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## International regulatory cooperation after the crisis

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The heads of state of a broad coalition of nations, the Group of Twenty (G-20), met in September 2009 in Pittsburgh to chart the course of recovery from the financial crisis and set internationally agreed-upon objectives for the reform of regulatory policy.

Formed in September 1999, the G-20 includes finance ministers and central bank governors from 19 countries and the European Union.[1] The International Monetary Fund (IMF) and World Bank participate in G-20 meetings on an *ex officio* basis.

**In** October 2007, as clear signs of financial market turbulence began to emerge, finance ministers and central bank governors from Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States met in Washington, DC, to discuss the situation.[2] In the following months, the crisis deepened—Northern Rock, a UK bank, was nationalized; Bear Stearns, facing collapse, was acquired by JPMorgan Chase; and Lehman Brothers filed for bankruptcy. Ultimately, the heads of state of the Group of Twenty (G-20) met in September 2009 in Pittsburgh to agree on objectives for the reform of regulatory policy to limit the extent and impact of future financial crises.

In this *Chicago Fed Letter*, we discuss the policy objectives established at the Pittsburgh Summit and briefly explain the evolving roles of the Financial Stability Board (FSB), the Committee on Payment and Settlement Systems (CPSS), the International Organization of Securities Commissions (IOSCO), and the OTC Derivatives Regulators' Forum (OTCDRF). We also briefly describe the new supervisory authorities that have been formed in major jurisdictions as a result of legislation enacted to implement the G-20 objectives and some of the new responsibilities they will exercise.

### The G-20 response

The heads of state of the G-20 countries held their first summit meeting to address the crisis in November 2008 in Washington, DC. The meeting focused on improving cooperation in key areas, so as to strengthen economic growth, deal with the financial crisis, and lay the foundation for reform to avoid similar crises in the future. The G-20 met again in London in April 2009 and in Pittsburgh that September to consider common objectives for the regulatory response to the financial crisis, which are to be implemented in the G-20 countries by the end of 2012, including changes to the infrastructure for over-the-counter (OTC) derivatives markets.

The G-20 called on the cadre of international agencies and standard-setting bodies for direct action on regulatory reform. For example, with regard to capital and liquidity standards, the Basel Committee on Banking and Supervision (BCBS) was given the objective of reaching agreement on a new capital framework; and in September 2010, the Basel III standards for bank capital were published. Similarly, the FSB, in consultation with the IMF, was asked to report to the G-20 finance ministers and central bank governors in October 2010 on recommendations to strengthen oversight and supervision, especially with regard to early identification of risks and principles for intervention.

#### *Financial Stability Forum and Financial Stability Board*

The Financial Stability Forum (FSF) was established in 1999 along with the G-20 to promote international financial stability in the wake of the Asian Financial

Crisis of the late 1990s. In response to the financial crisis in 2008, the G-20 called for expanding membership in the FSF and for giving it a stronger institutional basis. As a result, the FSF became the FSB in April 2009.

The FSB now includes representatives of governmental agencies and central banks from 24 countries and the European Union, as well as the Bank for International Settlements (BIS), BCBS, Committee on the Global Financial System (CGFS), CPSS, International Association of Insurance Supervisors, International Accounting Standards Board, and IOSCO. The FSB has primary responsibility for coordinating the actions agreed upon by the G-20.[3]

### Committee on Payment and Settlement Systems

CPSS is a forum for central banks, supported by the BIS.[4] The central bank governors of the Group of Ten (G-10) countries established the Group of Experts on Payment Systems, the predecessor to the CPSS, in 1980. In 1990, the G-10 established the CPSS as one of the three permanent central bank committees then reporting to the G-10 governors.[5]

The CPSS is "a standard-setting body for payment and securities settlement systems" and "serves as a forum for central banks to monitor and analyse developments in domestic payment, settlement and clearing systems, as well as in cross-border and multicurrency settlement schemes."[6] The CPSS includes representatives of 25 central banks (including both the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York) from 23 countries and the European Union. As a result of the expansion of CPSS membership in 2009, the committee now reports to the Governors of the Global Economy Meeting, a forum of 30 systemically important countries that are BIS shareholders, instead of the G-10 central banks.

### International Organization of Securities Commissions

IOSCO was founded in 1974 as the Inter-American Association of Securities Commissions, an informal annual gathering of regulators from countries in the Western Hemisphere. It was incorporated as a nonprofit corporation under the laws of the province of Quebec, Canada, in 1983 with headquarters in Montreal. In January 2001, IOSCO relocated its headquarters to Madrid, Spain. IOSCO's members include representatives from more than 100 countries, with regulatory responsibility for more than 90% of the world's securities markets.

### OTC Derivatives Regulators' Forum

The OTCDRF is a voluntary group of about 45 international financial regulators from 18 countries and the European Union. Formed in January 2009, the forum has worked to develop, harmonize, and coordinate regulatory standards for OTC derivatives market infrastructure, products, risk management, and data. Each of these market aspects received emphasis in the G-20 objectives. Other topics of consideration by the OTCDRF include the activities of OTC derivatives market participants, governance of financial market infrastructures, and access to such institutions. Recently, the FSB has delegated certain data standards issues to the OTCDRF for resolution.

## New agencies and responsibilities

In addition to the existing international standards bodies and national or regional regulators, new agencies have been (or are being) set up as the result of legislation in various countries. Some countries have found the regulatory authority of their existing agencies inadequate to cover the G-20 objectives by means of public and private initiatives using regulatory or market incentives. Consequently, competent authorities have been created or have become better equipped to monitor and respond to systemic risks in the financial markets. While the pace of adoption and implementation varies among those nations taking action, the target date for implementation for all is commonly held to be the end of 2012, as prescribed by the G-20.

### United States

The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), signed into law in July 2010, comprehensively restructures regulation of the U.S. financial markets. With specific regard to new regulatory bodies, Dodd–Frank established the Financial Stability Oversight Council (FSOC), chaired by the Secretary of the Treasury and composed of the heads of the Federal Reserve Board, Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), Bureau of Consumer Financial Protection (BCFP), and Federal Home Finance Agency (FHFA), as well as an independent member from the insurance industry and five nonvoting members representing the Office of Financial Research (OFR), the Federal Insurance Office (FIO), state insurance commissioners, state securities commissioners, and state banking supervisors. The council's goals include identifying risks to U.S. financial stability that might arise from the financial distress or failure of large, interconnected bank holding companies or nonbank financial companies.

One of the new agencies created by Dodd–Frank is the OFR, which is tasked with improving the quality and utility of financial data. The OFR will analyze such data and provide data and analysis for the FSOC, other agencies, and the public. The objectives of the OFR also include standardizing financial reporting requirements and ensuring that the scope of data is adequate and appropriate to meet regulatory needs.

### European Union

The EU established several new financial supervisory authorities on January 1, 2011: the European Securities and Markets Authority (ESMA); the European Banking Authority (EBA); and the European Insurance and Occupational Pensions Authority (EIOPA). ESMA replaces the former Committee on European Securities Regulators (CESR), which had functioned since 2001 to facilitate regulatory coordination with respect to securities markets in the EU. Yet another newly established financial supervisory body is the European Systemic Risk Board (ESRB), which is responsible for macroprudential oversight of the EU financial system.

On September 15, 2010, the European Commission published its final proposal for the European Market Infrastructure Regulation (EMIR), which is intended to enhance financial stability in OTC derivatives markets. The Commission's proposal has been under negotiation in the EU Council and Parliament. Those negotiations have been protracted as a result of differences among EU member states regarding whether EMIR should govern exchange-traded (listed) derivatives. On June 24, 2011, the European Parliament's Economic and Monetary Affairs Committee (ECON) approved a report on EMIR and, on July 5, 2011, the European Parliament voted on the draft legal text of EMIR. Compromise on the final formulation of EMIR is anticipated after further action by the European Economic and Financial Affairs Council (ECOFIN).

Once EMIR comes into effect, ESMA will be responsible for determining the clearing eligibility of OTC derivatives; authorizing central counterparties, including third-country CCPs; and registering trade repositories (TRs). Unlike EU directives, EMIR is a regulation and will become effective without the need for implementing legislation by EU member states.

The regulation of European financial markets is also covered by the EU Markets in Financial Instruments Directive (MiFID). In December 2010, the EU published its review of MiFID (in force since 2007) for comment, with the objectives of adapting the regulation to cover the broader diversity of financial instruments such as OTC derivatives. This consultation process is expected to help shape a formal European Commission proposal for revisions to MiFID by the end of 2011.

### United Kingdom

The government announced its agenda for financial reform in June 2010 and the UK Treasury published a consultative paper on the specifics in July 2010. The government is expected to propose legislation to become effective in 2013 that would broadly restructure the UK regulatory authorities' responsibilities, as well as reorganizing them administratively. Most notably, the UK Financial Services Authority (FSA) would cease to be a separate body and become a subsidiary of the Bank of England as the Prudential Regulatory Authority (PRA), responsible for the overall financial integrity of firms. In addition, a new agency, the Financial Conduct Authority (the FCA) would be established to oversee business conduct and wholesale market functions (i.e., market infrastructure) to include exchanges, CCPs, payment systems, and settlement systems. Regarding systemic risk matters, the Financial Policy Committee (FPC) would be established within the Bank of England, with responsibility for identifying imbalances, risks, and vulnerabilities in the financial system and authority to take decisive action to protect the economy.[7] The UK government has chosen to amend the Financial Services and Markets Act 2000 (FSMA) to implement these changes; in July 2011, it published draft amendments to FSMA, which will be subject to pre-legislative scrutiny.[8] Once EMIR, the EU regulation on market infrastructure, is finalized, the FSA anticipates that CCPs will have two years to apply for recognition by a competent authority.[9]

### Canada

In October 2010, the Canadian OTC Derivatives Working Group published a discussion paper on public and private initiatives that could be the means of implementing the G-20 objectives.[10] The group, headed by the Bank of Canada and including the key Canadian regulatory agencies, has responsibility for providing advice and coordinating efforts necessary to meet Canada's G-20 commitments related to OTC derivatives. The structure of Canadian federal and provincial regulatory authorities requires considerable coordination and might require the development of a new regulatory framework when international standards are finalized. The Canadian Securities Administrators, an interagency body comprising the provincial securities regulators, has issued consultation papers on OTC derivatives and TRs for the Canadian markets (in November 2010 and June 2011, respectively). The results of those consultations are expected to be incorporated into regulatory decisions to be taken later in 2011.

### Japan

In May 2010, the Japanese government enacted an amendment to the Financial Instruments and Exchange Act of 1948 that strengthened the regulation of financial market infrastructure and products according to G-20 mandates. The legislation mandates central clearing of standardized OTC derivatives. According to a recent report by the FSB, the development of regulations to implement the legislation are "proceeding according to established timelines."[11] The same report notes that Japan will allow actively traded OTC derivatives (such as "plain vanilla" interest rate swaps) to be cleared by a foreign central counterparty clearinghouse, but will require some OTC derivatives to be cleared by a clearinghouse domiciled in Japan. Whether the pace of implementation will be slowed by the impact of the earthquake and tsunami that struck the northeast coastline of Japan in March 2011 remains to be seen.

### Australia

The Australian financial regulatory authorities published a joint survey of the OTC derivatives markets in Australia in May 2009. The key recommendations of that report included encouraging voluntary improvements to market transparency and legal, counterparty, and operational risk management in the OTC derivatives market by industry participants rather than by formal rule-setting by the authorities. The report also noted

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that Australian market participants make "limited use of central counterparty facilities," in part because "Australian OTC derivatives product markets are too small to support a stand-alone domestic facility," and in part because few international CCPs "cover Australian dollar products and admit Australian participants."[12] In June 2011, the Australian Council of Financial Regulators issued a consultative discussion paper called "Central clearing of OTC derivatives in Australia,"[13] which, among other things, sought public comment on a proposal to require derivatives contracts that are systemically important in the Australian context (such as Australian-dollar-denominated OTC interest rate swaps, forward-rate agreements, and overnight index swaps) to be cleared through a domestic CCP. Comments on the discussion paper were due September 1, 2011.

## Conclusion

As we have discussed in this *Chicago Fed Letter*, the international response to the recent financial crisis reflects two key themes. First, the international community sought to make policy within the G-20 framework, thus ensuring that a broad coalition of countries would be involved in debating, deciding, and, ultimately, implementing legislative measures to deal with the crisis. Similarly, the G-20 allocated primary responsibility for overseeing the progress toward meeting the policy objectives agreed upon in September 2009 at the Pittsburgh Summit to the newly formed FSB, ensuring that a wide range of regulatory and policymaking expertise drawn from international lenders and standard-setting organizations, central banks, securities regulators, and others would enter into the analysis of the causes of the financial crisis and the crafting of appropriate responses to it.

Second, the G-20 and FSB have sought to coordinate national responses to the financial crisis to ensure that a comprehensive response is implemented and minimize the opportunities for regulatory arbitrage. The full implementation of legislative and regulatory changes to carry out the G-20's policy objectives is scheduled for completion by year-end 2012. Much work remains to be done before then. As this article explains, the FSB, CPSS, and IOSCO, together with the OTCDRF, will play key roles in that effort.

1 The G-20 countries are at www. www.g20.org/about_what_is_g20.aspx.

2 "Statement of G-7 finance ministers and central bank governors," October 19, 2007, available at www.g8.utoronto.ca/finance/fm071019.htm.

3 Group of Twenty, 2009, "Leaders' statement, the Pittsburgh Summit," September 24–25, available at www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

4 See Robert S. Steigerwald, 2001, "Coordinated regulation of financial markets and payment systems," *Journal of Global Financial Markets*, Vol. 2, No. 1, Spring.

5 The two other permanent central bank committees are the BCBS and CGFS.

6 See www.bis.org/cpss/index.htm. The CPSS standards for financial market infrastructure adopted to date are listed on the website.

7 The Bank of England established an interim FPC in February 2011.

8 HM Treasury, 2011, "A new approach to financial regulation: The blueprint for reform," June 16, available at www.hm-treasury.gov.uk/d/consult_finreg__new_approach_blueprint.pdf.

9 UK Financial Services Authority, European Market Infrastructure Regulation (EMIR), available at www.fsa.gov.uk/pages/About/What/International/pdf/EMIR.pdf.

10 Canadian OTC Derivatives Working Group, 2010, "Reform of over-the-counter (OTC) derivatives markets in Canada: Discussion paper from the Canadian OTC Derivatives Working Group," October 26, available at www.bankofcanada.ca/wp-content/uploads/2010/10/reform.pdf.

11 Financial Stability Board, 2011, "OTC derivatives market reforms, progress report on implementation," April 15, available at www.financialstabilityboard.org/publications/r_110415b.pdf.

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