11 March 2019

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Fragmentation and Extraterritoriality in Asian Markets

Dear Sirs,

Following our letter dated 14 January to the Japan G20 Presidency, the International Organization of Securities Commissions (IOSCO) and to the Financial Stability Board (FSB), the Asia Securities Industry & Financial Markets Association (ASIFMA)[1] seeks to provide you with further thought and analysis to feed into the FSB and the IOSCO work on market fragmentation following further consultation and analysis amongst members.

[1] ASIFMA is an independent, regional trade association with over 100-member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

As jurisdictions in Asia and internationally consider existing and future regulation, there is opportunity for policymakers globally to recall G20 leaders' 2009 commitment work together in raising standards, with national authorities implementing global standards consistently to ensure a level playing field and to avoid fragmentation of markets, protectionism and regulatory arbitrage.

Inconsistent standards and extraterritorial impacts disproportionately impact the functioning and efficiency of Asia's capital markets. Unchecked, fragmentation from excessive localisation and supervisory divergence can trap capital, liquidity, and risk in local markets, create significant financial and operational inefficiency and, ultimately, diminish returns to the end investor.

We have identified nine areas where changes can be made to significantly address some of the challenges. Detailed comments and analysis on these issues, based on member firms' feedback, are set out in the enclosed paper.

ASIFMA seeks to play a constructive role in helping to ensure that the international policy environment for financial services is one that fosters credit expansion, cross-border trade and investment, economic growth and enhanced regional employment, as well a financial system that best meets the need of the end user.

We look forward to continued engagement with the Japan G20 Presidency, IOSCO and the FSB on these matters. If you have further questions or would like to follow up, please do not hesitate to contact me at mausten@asifma.org or +852 9828.3637.

Sincerely,

Mark Austen
Chief Executive Officer
Asia Securities Industry & Financial Markets Association

Fragmentation and Extraterritoriality in Asian markets

At the 2009 Pittsburgh Summit, G20 leaders committed to act at national and international levels to work together in raising standards, with national authorities implementing global standards consistently to ensure a level playing field and avoid fragmentation of markets, protectionism and regulatory arbitrage.

Ten years later, as we evaluate regulation introduced as part of the G20 financial reform agenda, we are afforded an important opportunity to explore the effectiveness and consistency of these introduced measures. At the 2018 Buenos Aires summit, G20 leaders committed to the 'full timeline and consistent implementation and finalisation of the agreed financial reform agenda and the evaluation of its effects' and to 'continue to monitor and, if necessary, tackle emerging risks and vulnerabilities in the financial system; and, through continued regulatory and supervisory cooperation, address fragmentation.'

In 2019, raising awareness of market fragmentation and its effects on Asian capital markets is one of ASIFMA's key priorities. Inconsistent standards and extraterritorial impacts disproportionately impact the functioning and efficiency of Asia's capital markets. Unchecked, fragmentation from excessive localisation and supervisory divergence can trap capital and liquidity and risk in local markets, create significant financial and operational inefficiencies. Extraterritoriality can result in duplication, conflicting regulatory requirements and an unlevel playing field. Ultimately, this diminishes returns to the end investor.

ASIFMA advocates for greater cohesion and consistency in policy and sustained global regulatory cooperation in its implementation. This paper identifies examples of regulatory driven fragmentation and suggests specific actions regulators can to address concerns. ASIFMA intends to work with individual regulators as well as through international bodies such as the G20, IOSCO and the FSB to highlight areas of concern.

ASIFMA seeks to play a constructive role in ensuring the international policy environment for financial services is ultimately one that fosters credit expansion, cross-border trade and investment, economic growth and regional employment growth.

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TRADING & TRADING VENUES

Pre- and Post-trade Transparency Rules: Inconsistent Approaches Between Regions and Products	
Differences in pre- and post-trade transparency requirements results in uncertainty about execution and transparency-driven arbitrage. Moreover, lack of consistency in standards and approach between the EU and the US, for example, limit comparability of information between markets. At the same time, smaller illiquid markets may not be able to accommodate pre-trade transparency as it would make hedging difficult.	
Fragmentation Regulatory driven pre-trade transparency differs by region and types of product. This results in different levels of "imposed" pre-trade transparency, uncertainty about execution and transparency driven trading decisions. Regulatory driven post-trade transparency differs per region and for different products (e.g. TRACE and MIFID 2 post-trade transparency substantially different, including different volume masking mechanisms and thresholds). This results in transparency driven trading decisions and difficulty understanding global/cross-border volumes.	**Recommendation** ▪ IOSCO to undertake a review comparing approaches and recommendation areas for greater harmonisation and standardisation of approach, with some flexibility afforded to smaller, less liquid and developing markets. ▪ Eliminate pre-trade transparency requirements, allowing markets to commercially determine best avenues globally. ▪ Harmonise post-trade transparency regimes, including equivalent volume masking and product classification, while recognising time might be needed for some markets to mature. ▪ Create a Consolidated Tape in EU that allows for direct comparison with TRACE in US.

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Local Regulation of Venue Access: Local Controls Restricting Access and Resulting in Duplicative Counterparty On-boarding	
Where regulators tightly control access and participation requirements for local trading venues without due consideration of third-country firm access, they can severely limit access and necessitate duplicative counterparty on-boarding. On the other hand, developments like the EU/Singaporean and US/EU agreements to mutually recognise each other's derivatives venues are to be applauded and suggest a way forward for addressing this problem in other jurisdictions.	
Fragmentation Local regulators control access and participation requirements to trading venues. This limits/disincentivises third-country entities access, while resulting in diverse and duplicative counterparty on-boarding requirements.	**Recommendation** ▪ Ease third-country entities regimes, allowing for maximum cross-border access. ▪ G20 governments to coordinate and, where possible, establish MOUs establishing equivalence and/or allowing third-country firm access (e.g. EU/Singapore). ▪ Explore support for fintech/regtech initiatives to streamline on-boarding processes across jurisdictions (e.g. use of smart contracts).

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Trading, Trading Obligations and Trading Platforms (Derivatives): Extraterritoriality, Duplication, Conflicting Requirements, Fragmented Liquidity	
Regulation of trading and trading platforms are core to the G20's 2009 financial reforms. Today derivatives are mandated to be traded on different venues, depending on jurisdiction, creating significant liquidity fragmentation. Given the cross-border nature of derivatives trading, new or modified rules must be considered in the context of both global and domestic markets. It is critical that, where possible, regulators provide for substituted compliance or mutual venue recognition, and carefully consider which cross-border flows need to be in scope.	
Fragmentation It is not clear that national trading and trading platforms regulation has been designed with due consideration of international implications. Moreover, incompatibilities exist with counterparties/transactions being subject to more than one trading obligation, and liquidity fragmentation due to jurisdictional barriers translating into product silos. Introduced regulations are particularly challenging in Asia, for interest rate swaps in JPY, SGP, HKD and AUD for example. There is also concern that new rules by the CFTC have been implemented with limited consultation with fellow regulators, with few equivalence determinations in place. Inadequate consultation increases potential for local rules (Hong Kong and Singapore mandatory trading obligations are still to be finalised) duplicating and/or conflicting with existing rules. ASIFMA raised similar concerns including in relation to share trading and derivatives trading obligations under the Markets in Financial Instruments Directive (MiFID) II.	**Recommendation** ▪ G20 and IOSCO agree principles and a process for agreeing nexus, mutual recognition, timing and other implementation issues, helping regulators to better assess the international impact of reforms rather than just their own jurisdiction. ▪ IOSCO to undertake a review of global trading and trading platform regulation, identifying areas of inconsistency and impacts, especially on international markets. ▪ G20 to continue to promote and facilitate harmonised mandatory trading and trading platform rules globally. – If harmonisation is achievable, regulators to promote full, unconditional and global venue equivalence. – If harmonisation proves challenging, regulators should at least seek to grant temporary or conditional equivalence. ▪ Cross-border mutual recognition of trading venues among jurisdictions implementing G20 mandates. ▪ For Asia-Pacific, IOSCO could look at the effect reforms have on less liquid and developing markets and how international standards could be adapted whilst still supporting mutual recognition/equivalence.

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SYSTEMIC RISK & MARKET INTEGRITY

Margin Requirements for Uncleared Derivatives: New IM Thresholds Capture Non-systemically Important Institutions	
Financial institutions have implemented margin rules for uncleared derivatives in accordance with internationally-agreed timelines and initial margin (IM) thresholds. In September 2020, the last and final phase of margin rules requirements (Phase 5) will see the IM threshold decrease from EUR 0.75 trillion to EUR 8 billion. This decrease in IM threshold will subject many non-systemically important financial institutions to margin requirements. An estimated 1,100 counterparties (and their 9,500 counterparty pairs) are in scope of current rules. The industry welcomes recent clarification (March 2019) from BCBS and IOSCO that firms unlikely to exceed the EUR 50 million threshold for IM exchange will not be required to negotiate new documentation, custodial and operational arrangements, even if they come into scope based on the USD 8 billion threshold; however, further clarification and calibration of the overall regime remains necessary.	
Fragmentation Phase 5 implementation requires further recalibration. Notwithstanding recent clarification, subjecting such a significant number of non-systemically important financial institutions to these rules once the threshold falls to EUR 8 billion will still involve substantial cost and disruption for little improvement in financial stability. The Securities Industry and Financial Markets Association (SIFMA) and the International Swaps and Derivatives Association (ISDA) published a White Paper in July 2018 highlighting many of the challenges market participants will face during Phase 5. In September 2018, SIFMA, ISDA, ABA, GFXD and IIB submitted a letter to regulators around the globe recommending proposed actions, accompanied by an ISDA-led quantitative analysis that scoped the impact (including the number of market participants coming into scope, and amounts of initial margin that will be required). Inconsistencies between jurisdictions with respect to types of derivatives in scope (e.g. including/exclusion of equity options) creates additional complexity, particularly with respect to cross-border trade.	**Recommendation** ▪ Recalibrate overall initial margining requirements, raising the Gross Notional Threshold for Phase 5 to EUR/USD 100 Billion or the relevant jurisdictional equivalent. FSB to encourage G20 jurisdictions to clearly exempt entities that do not cross the above threshold in exchanging initial margin, and clarify documentation requirements for in-scope entities not exceeding the margin exchange threshold, in line with BCBS/IOSCO guidance. ▪ Once an IM threshold is triggered, an appropriate transition period should be provided for the relevant market participant to implement appropriate margin exchange processes. ▪ Remove physically settled foreign exchange swaps and forwards from aggregate average notional amount calculations for Phase 5. ▪ Remove burdens in the use of globally approved IM models, including the ISDA Standard Initial Margin Model (SIMM), by exempting Phase 4 and Phase 5 non-dealer counterparties from prudential-style governance of IM models designed for bank capital standards. Model governance requirements for broadly accepted, regulator approved internal IM models such as SIMM should be limited to entities brought in scope by Phases 1, 2 and 3 and their portfolios. Non-dealers should also be exempted from any SIMM approval (and/or pre-approval) under EU and Japanese margin rules. ▪ FSB member states to continue discussions with the relevant Basel Committee on Banking Supervision committee(s).

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IBOR transition: Cross-Jurisdictional Coordination Required to Avoid Market Disruption	
The financial industry recognises the need for transparency and robust governance in the administration of benchmark rates. ASIFMA and its sister associations, SIFMA and Association for Financial Markets in Europe (AFME), have been extensively involved in discussions regarding benchmark reforms and the transition to new reference rates. ASIFMA has also been actively involved in the discussions regarding the interbank offered rates (IBORs) transition. While we are very encouraged by the BCBS and IOSCO guidance in March 2019 that new margin requirements should not need to be applied to amendments to legacy derivative contracts for the purpose of accommodating interest rate benchmark reform, consultation and coordination is needed to ensure a non-disruptive IBOR transition.	
Fragmentation The IBOR transition is of particular concern in Asia due to the significant impact to financial markets in this region. IBOR benchmarks are referenced in over USD370 trillion of financial instruments in five currencies and used by a wide range of market participants. The transition from IBOR benchmarks to risk-free rates (RFRs) is unprecedented in the scope and size of the change. A coordinated IBOR transition is essential if market disruption/dislocation is to be avoided, and stability in the financial markets is to be preserved. Additionally, in order to promote consistency in cross-currency markets, it is important for all IBOR benchmarks to transition concurrently to avoid distortion in the cross-currency markets in particular. For example, if USD LIBOR transitions in 2021 but JPY LIBOR transitions in 2022, cross-currency markets will be distorted to the extent that one curve will be based on the secured overnight financing rate (SOFR) while the other will still be based on JPY LIBOR. SOFR is an overnight rate while the JPY LIBOR is a forward-looking term rate.	**Recommendation** ▪ IOSCO and the FSB to encourage G20 regulators in all key markets to establish consultation processes to facilitate a timely, well-coordinated transition. ▪ IOSCO and the FSB to encourage the G20 to also ensure coordination to ensure harmonised approaches to fall-backs and calculation methodologies. ▪ Regulators to coordinate with each other to ensure harmonised approaches to fall-backs and calculation methodologies. ▪ Where a member jurisdiction exempts legacy transactions from margin requirements, if a change to a risk-free rate(either as a primary or fall-back rate) is viewed as a material change, local provisions should be made for exempting such transactions from margin rules, in line with FSB and IOSCO guidance.

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EU Benchmarks Regulation: Better International Coordination, Frameworks for Third-country Determinations Required to Avoid Market Disruption	
Following a tripartite dialogue in February 2019 between the European Commission, the Council of the European Union and the European Parliament, EU authorities agreed to grant an extension of the EU Benchmarks Regulation for third-country benchmarks until 31 December 2021, which is welcomed by industry. There is now a strong need for administrators and regulators to use this extension period to work toward ensuring that benchmarks are available for use in the European Union after 2021, either by passing legislation governing the supervision of benchmarks to enable an equivalence decision, or by continuing to work towards compliance with the IOSCO Principles for Financial Benchmarks which will enable opportunities to achieve endorsement or recognition before 2021. If not, markets risk the possibility of deep fragmentation, with EU institutional investors no longer able to use local benchmarks to hedge risks or invest in Asian stocks, bonds or funds, or enter into trades with APAC clients referencing APAC benchmarks.	
Fragmentation In August 2016, ASIFMA conducted a survey of benchmarks used by its members which identified at least 59 important benchmarks used in the Asia-Pacific that will be affected, including several well-known Asian benchmarks. In September 2017, European-domiciled funds referencing Asian-administered benchmarks represented EUR34 billion under management. This does not include direct investment by European-domiciled investors in the region's markets through stocks, bonds or Asian-domiciled funds. Figures from Hong Kong's stock exchange show that EU-based investors accounted for 15% of trading in Hong Kong stocks in 2016. In addition, an analysis conducted in July 2017 by the Global Foreign Exchange Division (GFXD), a sister association of GFMA, showed that the BMR impacts a significant number of Asian non-deliverable forward (NDF) benchmarks. The data shows that trades with EU counterparties range between 38% and 52% of global volumes (2016 data from the Bank of International Settlements). Finally, Asia accounts for 40% of the EU's total trade (Eurostat, 2016), and these transactions often need to be hedged for foreign exchange (FX) or country risk. The EU BMR could affect hundreds of proprietary indexes.	**Recommendation** ▪ FSB members to have open dialogues with EU authorities regarding the impact of the EU BMR on their respective markets and discuss the need for clear and expedient registration processes for third-country benchmarks, with the European Supervisory Authorities (ESA) review to determine means to simplify the process for recognition. These processes need to be affordable and avoid EU/UK duplication. ▪ European Commission to adopt appropriate frameworks and adequately complete determinations for jurisdictions seeking equivalence ▪ IOSCO and the FSB to encourage G20 governments to work with industry to encourage and facilitate administrators in third-country jurisdictions to register their benchmarks. ▪ The type of deep cooperation which saw the mutual recognition of EU/Singapore and US/EU with respect to derivatives trading venues is a possible model that might be usefully emulated as a method of 'joint' supervision with respect to benchmarks reform and third countries impacted by it.

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RESILIENCY & CONTINUITY

<table>
<tr><th colspan="2">Recovery and Resolution Standards: Divergent Regimes and Inconsistent Standards Reducing Overall Safety and Soundness of International Markets</th></tr>
<tr><td colspan="2">There has been a concerning proliferation of recovery and resolution frameworks in Asia that differ from principles laid out in FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions, and the absence of proper resolution regimes in other jurisdictions. Global harmonisation of recovery and resolution documentation, firm-specific cooperation agreements, and robust peer reviews are imperative to the safety and soundness of markets in the event of a global firm's failure. ASIFMA seeks consistent global implementation of a well-constructed Total Loss-Absorbing Capacity (TLAC) standard, which we believe will, together with other post-crisis resiliency enhancements and actions taken by individual firms, secure a durable end to "too big to fail" risk.</td></tr>
<tr><td>Fragmentation
As Asian jurisdictions translate provisions of the TLAC Term Sheet into regulation inconsistencies have emerged in the interpretation of certain key provisions. Divergent TLAC requirements will result in unnecessary trapped capital and a fragmentation of liquidity.

For example, the absolute quantitative amount of a given internal TLAC requirement depends on the external TLAC requirement, which may vary between jurisdictions.

In addition, some jurisdictions seek to apply internal TLAC to material subsidiaries of foreign institutions.</td><td>Recommendation
▪ We encourage IOSCO and the FSB to continue promoting consistent implementation of recovery and resolution requirements among jurisdictions.
▪ Resolution planning should focus on domestically significant firms and any critical function whose failure stands to have a systemic impact.
▪ Local branches of global financial institutions should not be required to provide country-level resolution plans, as their operations are included in group level plans.
▪ Domestic resolution regimes should formally recognise home-country resolution plans and create clear statutory recognition procedures for cross-border resolution actions.
▪ With respect to cross-border coordination, the home authority should be the lead authority and their decisions should take precedence.
▪ Resolution regimes should also ensure that resolution does not affect set-off, netting and collateral arrangements.
▪ G20 and the FSB should encourage consistent implementation and calibration of external and internal TLAC standards across jurisdictions and consider issuing additional guidance to encourage global cooperation and standardisation.
▪ ASIFMA recommends the FSB raise these matters in its upcoming Review of the technical implementation of the TLAC Standard.</td></tr>
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Brexit and Equivalence Regimes: Significant Remaining Uncertainty about UK/EU CCP Equivalence	
Brexit will have a significant impact on equivalence determinations currently in place, ranging from central clearing to margining of derivatives.	
Fragmentation Many jurisdictions in Asia use central counterparties (CCPs) in the EU to clear trades with a significant share of global FX trades for APAC cleared through LCH. Uncertainty about the treatment of CCPs in the United Kingdom (UK) following its exit from the European Union has a significant bearing on Asian currency markets. While ASIFMA welcomes the announcement on 19 December that the Commission will, for a limited period, allow EU banks and companies to continue using UK-based CCPs to process derivatives trades if Brexit negotiations fail, further clarity is needed to alleviate fears of market disruption in the near future. It is unclear whether the temporary and conditional equivalence of UK CCPs will apply to cleared derivatives only or to all asset classes (including repos and cash equities). Clarity is needed before the end of March 2019 to assure firms can continue to access to UK trading venues to meet Markets in Financial Instruments Regulation (MIFIR) obligations. The industry is also concerned about regulatory powers proposed under revisions to European Market Infrastructure Regulation (EMIR) which could result in the potential relocation of CCPs deemed systemic to EU markets. Use of such powers may have a significant impact on the liquidity and margining of other products cleared by these CCPs and would need to consider if these CCPs are systemic to APAC markets also. Brexit also affects equivalence decisions regarding margining of derivatives transactions. Asian counterparties are currently able to transact with UK counterparties under EMIR rules due to regulators in Asia (i.e. Australian Prudential Regulatory Authority, Hong Kong Monetary Authority or Monetary Authority of Singapore) permitting substituted compliance on the basis of the UK/EU's membership to the Working Group on Margin Requirements (WGMR). Following Brexit, it is unclear whether such determinations may cease to apply, with firms in Asia becoming subject to inconsistent regulatory requirements when transacting with UK banks and brokers.	**Recommendation** ▪ EU and UK regulators to provide clarity and certainty regarding equivalence for UK CCPs, while ensuring continued access to UK trading venues. ▪ The industry welcomes the joint statement by the UK and US dated 25 February on continuity of derivatives trading and clearing post-Brexit. Similar statements from APAC regulators would do much to ease market concerns in respect of cliff edges. ▪ Asian regulators (e.g. MAS, SFC/HKMA) to clarify existing equivalency determinations. This would include deeming existing determinations: – That cover the EU but do not expressly refer to the UK including, or being deemed to include, the UK on the basis that, even after the UK exits the EU, the UK's regime in respect of financial services regulation will be identical to EU regulation (and, in respect of OTC derivatives margin requirements, the UK is a member of the BCBS-IOSCO Working Group on Margin Requirements (WGMR), and – That currently refer to the UK in respect of activities or products subject to EU regulation, can also be applied to the EU as a whole.

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DATA & PRIVACY

Data Localisation, Privacy and Security Requirements in Asia: Local Regulations Creating Barriers to Trade and Increasing Cybersecurity Risk	
Several jurisdictions in Asia have introduced data localisation requirements that restrict cross-border data flows and inhibit growth of digital trade. These requirements negatively impact the operations of financial firms and services to end users, and the safety and soundness of domestic and international financial systems. There are also negative impacts on financial inclusion, the broader digital economy and economic growth. Data localisation often stems from concerns over privacy and security which can be addressed in other ways. Examples in the region are China's Cybersecurity Law, India's draft Personal Data Protection Bill, Vietnam's Law on Cybersecurity, and Indonesia's Government Regulation No. 82/2012.	
Fragmentation Data localisation requirements impede data flows. It has negative impacts on the data architecture of financial institutions, particularly larger institutions working facilitating international trade and investment. With the growth of the digital economy, cross-border data flows are even more important. Firms often use global or regional data centres for data processing and storage to provide service 24/7, address security threats and provide business continuity in the face of events like national disasters. The move to cloud services is increasingly critical to firm-level resiliency. The cloud also helps with financial inclusion and improved serviced delivery to end users. There are wide ranging negative impacts from data localisation. Firms use regional and global data centres and cloud technology to counter increasingly sophisticated, frequent and cross border cybersecurity threats. These facilities are staffed with highly qualified individuals that are difficult to find and require reliable, globally connected infrastructure. Advances in technology, particularly cloud, mean resiliency and security data can be better ensured if data is able to be moved more freely across specialised platforms, resulting not only in greater protection of data and opportunity for market surveillance but greater overall system robustness. Adding additional entry points via localisation weakens the cyber security systems firms have in place. Information also needs to be pooled from various sources and locations to identify and combat cyber security threats.	**Recommendation** ▪ While not wholly an FSB and IOSCO remit, we ask members states to discuss with respective authorities in their jurisdictions the concerning trend towards data localisation which, on its present course, will serve to fragment markets and introduce inefficiencies and costs and reduce services. ▪ We encourage jurisdictions to assess existing regulations on data handling, information security, cyber security and privacy for financial services and avoid regulatory fragmentation and costly inconsistencies. ▪ Coordination between different agencies at the national level when introducing data policies is essential to ensuring cohesive, workable policies for each sector. ▪ The use of international standards and best practice where possible rather than bespoke regulation is key given the cross-border nature of threats. ▪ Regional and global frameworks which allow for the exchange of information, effective cross-border enforcement and cooperation should be encouraged in place of siloed national frameworks, which impede connectivity required for growth in the digital economy. ▪ GFMA recently released a set of Financial Data Handling Principles for Banks and Non-Banks. Policymakers and firms have a mutual interest in ensuring a balanced approach to handling and security of data without being overly restrictive of data flows and usage. GFMA's principles set out voluntary standards for firms to follow that ensure financial and personal data is appropriately handled and protected by capital market participants.

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