

# U.S. Financial Regulators and Foreign Policy

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# What Financial Regulators Do

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- Identify Regulatory Priorities and Allocate Resources
  - Respond to perceived regulatory challenges (i.e., accumulation of risk, market growth, inefficiencies)
  - Market surveillance and assess financial system vulnerabilities
  - Define their regulatory perimeter
  - Respond to innovation
- Set Regulatory Policy – decide on deployment of optimal regulatory strategies
  - Rulemaking
  - Supervision
  - Certification
  - Enforcement
- Evaluate, communicate and receive feedback

# Perspective of U.S. Financial Regulators

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- U.S. financial markets are the largest and most important in the world
- Focus should be on regulatory issues most important to the U.S. financial markets
- Regulatory priorities should be decided by what is in the domestic interest
- Stick closely to their legal mandates

# Impact of Foreign Regulatory Developments on the United States

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- Setting the U.S. financial regulatory agenda and priorities
- Pushing U.S. financial regulators to prematurely to take positions on optimal regulatory strategies
- Forcing U.S. financial regulators to defend their regulatory mandates
- Demanding reaction to the extraterritorial application of foreign regulation and pressure from market participants to remove inconsistencies with foreign regulatory regimes

# Example: Money Market Funds

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- In 2008 the Reserve Fund's Primary Fund "breaks-the-buck" in the United States raising questions about CNAV and risk of runs
- In 2010 the SEC promulgates Rule 2a-7 of the 1940 Act to improve MMF liquidity
- In 2011 G20 and FSB request IOSCO to develop policy recommendations to mitigate the susceptibility of MMFs to runs and other systemic risks
- In October 2012, IOSCO issues its policy recommendations over the objection of the SEC.

“The IOSCO Board approved the report on money market funds during its meeting on 3-4 October in Madrid. While it was noted that a majority of the Commissioners of the US Securities and Exchange Commission did not support its publication, there have been no other objection.”
- In November 2012 FSOC releases its proposed recommendations for MMF reform
- In July 2014 SEC adopts MMF reform rules

# Example: Research Fees

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- In 2014 EU finalizes the revised Markets in Financial Instruments Directive (MIFID II), taking effect in January 2018
  - Among MIFID II's provisions is a requirement that broker-dealers separate investment research fees from trade execution fees
- Under SEC rules, registered broker-dealers cannot receive payment for research fees unless they become registered investment advisors under the 1940 Act.
- In October 2017 and again in November 2019, SEC staff issue temporary no-action relief from the 1940 Act registration requirement.
- In July 2019 SEC Investor Advisory Committee issues report "Structural Changes to the US Capital Markets Re Investment Research in a Post-MIFID II world," recommending that the SEC harmonize with the EU's MIFID II regime.

# SEC Chair Says He Is Bracing For MiFID II Impact

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By [Ed Beeson](#)

Law360, New York (November 28, 2017, 10:19 PM EST)-- [U.S. Securities and Exchange Commission Chairman Jay Clayton](#) on Tuesday said dealing with the looming overhaul of European securities regulations — the new Markets in Financial Instruments Directive — has come to dominate his work lately, and that managing the stateside impact of the changes could prove more important than other items on his regulatory agenda for next year.

Speaking at a hedge fund conference in New York, Clayton said responding to the cross-border impact of the so-called MiFID II that's taking effect in January has crept up to the top of his to-do list in recent months. And he signaled that the European framework will be a major consideration for the commission down the road, perhaps even eclipsing some of the other items that the chairman plans to put in his regulatory agenda for the coming year.

# Example: Benchmarks

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- In 2012 U.S. and European regulators investigate manipulation of the London Interbank Offered Rate (LIBOR) by multiple international banks, raising the concerns about integrity of critical financial and commodity benchmarks.
- In 2012 and 2013 IOSCO, under co-leadership of CFTC and UK FCA, develop the IOSCO Principles for Financial Benchmarks and IOSCO Principles for Oil Price Reporting Agencies.
- In 2016 EU passes its new Benchmarks Regulation, which requires direct regulation and supervision of benchmark administrators by EU national competent authorities with “recognition” and “endorsement” proceedings for non-EU benchmark administrators.
- SEC and CFTC do not have statutory authority to regulate benchmark administrators; rely instead on their anti-fraud enforcement authority.
- Since passage of EU Benchmarks Regulation, however, most major jurisdictions, including Australia, Canada (Ontario and Quebec), Japan, and Singapore, have moved from the U.S. approach to the EU approach.



# Example: CCP Recovery and Resolution

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- G20 commitment for mandatory clearing of OTC derivatives has enhanced the systemic importance of large, cross-border CCPs.
- Dodd-Frank splits responsibility for CCP recovery and resolution between CFTC/SEC and FDIC.
- CPMI-IOSCO PFMI are main international standards for regulation of CCPs, but no international standards for recovery and resolution.
- FSB took up the issue in 2017-2018, but did not complete work. EU has drafted a proposal for an EU CCP Recovery and Resolution Legislation, but also did not complete its work.
- Financial institutions have called for enhanced capital requirements for CCPs.
- Completion of EU CCP Recovery and Resolution Legislation is priority for new European Commission.

# Example: Market Fragmentation and Cross-Border Regulation

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- Implementation of Dodd-Frank has resulted in criticism of extraterritorial application of U.S. rules (CFTC and SEC swaps rules, Fed regulation of foreign bank branches)
- Criticism has centered on U.S. financial regulators' unwillingness to “defer” to non-U.S. regulators
  - In 2013 G20 Leaders Communiqué states: “We agree 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. We call on regulators in cooperation with the FSB and the OTC Derivatives Regulators Group to report on their timeline to settle the remaining issues related to overlapping cross-border regulatory regimes, and regulatory arbitrage.”
  - In 2015 IOSCO establishes its Cross-Border Task Force to agree on deference tools.
  - In 2016 IOSCO Asia-Pacific Regional Committee sends letter to CFTC requesting deference to local regulators.
  - In 2018 Japan announces one of three G20 priorities is market fragmentation.

# Example: Crypto-Assets

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- In December 2018 the German and French Finance Ministers and Central Bank Governors call on the G20 to declare crypto-assets a financial stability risk and threat to investors.
- As G20 President in 2019, Japan prioritized discussion of regulation of crypto-asset trading.
- U.S. financial regulators have resisted treating crypto-asset regulation as a financial stability issue and have sought to limit development of new international standards.
  - SEC championed the creation of the IOSCO ICO Network to serve as a discussion forum, but not a standards-setting forum, regarding crypto and investor protection.
- Since the announcement of the Libra coin in the summer of 2019, there have renewed calls for the G20, FSB and IOSCO to develop international standards.

# Example: Environmental, Social and Governance (ESG)

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- U.S. financial regulators currently have not yet announced new initiatives on ESG with respect to corporate disclosure, financial stability or supervision of financial institutions.
- In January 2019 IOSCO issued statement expressing importance of issuers to consider the inclusion of ESG matters in providing material disclosure to investors.
  - IOSCO footnote: “The US Securities and Exchange Commission has not voted on the publication of this statement. The statement should not be viewed as an expression of the Commission’s view or an endorsement by the Commission.”
- Founded in 2017, the Network for Greening the Financial System has, as of October 2019, 46 central bank members. The NGFS is examining how to consider climate risk in financial supervision and macroeconomic policy. The Federal Reserve is the only major central bank not to be a member.
- In 2015 the EU announced its Sustainable Finance Plan, which includes development of an EU sustainability taxonomy and standards and labels, amending EU corporate disclosure rules, requiring investment advisors to provide information to retail investors about ESG issues, and development of an EU green bond standard.
  - Top priority for the new European Commission

# Direct Access to Books and Records

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- U.S. financial regulators require direct access to the books and records of registered firms even if located outside of the United States
  - Critical to supervisory and enforcement programs
  - Alternative would be “indirect access” where information is obtained through local regulator
- Historically, U.S. financial regulators have had to overcome local laws that limit the sharing of such information (i.e., French blocking statute and Swiss secrecy laws), and foreign jurisdictions have changed their laws to accommodate U.S. financial regulators’ demand.
- In recent years, however, U.S. financial regulators have faced resistance, ranging from China’s refusal to provide SEC and PCAOB access to audit work papers, EU General Data Protection Regulation limiting regular sharing of information without review by EU authorities, and India and Mexico citing laws that require local firms to share information only with home authorities.
- Discussions regarding an IOSCO Multilateral Supervisory Cooperation MOU do not include direct access.
- In 2018 SEC began delaying registration of EU-based investment advisers and earlier proposed new rules on registration of non-U.S. swap dealers requiring firms provide opinion of counsel that they can meet SEC books-and-records direct access requirements.

# Other Examples

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- Artificial Intelligence
- Cloud Computing
- Outsourcing (Third Party Service Providers)

# Recap: Impact of Foreign Regulatory Developments on the United States

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- Setting the U.S. financial regulatory agenda and priorities
- Pushing U.S. financial regulators to prematurely to take positions on optimal regulatory strategies
- Forcing U.S. financial regulators to defend their regulatory mandates
  - U.S.'s functional regulatory system complicates international discussions
- Demanding reaction to the extraterritorial application of foreign regulation and pressure from market participants to remove inconsistencies with foreign regulatory regimes

# Diagnosing the Challenge

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- Role of International Standard Setting Bodies
- The “Brussels” Effect
- Uncertain Role of U.S. Financial Regulators in Foreign Policy



# Role of International Standard Setting Bodies

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- **Scope:** SSBs exist in all areas of financial regulation (FSB, IOSCO, BCBS, CPMI, CGFS, IAIS)
- **Resources:** Professional secretariats, regularly scheduled meetings, permanent committees
- **Membership:** G20 jurisdictions, individual EU member states, emerging markets, senior-level representation
- **Decision-Making:**
  - Multi-level committees
  - “Weight-of-room” decision-making conveyed as the product of international consensus
  - All members with equal voice
- **Output:**
  - Principles and standards, guidance, toolkits, surveys and reports
  - Assessments, implementation reviews, peer reviews
- **Legitimacy:** G20 deliverables, incorporation in domestic legislation and regulation, IMF-World Bank FSAPs, reliance in capacity building efforts

# The “Brussels Effect”

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- Closer involvement of political bodies in regulation
  - Policy entrepreneurship
  - European Commission, European Parliament and Council as co-legislators and regulators
  - Regulation versus directives and the goal of a harmonized European regulatory framework
- “Third Country” provisions
  - Extraterritorial effect
  - Proportionality
- International influence

# Uncertain Role of U.S. Financial Regulators in Foreign Policy

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- Deference to the U.S. Treasury Department on international matters
- Traditional focus on international only to the extent it affects domestic markets
  - Foreign firms doing business in the U.S. market
  - Foreign firms providing services to U.S. investors and clients
  - Enforcement cooperation
  - Information-sharing and supervisory cooperation MOUs
  - International regulatory policy is new
- Limited number of international affairs specialists or staff involved in international workstreams

# What Does a Foreign Policy Look Like?

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- International as a distinct regulatory strategy
- Developing a focused international regulatory policy
- Active engagement in multilateral and bilateral fora

# International as a Distinct Regulatory Strategy

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|               | Public Strategies  | Private Strategies  |
|---------------|--|---|
| Rulemaking    | Rules  | Principles<br>Self-regulatory organizations (SROs)<br>Industry standards    |
| Supervision   | Prudential supervision<br>Inspections and examinations   | SROs<br>Gatekeepers<br>Fiduciary duties<br>Third party monitor              |
| Certification | Investigation and evaluation<br>Licensing<br>Approvals and authorizations  | Disclosure<br>Gatekeepers<br>Financial intermediaries<br>Self-certification |
| Enforcement   | Enforcement by regulator   | Private rights of action  |
| International | Coordination/Harmonization<br>Deference (Equivalence and Substituted Compliance;<br>Exemptions, Proportionality and Registration Categories) | Comply with the strictest rule<br>Dual-registration                         |

# Developing a Focused International Regulatory Policy

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- View international discussions as a means to evangelize U.S. financial regulatory policy
- Assert greater influence over the international agenda
- Incorporate international affairs into mainstream of the policymaking process
- Identify outcomes and develop a negotiation strategy to achieve such outcomes

# Active Engagement in Multilateral and Bilateral Fora

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- Take leadership positions in multilateral fora, set the work agenda, control the pen regarding international reports
- Involve senior personnel in international workstreams with adequate resources
- Demand changes to the governance of international bodies to improve fairness of decision-making and accountability of other members
  - Real “weight-of-the-room” decision-making
  - Recognize the relative legal competency and expertise of members
  - Clear rules of procedures and timelines
- Treat bilateral dialogues as opportunities to resolve disputes and negotiate positions
- Involve bilateral dialogues in the rulemaking record

# Challenges

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- Making regulatory policy through negotiation
- Participation in international standards setting prior to completion of rulemaking
- Authority of the Chair to represent the views of the Commission
- Overcoming domestic jurisdictional battles to present common positions internationally
- Finding adequate resources to support a foreign policy