ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

6 September 2012

Masamichi Kono, Chairman
IOSCO Board
Calle Oquendo 12
28006 Madrid
Spain

David Wright, Secretary General
IOSCO Board
Calle Oquendo 12
28006 Madrid
Spain

Re: Developing global principles for mutual recognition

Dear Mr. Kono and Mr. Wright:

We are writing to you on behalf of the members of the International Council of Securities Associations (ICSA), which is the global forum for associations that represent and/or regulate securities markets around the world.[1] ICSA members remain concerned that the various financial sector reforms being enacted around the world are not consistent with one another and, as a result the key goal of global regulatory comparability set by the G20 in the aftermath of the financial crisis is not likely to be met. We are very supportive of the work that has been done by regulators over the past several years to advance the objective of reconciling diverse national regulatory standards. However, it is clear that much more needs to be done in this area. As part of that process, we urge IOSCO to take a leading role in promoting mutual recognition among securities regulators. This could include developing global principles for mutual recognition agreements as well as developing better methodologies for measuring and comparing the effectiveness of national regulatory systems, which in turn would make "comparability" assessments more reliable.[2]

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[1] ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA is available at: www.icsa.bz

[2] Various terms are used to describe inter-jurisdictional regulatory recognition, including mutual recognition and substituted compliance. While there may be subtle differences between the different terms, for the sake of simplicity we have used the term "mutual recognition" in this letter to cover the concept generally.

Mutual recognition as a way to promote regulatory convergence

Significant progress has been made by the Financial Stability Board and the international standard setters, specifically IOSCO and the Basel Committee on Banking Supervision, in developing global standards since the global financial crisis in 2008. At the same time, however, progress has been much slower and less globally consistent in the area of national rulemaking, resulting in substantial differences in the manner in which global standards are being implemented as well as differently paced timetables for the implementation of regulatory reforms. In a number of cases, moreover, national regulators have proposed or issued regulations with extensive extraterritorial consequences. These regulations are problematic since they not only encroach on other regulators' authority but also impose onerous and potentially contradictory compliance obligations on financial firms that would be subject to both home and host country regulations.

As the experience since the emergence of the financial crisis demonstrates, it is imperative to develop mechanisms for coordinating national regulatory policies in a more effective and efficient manner in order to ensure that those policies are consistent with one another. In theory, the optimal way to ensure that domestic regulatory policies and frameworks are consistent with one another would be to have full harmonization. However, as the EU's experience makes quite clear, full harmonization is an extremely time-consuming process. In these circumstances, there is an emerging consensus among some regulators, many market participants and some legal scholars in favor of mutual recognition as a way to encourage greater regulatory cooperation and, over time, regulatory convergence.

As you are aware, mutual recognition was already well established in some jurisdictions prior to the financial crisis. In the EU, mutual recognition agreements have been the primarily mechanism used for eliminating regulatory barriers to the common market in financial services since the 1980s. In addition, both the CFTC and the SEC in the U.S. have adopted mutual recognition agreements with other jurisdictions, albeit on a limited basis, beginning with specific rules adopted by the CFTC in 1987.[3] In 1990, the SEC entered into an MOU with four Canadian provincial securities commissions to recognize public offering disclosure documents, known as the Multi-Jurisdictional Disclosure System. More significantly, the SEC launched several initiatives in 2007 that demonstrated its commitment to rapid progress on mutual recognition. Along with continued negotiations on a more comprehensive mutual recognition agreement with Canada, the SEC and the EU Commission released a joint statement in early 2008 declaring that the implementation of a mutual recognition agreement between the US and EU would be intensified that year. In August of that year the SEC announced that it had signed a formal mutual recognition arrangement with the government of Australia and the Australian Securities and Investments Commission.[4]

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[3] Chris Brummer, "Curbing the Extraterritoriality of Dodd-Frank's Derivatives Regulation: An Examination of the Swap Jurisdiction Certainty Act", Written Testimony before the House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Entities, February 8, 2012 (page 7).

[4] Mutual Recognition Arrangement Between the United Stated Securities and Exchange Commission and the Australian Securities and Investments Commission, together with the Australian Minister for Superannuation and Corporate Law (August 2008).

The concept of mutual recognition lost a great deal of its appeal for some regulators, particularly in the U.S., in the aftermath of the global financial crisis in large part because of a concern that mutual recognition would be perceived as a relaxation of regulatory standards. However, the concept of mutual recognition remains valid and useful as a way to reconcile regulatory approaches in different jurisdictions, thereby streamlining regulation in global markets without jeopardizing market integrity. There is already a substantial and growing literature on the role that mutual recognition agreements could play in encouraging greater regulatory cooperation and convergence, including the recently published study by EU-US Coalition of Financial Regulation as well as a number of academic studies.[5]

In addition, on a practical level the concept of mutual recognition remains alive and well in some parts of the world. In Southeast Asia, for example, the ASEAN countries adopted a new Charter in 2007 aimed at enhancing regional cooperation and integration, notably through the establishment of an ASEAN Economic Community along with an ambitious program to create a common market in goods, services and capital by 2015. Within this framework, the ASEAN Capital Markets Forum (ACMF), composed of securities regulators from the ten member states, is committed to a regional integration program that rests principally on a mutual recognition process with gradually expanding scope and country coverage.

The EU also remains interested in mutual recognition agreements with other jurisdictions. In June 2009, the Committee of European Securities Regulators (CESR) released a call for evidence on potential mutual recognition agreements with non-EU jurisdictions. While recognizing that progress with the United States had been "delayed," CESR expressed hope that it would soon be continued and its intention to investigate mutual recognition with other countries. Commenting on this issue, Eddy Wymeersch, former Chairman of the Committee of European Securities Regulators, noted that, “One can expect these discussions [between the US and EU] to be resumed once the crisis has subsided: mutual recognition is indispensable in today’s intertwined financial world, but presupposes a sufficient degree of confidence in the effectiveness of each other’s supervisory systems.”[6]

IOSCO’s role in promoting mutual recognition

Given the importance of this issue and IOSCO’s position as both the primary standard setter and global forum for securities regulators, we urge IOSCO to take a leading role in encouraging mutual recognition between securities market regulators. We suggest that this could be done in several ways.

First, IOSCO could develop high-level principles setting out the necessary conditions to achieve a mutual recognition agreement. This would include most critically principles for the assessment

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[5] EU-US Coalition of Financial Regulation (June 2012), “Inter-jurisdictional Regulatory Recognition: Facilitating Recovery and Streamlining Regulation”. For a broad overview from an academic perspective see Pierre-Hugues Verdier (Winter 2011), “Mutual Recognition in International Finance”, *Harvard International Law Journal*, 52:1.

[6] Eddy Wymeersch (2010), "Global and Regional Financial Regulation: the Viewpoint of a European Securities Regulator“, *Global Policy*, 1:2, pg. 203. See also the comments made by Steven Maijoor, Chairman of the European Securities Market Authority, in his Public Statement at the 2012 IOSCO Annual Conference, May 2012.

of "comparability" between regulatory regimes. We suggest, for example, that any comparability assessment should be principles-based and focused on whether the regulatory objectives, intended outcomes and supervisory resources and practices in individual jurisdictions are similar enough to one another, rather than insisting on identical regulation as a prerequisite to mutual recognition. In addition, comparability assessments would need to focus on the regulatory regime as a whole, rather than looking at individual regulations. Finally, the principles would need to make clear that mutual recognition agreements between two autonomous regulatory authorities could not be used as a tool to export regulations from one jurisdiction to another.[7]

Since mutual recognition requires enhanced cross-border supervision and enforcement cooperation, beyond what it provided in existing instruments such as IOSCO's MMOU, any principles for mutual recognition agreements would also need to include a framework setting out at a high level how information exchange, and supervisory and enforcement actions could work in mutual recognition agreements. In that area, IOSCO could draw upon its 2010 *Principles Regarding Cross-Border Supervisory Cooperation* along with other relevant reports by IOSCO and its members

In addition to developing principles for mutual recognition, we also urge IOSCO to develop a methodology that would allow regulators to efficiently measure and compare the effectiveness of national regulatory systems. A more sophisticated and efficient method for measuring and comparing national regulatory systems would make "comparability" assessments more reliable and would therefore help to widen the appeal of mutual recognition as a viable option. An improved assessment methodology would be particularly useful in developing mutual recognition agreements between jurisdictions with different legal systems and regulatory philosophies. Here again, it is quite likely that IOSCO could draw upon its other workstreams, including in particular the work being done by IOSCO's newly created Assessment Committee.

Finally, we suggest that IOSCO might also play a role by training regulators how to carry out compatibility assessments of one another's regulatory regimes. This is critical since, at the end of the day, mutual recognition is only possible when the regulators that would be party to the agreement are fully satisfied that the regulatory and supervisory standards and practices in the other jurisdiction(s) are sufficiently similar to their own that they can, in effect, outsource some portion of their regulatory responsibilities. The process of learning about another regulator's standards and practices can result in a positive feedback loop, as each regulator can potentially see areas where their own standards and practices may be improved. This process could extend to shaping common approaches to regulatory challenges, so that over time mutual recognition could serve as a bridge to a closer convergence between regulatory standards and practices. All of which would be consistent with IOSCO's mission, particularly that aspect of its mission involving the exchange of information among IOSCO members, "…in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation".

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[7] We also suggest that any principles for mutual recognition should be based on the understanding that 'mutual recognition' can be on a unilateral basis as well as bilateral or multilateral basis.

Conclusion

We reiterate ICSA's members' commitment to the goals of global regulatory reform, including most importantly the goal of creating globally consistent regulations to encourage capital mobility, market efficiency and economic growth. ICSA members stand ready to engage with IOSCO to expand on our ideas regarding the importance of mutual recognition between securities market regulators.

We look forward to hearing from you on this mutual recognition agenda at your earliest convenience. Our ICSA working group would be delighted for an opportunity to meet with IOSCO officials in Madrid to exchange views on this subject in more detail.

Yours sincerely,

Jong Soo Park, Chairman
International Council of
Securities Associations (ICSA)

Ian C. W. Russell, Chairman
ICSA Standing Committee on
Regulatory Affairs

cc: Vedat Akgiray, Vice-Chairman, IOSCO Board
Ethiopis Tafara, Vice-Chairman, IOSCO Board