of multiple rules to cross-border activity will result in conflicting, inconsistent or duplicative requirements on market participants, which could be a real barrier to such trading. Where two jurisdictions each have rules which ensure equivalent regulatory outcomes are achieved, requiring a cross-border trade to comply simultaneously with both sets of rules is disruptive, costly and unnecessary. It also runs the risk of encouraging market fragmentation, as participants are deterred from transacting cross-border. We therefore cannot see a workable regime functioning without a comprehensive global commitment to the principle of substituted compliance, including:

- **Full scope – substituted compliance should be available to all market participants** for all transaction-level rules, and for all entity-level rules where these are applied to legal entities established outside the jurisdiction.
- **Jurisdiction-level assessment** – access to substituted compliance should be determined on the basis of an objective assessment of equivalence at the jurisdictional level. Where the rules in a foreign jurisdiction have been assessed as equivalent by the home authority, substituted compliance must be available in all circumstances for transactions with, and entities established in, that foreign jurisdiction. There should be no requirement for individual firms to apply for substituted compliance relief.
- **Outcomes-based approach to equivalence assessment** – differences in national legal regimes and market customs make it unfeasible to achieve identical regulatory frameworks. As such, when assessing equivalence, it will be vital to assess whether the outcome delivered by the rules is equivalent in terms of the protections provided, and not to seek a precise rule-by-rule match up. International standards are key to facilitating the establishment of equivalence between different jurisdictions;

international standards should be used as an essential element in assessing equivalence wherever possible. Regulators should remain vigilant to risks of regulatory arbitrage and be willing to agree more granular international standards where necessary to achieve a consistent implementation.

Registration requirements

We regard the imposition of registration requirements on foreign firms as an unnecessary additional burden. We accept that this approach has already been adopted in some jurisdictions, and do not believe that it will prevent the regulatory outcome envisaged by the G20 in 2009, provided it is accompanied by a full substituted compliance regime applied to those firms. However, we hold the view that as a principle, local regulations should not be extended beyond national borders. We expect any deviations from this principle to be narrow, and to exist only where there is a clear and specific justification (for example, this may notably be the case for clearing-houses (CCPs) offering their services in another jurisdiction).

Timing

Alongside an effective framework for substituted compliance, there should also be appropriate transitional measures and a reasonable transition period for foreign entities. Particularly in areas where international negotiations are ongoing, these will help address firms' difficulties in complying with cross-border rules, and ensure a smooth transition to the new framework of global standards.

Regulatory cooperation and access to data

Access of regulators to trade repository data should be governed by the draft CPSS-IOSCO principles on this issue, to ensure that mutual access to data can be assured as soon as possible. Regulators should be able to access such information from the trade repository directly, in accordance with agreements among regulators, rather than requesting data indirectly via another regulator.